Court File No.: CV-12-9667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, AND IN THE MATTER OF A PLAN OF COMPRISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No. CV-11-431153-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

THE TRUSTEES OF THE LABOURERS' PENSION FUND OF CENTRAL AND EASTERN CANADA, THE TRUSTEES OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS LOCAL 793 PENSION PLAN FOR OPERATING ENGINEERS IN ONTARIO, SJUNDE AP-FONDEN, DAVID GRANT and ROBERT WONG

Plaintiffs

- and -

SINO-FOREST CORPORATION, ERNST & YOUNG LLP, BDO LIMITED (formerly known as BDO MCCABE LO LIMITED), ALLEN T.Y. CHAN, W. JUDSON MARTIN, KAI KIT POON, DAVID J. HORSLEY, WILLIAM E. ARDELL, JAMES P. BOWLAND, JAMES M.E. HYDE, EDMUND MAK, SIMON MURRAY, PETER WANG, GARRY J. WEST, PÖYRY (BEIJING) CONSULTING COMPANY LIMITED, CREDIT SUISSE SECURITIES (CANADA), INC., TD SECURITIES INC., DUNDEE SECURITIES CORPORATION, RBC DOMINION SECURITIES INC., SCOTIA CAPITAL INC., CIBC WORLD MARKETS INC., MERRILL LYNCH CANADA INC., CANACCORD FINANCIAL LTD., MAISON PLACEMENTS CANADA INC., CREDIT SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

BOOK OF AUTHORITIES OF THE PLAINTIFFS
(Claims and Distribution Protocol Approval, returnable December 13, 2013)

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Lawyers for the Plaintiffs and CCAA Representative Counsel

TO : THE ATTACHED SERVICE LIST

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Case Name:

Sino-Forest Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF a Plan of Compromise or Arrangement of Sino-Forest Corporation, Applicant

[2012] O.J. No. 5958

2012 ONSC 7050

Court File No. CV-12-9667-00CL

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: December 7, 2012.
Judgment: December 10, 2012.
Released: December 12, 2012.

(79 paras.)

Counsel:

Robert W. Staley, Kevin Zych, Derek J. Bell and Jonathan Bell, for Sino-Forest Corporation.

Derrick Tay, Jennifer Stam, and Cliff Prophet for the Monitor, FTI Consulting Canada Inc.

Robert Chadwick and Brendan O'Neill, for the Ad Hoc Committee of Noteholders.

Kenneth Rosenberg, Kirk Baert, Max Starnino, and A. Dimitri Lascaris, for the Class Action Plaintiffs.

Won J. Kim, James C. Orr, Michael C. Spencer, and Megan B. McPhee, for Invesco Canada Ltd., Northwest & Ethical Investments LP and Comité Syndicale Nationale de Retraite Bâtirente Inc.

Peter Griffin, Peter Osborne and Shara Roy, for Ernst & Young Inc.

Peter Greene and Ken Dekkar, for BDO Limited.

Edward A. Sellers and Larry Lowenstein, for the Board of Directors of Sino-Forest Corporation.

John Pirie and David Gadsden, for Poyry (Beijing).

James Doris, for the Plaintiff in the New York Class Action.

David Bish, for the Underwriters.

Simon Bieber and Erin Pleet, for David Horsley.

James Grout, for the Ontario Securities Commission.

Emily Cole and Joseph Marin, for Allen Chan.

Susan E. Freedman and Brandon Barnes, for Kai Kit Poon.

Paul Emerson, for ACE/Chubb.

Sam Sasso, for Travelers.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- On December 10, 2012, I released an endorsement granting this motion with reasons to follow. These are those reasons.

Overview

2 The Applicant, Sino-Forest Corporation ("SFC"), seeks an order sanctioning (the "Sanction Order") a plan of compromise and reorganization dated December 3, 2012 as modified, amended, varied or supplemented in accordance with its terms (the "Plan") pursuant to section 6 of the *Companies' Creditors Arrangement Act* ("CCAA").

3 With the exception of one party, SFC's position is either supported or is not opposed.

4 Invesco Canada Ltd., Northwest & Ethical Investments LP and Comité Syndicale Nationale de Retraite Bâtirente Inc. (collectively, the "Funds") object to the proposed Sanction Order. The Funds requested an adjournment for a period of one month. I denied the Funds' adjournment request in a separate endorsement released on December 10, 2012 (*Re Sino-Forest Corporation*, 2012 ONSC 7041). Alternatively, the Funds requested that the Plan be altered so as to remove Article 11

"Settlement of Claims Against Third Party Defendants".

5 The defined terms have been taken from the motion record.

6 SFC's counsel submits that the Plan represents a fair and reasonable compromise reached with SFC's creditors following months of negotiation. SFC's counsel submits that the Plan, including its treatment of holders of equity claims, complies with CCAA requirements and is consistent with this court's decision on the equity claims motions (the "Equity Claims Decision") (2012 ONSC 4377, 92 C.B.R. (5th) 99), which was subsequently upheld by the Court of Appeal for Ontario (2012 ONCA 816).

7 Counsel submits that the classification of creditors for the purpose of voting on the Plan was proper and consistent with the CCAA, existing law and prior orders of this court, including the Equity Claims Decision and the Plan Filing and Meeting Order.

8 The Plan has the support of the following parties:

- (a) the Monitor;
- (b) SFC's largest creditors, the Ad Hoc Committee of Noteholders (the "Ad Hoc Noteholders");
- (c) Ernst & Young LLP ("E&Y");
- (d) BDO Limited ("BDO"); and
- (e) the Underwriters.

9 The Ad Hoc Committee of Purchasers of the Applicant's Securities (the "Ad Hoc Securities Purchasers Committee", also referred to as the "Class Action Plaintiffs") has agreed not to oppose the Plan. The Monitor has considered possible alternatives to the Plan, including liquidation and bankruptcy, and has concluded that the Plan is the preferable option.

10 The Plan was approved by an overwhelming majority of Affected Creditors voting in person or by proxy. In total, 99% in number, and greater than 99% in value, of those Affected Creditors voting favoured the Plan.

11 Options and alternatives to the Plan have been explored throughout these proceedings. SFC carried out a court-supervised sales process (the "Sales Process"), pursuant to the sales process order (the "Sales Process Order"), to seek out potential qualified strategic and financial purchasers of SFC's global assets. After a canvassing of the market, SFC determined that there were no qualified purchasers offering to acquire its assets for qualified consideration ("Qualified Consideration"), which was set at 85% of the value of the outstanding amount owing under the notes (the "Notes").

12 SFC's counsel submits that the Plan achieves the objective stated at the commencement of the CCAA proceedings (namely, to provide a "clean break" between the business operations of the

global SFC enterprise as a whole ("Sino-Forest") and the problems facing SFC, with the aspiration of saving and preserving the value of SFC's underlying business for the benefit of SFC's creditors).

Facts

13 SFC is an integrated forest plantation operator and forest products company, with most of its assets and the majority of its business operations located in the southern and eastern regions of the People's Republic of China ("PRC"). SFC's registered office is located in Toronto and its principal business office is located in Hong Kong.

14 SFC is a holding company with six direct subsidiaries (the "Subsidiaries") and an indirect majority interest in Greenheart Group Limited (Bermuda), a publicly-traded company. Including SFC and the Subsidiaries, there are 137 entities that make up Sino-Forest: 67 companies incorporated in PRC, 58 companies incorporated in British Virgin Islands, 7 companies incorporated in Hong Kong, 2 companies incorporated in Canada and 3 companies incorporated elsewhere.

15 On June 2, 2011, Muddy Waters LLC ("Muddy Waters"), a short-seller of SFC's securities, released a report alleging that SFC was a "near total fraud" and a "Ponzi scheme". SFC subsequently became embroiled in multiple class actions across Canada and the United States and was subjected to investigations and regulatory proceedings by the Ontario Securities Commission ("OSC"), Hong Kong Securities and Futures Commission and the Royal Canadian Mounted Police.

16 SFC was unable to file its 2011 third quarter financial statements, resulting in a default under its note indentures.

17 Following extensive arm's length negotiations between SFC and the Ad Hoc Noteholders, the parties agreed on a framework for a consensual resolution of SFC's defaults under its note indentures and the restructuring of its business. The parties ultimately entered into a restructuring support agreement (the "Support Agreement") on March 30, 2012, which was initially executed by holders of 40% of the aggregate principal amount of SFC's Notes. Additional consenting noteholders subsequently executed joinder agreements, resulting in noteholders representing a total of more than 72% of aggregate principal amount of the Notes agreeing to support the restructuring.

18 The restructuring contemplated by the Support Agreement was commercially designed to separate Sino-Forest's business operations from the problems facing the parent holding company outside of PRC, with the intention of saving and preserving the value of SFC's underlying business. Two possible transactions were contemplated:

(a) First, a court-supervised Sales Process to determine if any person or group of persons would purchase SFC's business operations for an amount in excess of the 85% Qualified Consideration;

(b) Second, if the Sales Process was not successful, a transfer of six immediate holding companies (that own SFC's operating business) to an acquisition vehicle to be owned by Affected Creditors in compromise of their claims against SFC. Further, the creation of a litigation trust (including funding) (the "Litigation Trust") to enable SFC's litigation claims against any person not otherwise released within the CCAA proceedings, preserved and pursued for the benefit of SFC's stakeholders in accordance with the Support Agreement (concurrently, the "Restructuring Transaction").

19 SFC applied and obtained an initial order under the CCAA on March 30, 2012 (the "Initial Order"), pursuant to which a limited stay of proceedings ("Stay of Proceedings") was also granted in respect of the Subsidiaries. The Stay of Proceedings was subsequently extended by orders dated May 31, September 28, October 10, and November 23, 2012, and unless further extended, will expire on February 1, 2013.

20 On March 30, 2012, the Sales Process Order was granted. While a number of Letters of Intent were received in respect of this process, none were qualified Letters of Intent, because none of them offered to acquire SFC's assets for the Qualified Consideration. As such, on July 10, 2012, SFC announced the termination of the Sales Process and its intention to proceed with the Restructuring Transaction.

21 On May 14, 2012, this court granted an order (the "Claims Procedure Order") which approved the Claims Process that was developed by SFC in consultation with the Monitor.

22 As of the date of filing, SFC had approximately $1.8 billion of principal amount of debt owing under the Notes, plus accrued and unpaid interest. As of May 15, 2012, Noteholders holding in aggregate approximately 72% of the principal amount of the Notes, and representing more than 66.67% of the principal amount of each of the four series of Notes, agreed to support the Plan.

23 After the Muddy Waters report was released, SFC and certain of its officers, directors and employees, along with SFC's former auditors, technical consultants and Underwriters involved in prior equity and debt offerings, were named as defendants in a number of proposed class action lawsuits. Presently, there are active proposed class actions in four jurisdictions: Ontario, Quebec, Saskatchewan and New York (the "Class Action Claims").

24 *The Labourers v. Sino-Forest Corporation Class Action* (the "Ontario Class Action") was commenced in Ontario by Koskie Minsky LLP and Siskinds LLP. It has the following two components: first, there is a shareholder claim (the "Shareholder Class Action Claims") brought on behalf of current and former shareholders of SFC seeking damages in the amount of $6.5 billion for general damages, $174.8 million in connection with a prospectus issued in June 2007, $330 million in relation to a prospectus issued in June 2009, and $319.2 million in relation to a prospectus issued in December 2009; second, there is a $1.8 billion noteholder claim (the "Noteholder Class Action Claims") brought on behalf of former holders of SFC's Notes. The noteholder component seeks damages for loss of value in the Notes.

25 The Quebec Class Action is similar in nature to the Ontario Class Action, and both plaintiffs filed proof of claim in this proceeding. The plaintiffs in the Saskatchewan Class Action did not file a proof of claim in this proceeding, whereas the plaintiffs in the New York Class Action did file a proof of claim in this proceeding. A few shareholders filed proofs of claim separately, but no proof of claim was filed by the Funds.

26 In this proceeding, the Ad Hoc Securities Purchasers Committee - represented by Siskinds LLP, Koskie Minsky, and Paliare Roland Rosenberg Rothstein LLP - has appeared to represent the interests of the shareholders and noteholders who have asserted Class Action Claims against SFC and others.

27 Since 2000, SFC has had the following two auditors ("Auditors"): E&Y from 2000 to 2004 and 2007 to 2012 and BDO from 2005 to 2006.

28 The Auditors have asserted claims against SFC for contribution and indemnity for any amounts paid or payable in respect of the Shareholder Class Action Claims, with each of the Auditors having asserted claims in excess of $6.5 billion. The Auditors have also asserted indemnification claims in respect the Noteholder Class Action Claims.

29 The Underwriters have similarly filed claims against SFC seeking contribution and indemnity for the Shareholder Class Action Claims and Noteholder Class Action Claims.

30 The Ontario Securities Commission ("OSC") has also investigated matters relating to SFC. The OSC has advised that they are not seeking any monetary sanctions against SFC and are not seeking monetary sanctions in excess of $100 million against SFC's directors and officers (this amount was later reduced to $84 million).

31 SFC has very few trade creditors by virtue of its status as a holding company whose business is substantially carried out through its Subsidiaries in PRC and Hong Kong.

32 On June 26, 2012, SFC brought a motion for an order declaring that all claims made against SFC arising in connection with the ownership, purchase or sale of an equity interest in SFC and related indemnity claims to be "equity claims" (as defined in section 2 of the CCAA). These claims encapsulate the commenced Shareholder Class Action Claims asserted against SFC. The Equity Claims Decision did not purport to deal with the Noteholder Class Action Claims.

33 In reasons released on July 27, 2012, I granted the relief sought by SFC in the Equity Claims Decision, finding that the "the claims advanced in the shareholder claims are clearly equity claims." The Auditors and Underwriters appealed the decision and on November 23, 2012, the Court of Appeal for Ontario dismissed the appeal.

34 On August 31, 2012, an order was issued approving the filing of the Plan (the "Plan Filing and Meeting Order").

35 According to SFC's counsel, the Plan endeavours to achieve the following purposes:

(a) to effect a full, final and irrevocable compromise, release, discharge, cancellation and bar of all affected claims;
(b) to effect the distribution of the consideration provided in the Plan in respect of proven claims;
(c) to transfer ownership of the Sino-Forest business to Newco and then to Newco II, in each case free and clear of all claims against SFC and certain related claims against the Subsidiaries so as to enable the Sino-Forest business to continue on a viable, going concern basis for the benefit of the Affected Creditors; and
(d) to allow Affected Creditors and Noteholder Class Action Claimants to benefit from contingent value that may be derived from litigation claims to be advanced by the litigation trustee.

36 Pursuant to the Plan, the shares of Newco ("Newco Shares") will be distributed to the Affected Creditors. Newco will immediately transfer the acquired assets to Newco II.

37 SFC's counsel submits that the Plan represents the best available outcome in the circumstances and those with an economic interest in SFC, when considered as a whole, will derive greater benefit from the implementation of the Plan and the continuation of the business as a going concern than would result from bankruptcy or liquidation of SFC. Counsel further submits that the Plan fairly and equitably considers the interests of the Third Party Defendants, who seek indemnity and contribution from SFC and its Subsidiaries on a contingent basis, in the event that they are found to be liable to SFC's stakeholders. Counsel further notes that the three most significant Third Party Defendants (E&Y, BDO and the Underwriters) support the Plan.

38 SFC filed a version of the Plan in August 2012. Subsequent amendments were made over the following months, leading to further revised versions in October and November 2012, and a final version dated December 3, 2012 which was voted on and approved at the meeting. Further amendments were made to obtain the support of E&Y and the Underwriters. BDO availed itself of those terms on December 5, 2012.

39 The current form of the Plan does not settle the Class Action Claims. However, the Plan does contain terms that would be engaged if certain conditions are met, including if the class action settlement with E&Y receives court approval.

40 Affected Creditors with proven claims are entitled to receive distributions under the Plan of (i) Newco Shares, (ii) Newco notes in the aggregate principal amount of U.S. $300 million that are secured and guaranteed by the subsidiary guarantors (the "Newco Notes"), and (iii) Litigation Trust Interests.

41 Affected Creditors with proven claims will be entitled under the Plan to: (a) their *pro rata*

share of 92.5% of the Newco Shares with early consenting noteholders also being entitled to their *pro rata* share of the remaining 7.5% of the Newco Shares; and (b) their *pro rata* share of the Newco Notes. Affected Creditors with proven claims will be concurrently entitled to their *pro rata* share of 75% of the Litigation Trust Interests; the Noteholder Class Action Claimants will be entitled to their *pro rata* share of the remaining 25% of the Litigation Trust Interests.

42 With respect to the indemnified Noteholder Class Action Claims, these relate to claims by former noteholders against third parties who, in turn, have alleged corresponding indemnification claims against SFC. The Class Action Plaintiffs have agreed that the aggregate amount of those former noteholder claims will not exceed the Indemnified Noteholder Class Action Limit of $150 million. In turn, indemnification claims of Third Party Defendants against SFC with respect to indemnified Noteholder Class Action Claims are also limited to the $150 million Indemnified Noteholder Class Action Limit.

43 The Plan includes releases for, among others, (a) the subsidiary; (b) the Underwriters' liability for Noteholder Class Action Claims in excess of the Indemnified Noteholder Class Action Limit; (c) E&Y in the event that all of the preconditions to the E&Y settlement with the Ontario Class Action plaintiffs are met; and (d) certain current and former directors and officers of SFC (collectively, the "Named Directors and Officers"). It was emphasized that non-released D&O Claims (being claims for fraud or criminal conduct), conspiracy claims and section 5.1 (2) D&O Claims are not being released pursuant to the Plan.

44 The Plan also contemplates that recovery in respect of claims of the Named Directors and Officers of SFC in respect of any section 5.1 (2) D&O Claims and any conspiracy claims shall be directed and limited to insurance proceeds available from SFC's maintained insurance policies.

45 The meeting was carried out in accordance with the provisions of the Plan Filing and Meeting Order and that the meeting materials were sent to stakeholders in the manner required by the Plan Filing and Meeting Order. The Plan supplement was authorized and distributed in accordance with the Plan Filing and Meeting Order.

46 The meeting was ultimately held on December 3, 2012 and the results of the meeting were as follows:

(a) the number of voting claims that voted on the Plan and their value for and against the Plan;

(b) The results of the Meeting were as follows:

a. the number of Voting Claims that voted on the Plan and their value for and against the Plan:

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	250	98.81%	$	1,465,766,204	99.97%
Total Claims Voting Against	3	1.19%	$	414,087	0.03%
Total Claims Voting	253	100.00%	$	1,466,180,291	100.00%

b. the number of votes for and against the Plan in connection with Class Action Indemnity Claims in respect of Indemnified Noteholder Class Action Claims up to the Indemnified Noteholder Limit:

	Vote For	Vote Against	Total Votes
Class Action Indemnity Claims	4	1	5

c. the number of Defence Costs Claims votes for and against the Plan and their value:

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	12	92.31%	$	8,375,016	96.10%
Total Claims Voting Against	1	7.69%	$	340,000	3.90%
Total Claims Voting	13	100.00%	$	8,715,016	100.00%

d. the overall impact on the approval of the Plan if the count were to include Total Unresolved Claims (including Defence Costs Claims) and, in order to demonstrate the "worst case scenario" if the entire $150 million of the Indemnified Noteholder Class Action Limit had been voted a "no" vote (even though 4 of 5 votes were "yes" votes and the remaining "no" vote was from BDO, who has now agreed to support the Plan):

	Number of Votes	%		Value of Votes	%
Total Claims Voting For	263	98.50%	$	1,474,149,082	90.72%
Total Claims Voting Against	4	1.50%	$	150,754,087	9.28%
Total Claims Voting	267	100.00%	$	1,624,903,169	100.00%

e. E&Y has now entered into a settlement ("E&Y Settlement") with the Ontario plaintiffs and the Quebec plaintiffs, subject to several conditions and approval of the E&Y Settlement itself.

47 As noted in the endorsement dated December 10, 2012, which denied the Funds' adjournment request, the E&Y Settlement does not form part of the Sanction Order and no relief is being sought on this motion with respect to the E&Y Settlement. Rather, section 11.1 of the Plan contains provisions that provide a framework pursuant to which a release of the E&Y claims under the Plan will be effective if several conditions are met. That release will only be granted if all conditions are met, including further court approval.

48 Further, SFC's counsel acknowledges that any issues relating to the E&Y Settlement, including fairness, continuing discovery rights in the Ontario Class Action or Quebec Class Action, or opt out rights, are to dealt with at a further court-approval hearing.

Law and Argument

49 Section 6(1) of the CCAA provides that courts may sanction a plan of compromise if the plan has achieved the support of a majority in number representing two-thirds in value of the creditors.

50 To establish the court's approval of a plan of compromise, the debtor company must establish the following:

(a) there has been strict compliance with all statutory requirements and adherence to previous orders of the court;
(b) nothing has been done or purported to be done that is not authorized by the CCAA; and
(c) the plan is fair and reasonable.

(See *Re Canadian Airlines Corporation*, 2000 ABQB 442, leave to appeal denied, 2000 ABCA 238, aff'd 2001 ABCA 9, leave to appeal to SCC refused July 21, 2001, [2001] S.C.C.A. No. 60 and Re Nelson Financial Group Limited, 2011 ONSC 2750, 79 C.B.R. (5th) 307).

51 SFC submits that there has been strict compliance with all statutory requirements.

52 On the initial application, I found that SFC was a "debtor company" to which the CCAA applies. SFC is a corporation continued under the *Canada Business Corporations Act* ("CBCA") and is a "company" as defined in the CCAA. SFC was "reasonably expected to run out of liquidity within a reasonable proximity of time" prior to the Initial Order and, as such, was and continues to be insolvent. SFC has total claims and liabilities against it substantially in excess of the $5 million statutory threshold.

53 The Notice of Creditors' Meeting was sent in accordance with the Meeting Order and the revised Noteholder Mailing Process Order and, further, the Plan supplement and the voting procedures were posted on the Monitor's website and emailed to each of the ordinary Affected Creditors. It was also delivered by email to the Trustees and DTC, as well as to Globic who disseminated the information to the Registered Noteholders. The final version of the Plan was emailed to the Affected Creditors, posted on the Monitor's website, and made available for review at the meeting.

54 SFC also submits that the creditors were properly classified at the meeting as Affected Creditors constituted a single class for the purposes of considering the voting on the Plan. Further, and consistent with the Equity Claims Decision, equity claimants constituted a single class but were not entitled to vote on the Plan. Unaffected Creditors were not entitled to vote on the Plan.

55 Counsel submits that the classification of creditors as a single class in the present case complies with the commonality of interests test. See *Re Canadian Airlines Corporation.*

56 Courts have consistently held that relevant interests to consider are the legal interests of the creditors hold *qua* creditor in relationship to the debtor prior to and under the plan. Further, the commonality of interests should be considered purposively, bearing in mind the object of the CCAA, namely, to facilitate reorganizations if possible. See *Stelco Inc.* (2005), 78 O.R. (3d) 241 (Ont. C.A.), *Re Canadian Airlines Corporation*, and *Re Nortel Networks Corporation* [2009] O.J. No. 2166 (Ont. S.C.). Further, courts should resist classification approaches that potentially jeopardize viable plans.

57 In this case, the Affected Creditors voted in one class, consistent with the commonality of interests among Affected Creditors, considering their legal interests as creditors. The classification was consistent with the Equity Claims Decision.

58 I am satisfied that the meeting was properly constituted and the voting was properly carried out. As described above, 99% in number, and more than 99% in value, voting at the meeting favoured the Plan.

59 SFC's counsel also submits that SFC has not taken any steps unauthorized by the CCAA or by court orders. SFC has regularly filed affidavits and the Monitor has provided regular reports and has consistently opined that SFC is acting in good faith and with due diligence. The court has so ruled on this issue on every stay extension order that has been granted.

60 In *Nelson Financial,* I articulated relevant factors on the sanction hearing. The following list of factors is similar to those set out in *Re Canwest Global Communications Corporation*, 2010 ONSC 4209, 70 C.B.R. (5th) 1:

1. The claims must have been properly classified, there must be no secret arrangements to give an advantage to a creditor or creditor; the approval of the plan by the requisite majority of creditors is most important;
2. It is helpful if the Monitor or some other disinterested person has prepared an analysis of anticipated receipts and liquidation or bankruptcy;
3. If other options or alternatives have been explored and rejected as workable, this will be significant;
4. Consideration of the oppression rights of certain creditors; and
5. Unfairness to shareholders.
6. The court will consider the public interest.

61 The Monitor has considered the liquidation and bankruptcy alternatives and has determined that it does not believe that liquidation or bankruptcy would be a preferable alternative to the Plan. There have been no other viable alternatives presented that would be acceptable to SFC and to the Affected Creditors. The treatment of shareholder claims and related indemnity claims are, in my view, fair and consistent with CCAA and the Equity Claims Decision.

62 In addition, 99% of Affected Creditors voted in favour of the Plan and the Ad Hoc Securities Purchasers Committee have agreed not to oppose the Plan. I agree with SFC's submission to the effect that these are exercises of those parties' business judgment and ought not to be displaced.

63 I am satisfied that the Plan provides a fair and reasonable balance among SFC's stakeholders while simultaneously providing the ability for the Sino-Forest business to continue as a going concern for the benefit of all stakeholders.

64 The Plan adequately considers the public interest. I accept the submission of counsel that the Plan will remove uncertainty for Sino-Forest's employees, suppliers, customers and other stakeholders and provide a path for recovery of the debt owed to SFC's non-subordinated creditors. In addition, the Plan preserves the rights of aggrieved parties, including SFC through the Litigation Trust, to pursue (in litigation or settlement) those parties that are alleged to share some or all of the responsibility for the problems that led SFC to file for CCAA protection. In addition, releases are not being granted to individuals who have been charged by OSC staff, or to other individuals against whom the Ad Hoc Securities Purchasers Committee wishes to preserve litigation claims.

65 In addition to the consideration that is payable to Affected Creditors, Early Consent Noteholders will receive their *pro rata* share of an additional 7.5% of the Newco Shares ("Early Consent Consideration"). Plans do not need to provide the same recovery to all creditors to be considered fair and reasonable and there are several plans which have been sanctioned by the courts featuring differential treatment for one creditor or one class of creditors. See, for example, *Canwest*

Global and *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. Gen. Div.). A common theme permeating such cases has been that differential treatment does not necessarily result in a finding that the Plan is unfair, as long as there is a sufficient rational explanation.

66 In this case, SFC's counsel points out that the Early Consent Consideration has been a feature of the restructuring since its inception. It was made available to any and all noteholders and noteholders who wished to become Early Consent Noteholders were invited and permitted to do so until the early consent deadline of May 15, 2012. I previously determined that SFC made available to the noteholders all information needed to decide whether they should sign a joinder agreement and receive the Early Consent Consideration, and that there was no prejudice to the noteholders in being put to that election early in this proceeding.

67 As noted by SFC's counsel, there was a rational purpose for the Early Consent Consideration. The Early Consent Noteholders supported the restructuring through the CCAA proceedings which, in turn, provided increased confidence in the Plan and facilitated the negotiations and approval of the Plan. I am satisfied that this feature of the Plan is fair and reasonable.

68 With respect to the Indemnified Noteholder Class Action Limit, I have considered SFC's written submissions and accept that the $150 million agreed-upon amount reflects risks faced by both sides. The selection of a $150 million cap reflects the business judgment of the parties making assessments of the risk associated with the noteholder component of the Ontario Class Action and, in my view, is within the "general range of acceptability on a commercially reasonable basis". See *Re Ravelston Corporation,* (2005) 14 C.B.R. (5th) 207 (Ont. S.C). Further, as noted by SFC's counsel, while the New York Class Action Plaintiffs filed a proof of claim, they have not appeared in this proceeding and have not stated any opposition to the Plan, which has included this concept since its inception.

69 Turning now to the issue of releases of the Subsidiaries, counsel to SFC submits that the unchallenged record demonstrates that there can be no effective restructuring of SFC's business and separation from its Canadian parent if the claims asserted against the Subsidiaries arising out of or connected to claims against SFC remain outstanding. The Monitor has examined all of the releases in the Plan and has stated that it believes that they are fair and reasonable in the circumstances.

70 The Court of Appeal in *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corporation,* 2008 ONCA 587, 45 C.B.R. (5th) 163 stated that the "court has authority to sanction plans incorporating third party releases that are reasonably related to the proposed restructuring".

71 In this case, counsel submits that the release of Subsidiaries is necessary and essential to the restructuring of SFC. The primary purpose of the CCAA proceedings was to extricate the business of Sino-Forest, through the operation of SFC's Subsidiaries (which were protected by the Stay of Proceedings), from the cloud of uncertainty surrounding SFC. Accordingly, counsel submits that there is a clear and rational connection between the release of the Subsidiaries in the Plan. Further, it is difficult to see how any viable plan could be made that does not cleanse the Subsidiaries of the claims made against SFC.

72 Counsel points out that the Subsidiaries who are to have claims against them released are contributing in a tangible and realistic way to the Plan. The Subsidiaries are effectively contributing their assets to SFC to satisfy SFC's obligations under their guarantees of SFC's note indebtedness, for the benefit of the Affected Creditors. As such, counsel submits the releases benefit SFC and the creditors generally.

73 In my view, the basis for the release falls within the guidelines previously set out by this court in *ATB Financial*, *Re Nortel Networks*, 2010 ONSC 1708, and *Re Kitchener Frame Limited*, 2012 ONSC 234, 86 C.B.R. (5th) 274. Further, it seems to me that the Plan cannot succeed without the releases of the Subsidiaries. I am satisfied that the releases are fair and reasonable and are rationally connected to the overall purpose of the Plan.

74 With respect to the Named Directors and Officers release, counsel submits that this release is necessary to effect a greater recovery for SFC's creditors, rather than having those directors and officers assert indemnity claims against SFC. Without these releases, the quantum of the unresolved claims reserve would have to be materially increased and, to the extent that any such indemnity claim was found to be a proven claim, there would have been a corresponding dilution of consideration paid to Affected Creditors.

75 It was also pointed out that the release of the Named Directors and Officers is not unlimited; among other things, claims for fraud or criminal conduct, conspiracy claims, and section 5.1 (2) D&O Claims are excluded.

76 I am satisfied that there is a reasonable connection between the claims being compromised and the Plan to warrant inclusion of this release.

77 Finally, in my view, it is necessary to provide brief comment on the alternative argument of the Funds, namely, the Plan be altered so as to remove Article 11 "Settlement of Claims Against Third Party Defendants". The Plan was presented to the meeting with Article 11 in place. This was the Plan that was subject to the vote and this is the Plan that is the subject of this motion. The alternative proposed by the Funds was not considered at the meeting and, in my view, it is not appropriate to consider such an alternative on this motion.

Disposition

78 Having considered the foregoing, I am satisfied that SFC has established that:

(i) there has been strict compliance with all statutory requirements and adherence to the previous orders of the court;
(ii) nothing has been done or purported to be done that is not authorized by the CCAA; and

(iii) the Plan is fair and reasonable.

79 Accordingly, the motion is granted and the Plan is sanctioned. An order has been signed substantially in the form of the draft Sanction Order.

G.B. MORAWETZ J.

cp/e/qljel/qlpmg

Case Name:
Zaniewicz v. Zungui Haixi Corp.

Between
Jerzy Robert Zaniewicz and Edward C. Clarke, Plaintiffs, and Zungui Haixi Corporation, E&Y, Fengyi Cai, Jixu Cai, Yanda Cai, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle, Margaret Cornish, CIBC World Markets Inc., Canaccord Genuity Corp. (f.k.A. Canaccord Financial Ltd)., GMP Securities LP and Mackie Research Capital Corporation (f.k.a. Research Capital Corporation)
Defendants Proceeding under the Class Proceedings Act

[2013] O.J. No. 3894

2013 ONSC 5490

Court File No. 11-CV-436360-00CP

Ontario Superior Court of Justice

P.M. Perell J.

Heard: August 27, 2013.
Judgment: August 27, 2013.

(105 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Class counsel -- Fees -- Definition of class -- Members of class or sub-class -- Settlements -- Approval -- Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution and approval of counsel fees allowed in part -- Plaintiffs alleged defendant's prospectus and financial statements were misleading -- Certification of class action allowed and settlements approved -- Counsel fees approved -- Modified plan of distribution approved -- It was unfair to include investors who purchased shares after corrective press release in class definition but exclude them from distribution -- Such class members were to be included in distribution at 80 per cent discount -- Class Proceedings Act, s. 26(1).

Securities regulation -- Civil liability -- Misrepresentation in a prospectus -- Plaintiffs -- Purchase *during period of distribution -- Secondary market disclosure -- Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution and approval of counsel fees allowed in part -- Plaintiffs alleged defendant's prospectus and financial statements were misleading -- Certification of class action allowed and settlements approved -- Counsel fees approved -- Modified plan of distribution approved -- It was unfair to include investors who purchased shares after corrective press release in class definition but exclude them from distribution -- Such class members were to be included in distribution at 80 per cent discount -- Class Proceedings Act, s. 26(1).*

Motion by plaintiffs for certification of class action for settlement purposes, approval of settlements, approval of the plan of distribution, approval of class counsel fees, and ancillary orders. The plaintiffs purchased common shares of the defendant corporation in the primary and secondary markets. The plaintiffs advanced common law tort claims and securities law claims. The plaintiffs alleged that the defendant's initial public offering prospectus was misleading as it contained material misrepresentations, that the financial statements contained in the prospectus and other financial statements later prepared and disseminated in the secondary securities market were neither accurate nor reliable. The proposed settlement funds totalled $10,850,000. The plaintiff's plan of distribution was structured to reflect the theory of damages that the corporation's share value was artificially inflated and that this artificial inflation was removed in two share price falls. The first share price fall occurred when a report was issued alleging fraud, and the second occurred when the defendant issued a press release announcing that its auditor had suspended its audit of the corporation's financial statements for the year. One month after the press release, the auditor resigned and withdrew its opinions that the corporation's financial statements were GAAP compliant. The class definition included all persons who acquired shares during the period to and including the date of the second event. No compensation was to be paid to class members who purchased shares in the secondary market after the press release. Class counsel received one written objection to the proposed plan of allocation from a class member who purchased shares on the day of the press release, proposing that such class members be included in the distribution at a discount of 80 per cent.

HELD: Motions allowed in part. Motions to certify action and approve settlements allowed and ancillary orders allowed. Modified plan of allocation allowed. Aside from the plan of distribution, the settlement agreements were fair, reasonable, and in the best interests of the class members. The settlements were approved independent of the plan of distribution. It was inappropriate and unfair to include investors who purchased their shares on the day of the press release as class members and exclude them from the plan of allocation. After including those purchasers as class members as part of the bargaining for the settlements, it was inappropriate for the plaintiffs to advocate a theory of the case that they were not eligible for any compensation at all. The plan of distribution was modified to include compensation for those class members at a discount of 80 per cent. Class counsel's request for fees represented 20.75 per cent of the recovery. Having regard to the risk undertaken by class counsel and the degree of success achieved, class counsel's request for approval of its legal fees in the amount of $2,807,037 was approved.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 26, s. 26(1), s. 29(2)

Securities Act, R.S.O. 1990, c. S.5,

Counsel:

Charles M. Wright and *Douglas M. Worndl,* for the Plaintiffs.

Deborah Berlach, for the Defendant, Zungui Haizi Corporation.

Margaret L. Waddell, for the Defendant, Michelle Gobin.

Michael A. Eizenga, for the Defendant, Michael W.
Manley.

James S.F. Wilson, for the Defendants, Patrick A. Ryan, Elliott Wahle, and Margaret Cornish.

Linda L. Fuerst, for the Defendant Ernst & Young LLP.

Kent Thomson and *Derek Ricci,* for the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp. (f.k.A. Canaccord Financial Ltd.) and Mackie Research Capital Corporation (f.k.A. Research Capital Corporation and GMP Securities LP.

REASONS FOR DECISION

P.M. PERELL J.:--

A. INTRODUCTION AND OVERVIEW

1 This is a securities class action under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 and the Ontario *Securities Act,* R.S.O. 1990, c. S.5. The Plaintiffs Jerzy Robert Zaniewicz and Edward C. Clarke advance common law tort claims and also statutory claims with respect to the sale of the shares of Zungui Haizi Corporation in the primary and secondary markets.

2 The Plaintiffs bring this motion for: (a) certification for settlement purposes as against the Defendants CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP, and Mackie Research Capital Corporation (the "Underwriting Syndicate"); (b) approval of three settlements; (c) ancillary orders, including the appointment of an administrator; (d) approval of the notice program; and (e) approval of the plan of distribution (the "Plan of Allocation") for the settlement funds.

3 Class Counsel also bring a motion for approval of its counsel fees and disbursements. Class Counsel seeks $2,250,000.00, plus disbursements, interest on disbursements, and applicable taxes. The total request is for $2,807,037.56.

4 For the reasons that follow, I certify the action as against the Underwriting Syndicate for settlement purposes. I approve the three settlements and Class Counsel's request for counsel fees. I approve the requests for ancillary orders. However, I do not approve the proposed Plan of Allocation, and, rather, I have varied the plan and approved a modified Plan of Allocation.

5 As I will explain, in this case, the court has the jurisdiction to approve the settlement agreements and then establish a plan of distribution that is different than the plan of distribution proposed by the parties.

B. <u>FACTUAL BACKGROUND TO THE CLASS ACTION</u>

6 See *Zaniewicz v. Zungui Haixi Corp.*, 2013 ONSC 2959, which sets out most of the factual background and the procedural history. See also: *Zaniewicz v. Zungui Haixi Corp.*, *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 4842, *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 4904, and *Zaniewicz v. Zungui Haixi Corp.*, 2012 ONSC 6061.

7 In December 2009, Zungui made an initial public offering ("IPO"), and it raised approximately $40 million in Ontario's capital markets.

8 Zungui and its directors and officers had a statutory obligation under the Ontario *Securities Act* to provide Zungui's investors with timely and accurate disclosure regarding the business of Zungui, including disclosure in Zungui's interim and annual financial statements.

9 In its interim and annual financial statements, Zungui and the Defendants Yanda, Fengyi, and Zungui Cai (the "Cai Brothers") assured investors that Zungui's financial statements presented fairly, in all material respects, the financial position of Zungui in accordance with GAAP. They represented that the Zungui's offering documents contained full true and plain disclosure of all material facts relating to the offering of securities.

10 The Plaintiffs are residents of Ontario. Each purchased common shares of Zungui in the primary market. Mr. Clarke also purchased common shares of Zungui in the secondary market.

11 On August 22, 2011, Zungui issued a press release announcing that its auditor, Ernst & Young LLP ("E&Y"), had suspended its audit of Zungui's financial statements for the year ended June 30, 2011. With that announcement, Zungui's shares immediately lost 77% of their value. Subsequently, Zungui's shares became the subject of various temporary and permanent cease trade orders, and they are now worthless.

12 On September 22, 2011, Zungui's Chief Financial Officer and all independent members of the Board resigned, in part, because the special committee formed to investigate E&Y's concerns had been prevented from fulfilling its mandate.

13 On September 23, 2011, E&Y resigned as Zungui's auditor. E&Y withdrew its opinions that Zungui's financial statements were GAAP compliant.

14 On February 2, 2012, 2012 LNONOSC 162, the Ontario Securities Commission ("OSC") ruled that Yanda, Fengyi, and Zungui Cai had engaged in conduct contrary to the public interest, and on August 28, 2012, 2012 LNONOSC 619, the OSC ordered, among other things, that Yanda and Fengyi resign as directors or officers of Zungui and be permanently prohibited from acting as directors or officers of any issuer.

15 The OSC investigation revealed that when E&Y resigned, it advised that all of its audit opinions that formed part of the IPO Prospectus, as well as Zungui's June 2010 financial statements could no longer be relied upon.

16 On October 3, 2011, Mr. Zaniewicz, commenced the action by the issuance of a Notice of Action. On November 2, 2011, he filed his Statement of Claim. On February 7, 2012 and February 10, 2012, I made orders granting leave to amend the Statement of Claim to add Mr. Clarke as a plaintiff and to correct the description of two of the Underwriters incorrectly described in the style of cause.

17 On February 8, 2012, the Plaintiffs filed their Fresh as Amended Statement of Claim.

18 In the action, the Plaintiffs sue not only Zungui and the Cai Brothers, but others allegedly responsible for ensuring that Zungui's public disclosure to primary and secondary market investors was timely and accurate in accordance with securities law. The Plaintiffs allege various statutory claims under the Ontario *Securities Act* and also common law claims.

19 The Plaintiffs allege that Zungui's IPO Prospectus was misleading as it contained material misrepresentations. The Plaintiffs allege that the representations were materially false, and Zungui's financial statements contained in the prospectus, and other financial statements later prepared and disseminated in the secondary securities market, were neither accurate nor reliable in respect of reported revenues, net income, assets, and shareholders' equity. Moreover, the Plaintiffs allege that the financial statements did not fairly present, in all material respects, the financial condition, results of operations and cash flows of Zungui for the reporting periods presented.

20 Alan Mak, who is a chartered accountant, a member of the Institute of Chartered Accountants of Ontario, and a member of the Association of Certified Fraud Examiners opined that the audits conducted by Ernst & Young were not in accordance with GAAP and that Ernst & Young's unqualified audit opinions should not have been given for the 2006 through 2010 reporting periods. E&Y does not admit that it was negligent.

21 In the class action, the Class Definition is as follows:

> All persons or entities wherever they may reside or be domiciled, other than Excluded Persons and Opt-Out Parties, who acquired Eligible Shares.
>
> Eligible Shares means the Shares acquired by a Class Member or Opt-Out Party during the Class Period.
>
> Class Period means the period from and including August 11, 2009 to and including August 22, 2011.
>
> Excluded Persons means each Defendant, the past or present subsidiaries or affiliates, officers, directors, partners, legal representatives, consultants, agents, successors and assigns of Zungui and any member of each Defendant's families, their heirs, successors or assigns, and includes any Southern Zungui Acquirers who acted as a consultant or provided other professional services to Zungui or its subsidiaries in connection with the IPO.

22 The Class is comprised of three (3) types of acquirers of Zungui common shares: (1) primary market purchasers; (2) secondary market purchasers; and (3) share exchange acquirors (i.e. anyone who was a shareholder of Zungui's subsidiary, Southern Trends International Holding Company (BVI), who entered into an agreement with Zungui, before its IPO, to exchange their Southern Trends shares for Zungui common shares on a basis of 1:5,000.

23 Paul Mulholland, a US based certified forensic accountant, was retained by the Plaintiffs, to among other things, calculate the damages of class members. Mr. Mulholland's estimate of damages was $23.76 million comprised of: (a) $10.1 million in damage to primary market purchasers; $12.9 million in damage to secondary market Purchasers; and $0.7 million in damage to share exchange acquirors. (The original Statement of Claim sought damages of $30 million.)

24 The Defendants, of course, do not admit liability or the amount of the Class Member's alleged losses.

C. <u>CERTIFICATION FOR SETTLEMENT PURPOSES</u>

25 I have already certified this action for settlement purposes as against Zungui, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle, and Margaret Cornish (the "Zungui

Defendants") and against Ernst & Young LLP and the Cai Brothers.

26 I am satisfied that that action should now be certified for settlement purposes as against the Underwriting Syndicate, and an Order should issue accordingly.

D. SETTLEMENT APPROVAL

27 The Plaintiffs have concluded three settlements: (1) the Auditor Settlement; (2) the Zungui Settlement; and (3) Underwriter Settlement.

28 The Auditor Settlement is for $2 million. The Zungui Settlement is for $8 million, and the Underwriter Settlement is for $750,000.00.

29 The Zungui Defendants have agreed to contribute an additional $100,000.00 if the Plaintiffs: (a) settled their claims against the Underwriting Syndicate before the scheduled settlement approval hearings for the Auditor Settlement and the Zungui Settlement; and (b) obtained the Court's approval of a settlement with the Underwriting Syndicate. Thus, if all the settlements are approved, the settlement funds will total $10,850,000.00 plus interest before deductions for counsel fee and administrative expenses.

30 The settlement funds under the Auditor Settlement were received on May 17, 2013, and have been accruing interest since that date. The settlement funds under the Zungui Settlement were received on May 24, 2013, and have been accruing interest since February 22, 2013. The settlement funds under the Underwriter Settlement will be paid within fourteen days of execution of the Underwriter Agreement (i.e., by September 2, 2013).

31 The Settlement Amounts that have been received are currently invested at RBC in interest bearing accounts. Each settlement amount is held in a separate escrow account.

32 Class Counsel has been informed that, as of August 16, 2013, the escrow accounts contain: (1) Zungui Escrow Account, $7,984,781.20; and (2) Auditor Escrow Account, $1,995,373.52. These accounts reflect the payment of $48,931.32 for the publication of the First Notice (allocated, $39,145.07 from the Zungui Escrow Account and $9,786.25 from the Auditor Escrow Account) and the accrual of $23,926.27 in interest on the Zungui Settlement Amount and $5,159.68 in interest on the Auditor Settlement Amount.

33 Notice of the certification of the action as against the Zungui Defendants, Ernst & Young LLP, and the Cai Brothers has been given to the Class Members. There were no opt-outs. The notice also provided notice of the Auditor Settlement and the Zungui Settlement.

34 Notice of the proposed Underwriter Settlement has recently been given to the Class Members pursuant to a recent court order made at a case conference. Having already had a right to opt-out, class members do not have a right to opt-out with respect to the certification of the action as against

the Underwriting Syndicate. When there are partial or progressive certifications of a class action, provided that there was adequate notice, the right to opt-out is a procedural right that may only be exercised once: *Eidoo v. Infineon Technologies AG*, 2012 ONSC 7299 at paras. 29-32; *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065 (SCJ).

35 Under the settlements, the Plaintiffs and the Class will provide releases to all of the Defendants. The Cai Brothers will be released as part of the Zungui Settlement. The settlements, if approved, would complete the class action.

36 The key terms of the settlement agreements are as follows:

* The settlement will be administered by an Administrator;
* the Defendants will pay their respective settlement amounts for the benefit of the Class;
* the settlement funds will be distributed, after payment of any administration expenses and Class Counsel fees, disbursements, and taxes as awarded by the Court;
* the settlement funds will be distributed in accordance with a Plan of Allocation that is in a form satisfactory to the Defendants or as fixed by the Court;
* if the settlement is approved by the court, the Notices of the Settlement will provide Class Members with information concerning their right to participate by filing a Claim Form;
* the settlement funds will be distributed among all Class Members who timely submit valid Claim Forms to the Administrator;
* there are no rights of reversion;
* the Plan of Allocation provides for the possibility of a *cy près* distribution to the Small Investor Protection Association Canada in the event that less than $25,000.00 remains 180 days from the date on which the Administrator distributes the net settlement amount; and
* the Plaintiffs and the Class Members will release the Defendants and certain identified associated entities.

37 Under the Plan of Notice, the Short Form Notice of Settlement will be published: (a) in the English language, in the business/legal section of the national weekend editions of the *National Post* and the *Globe and Mail*; (b) in the French language, in the business section of *La Presse*; and (c) in the French and English languages across *Marketwire*, a major business newswire in Canada.

38 Under the Plan of Notice, the Long Form Notice of Settlement will be: (a) posted in both the French and English languages on www.classaction.ca; (b) posted in both the French and English languages on the Administrator's website; and (c) mailed or emailed, along with the Claim Form and the Opt-Out Form, directly to persons that have contacted Class Counsel and have provided their contact information.

39 Also in accordance with the Plan of Notice, the Long Form Notice of Settlement and the Claim Form will be sent by the Administrator: (a) directly to persons identified as Class Members by way of a computer-generated list provided by Zungui's litigation receiver to Class Counsel and the Administrator; and (b) to the brokerage firms in the Administrator's proprietary databases, requesting that these firms either send a copy of these materials to all individuals and entities identified as Class Members, or to send the names and addresses of all such individuals and entities to the Administrator, who will mail these materials to the individuals and entities so identified.

40 The estimated cost of implementing the Plan of Notice, excluding the First Notice that has already been published and paid for, will be approximately $140,000.00 (before tax). Of that amount, approximately $85,000.00 is attributable to the cost of effecting direct notice.

41 David Weir, the President of NPT RicePoint Class Action Services, the proposed Administrator, deposes that the broker outreach portion of the notice plan is likely to bring the settlement to the attention of the Class Members in a manner consistent with other notice programs in securities class actions.

42 Class Counsel believes that the Approval Notices, disseminated in accordance with the Plan of Notice, will come to the attention of a substantial portion of the Class.

43 Class Counsel recommends that the court approve the settlements. Class Counsel is of the view that the settlement terms and conditions are fair and reasonable, and represent a significant recovery for Class Members in a securities class action.

44 Based on the expert opinion of Paul Mulholland, CFA, Class Counsel believes that the combined settlement amounts represent close to 50% of the damages allegedly suffered by the Class Members as calculated by Mr. Muhlholland. I would calculate the class's gross recovery as 46% of the damages allegedly suffered and the class's net recovery after the payment of administrative expenses and legal fees, as claimed, as approximately 33%.

45 The Plaintiffs have instructed Class Counsel to seek approval of the settlements.

46 No objections to the quantum of the Settlements have been received to date. However, Class Counsel has received: (a) one objection to the release provisions in the Zungui Agreement insofar as they apply to the Cai Brothers; and (b) one written objection to the proposed Plan of Allocation, discussed below, concerning the proposed ineligibility for any payment to Class Members for shares purchased in the secondary market after the alleged corrective press release on August 22, 2011.

47 Section 29(2) of the *Class Proceedings Act, 1992* provides that a settlement of a class proceeding is not binding unless approved by the court. To approve a settlement of a class proceeding, the court must find that, in all the circumstances, the settlement is fair, reasonable, and in the best interests of the class: *Fantl v. Transamerica Life Canada*, [2009] O.J. No. 3366 (S.C.J.) at para 57; *Farkas v. Sunnybrook and Women's Health Sciences Centre*, [2009] O.J. No. 3533 (S.C.J.), at para. 43; *Kidd v. Canada Life Assurance Company*, 2013 ONSC 1868.

48 In determining whether a settlement is reasonable and in the best interests of the class, the following factors may be considered: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) the proposed settlement terms and conditions; (d) the recommendation and experience of counsel; (e) the future expense and likely duration of litigation; (f) the number of objectors and nature of objections; (g) the presence of good faith, arm's-length bargaining and the absence of collusion; (h) the information conveying to the court the dynamics of, and the positions taken by, the parties during the negotiations; and, (i) the nature of communications by counsel and the representative plaintiff with class members during the litigation. See: *Fantl v. Transamerica Life Canada, supra* at para 59; *Corless v. KPMG LLP*, [2008] O.J. No. 3092 (S.C.J.), at para. 38; *Farkas v. Sunnybrook and Women's Health Sciences Centre, supra,* at para. 45; *Kidd v. Canada Life Assurance Company*, 2013 ONSC 1868.

49 In my opinion -- independent of the matter of the Plan of Allocation (the plan of distribution) -- having regard to the various criteria set out above, the three settlement agreements taken together are fair, reasonable, and in the best interests of the Class Members.

50 Therefore, independent of the matter of the Plan of Allocation, which I will discuss next, I approve the three settlements.

E. <u>DISTRIBUTION PLAN</u>

1. The Court's Jurisdiction to Approve the Distribution Plan

51 In the case at bar, the court's authority to approve the plan of distribution, the Plan of Allocation, comes from the settlement agreements, where the plan of distribution is referred to as a Plan of Allocation.

52 The settlement agreements define the "Plan of Allocation" as follows:

> Plan of Allocation means the distribution plan distributing the proposed settlement in a form satisfactory to the Settling Defendants or as fixed by the Court.

53 As I interpret the settlement agreements, and as confirmed by the Plaintiffs during argument, I can approve the settlements independent of approving the Plan of Allocation, which is what I have done. In other words, I have approved the settlements, which are now binding on the parties and on the Class Members, and I shall determine or fix the Plan of Allocation.

54 For reasons that I will set out below, I do not approve of the Plan of Allocation proposed by the parties, but I shall vary it, and I shall approve a different plan of distribution.

55 Had the settlement agreements in the case at bar not left it to the court to ultimately determine what is an appropriate plan of distribution, I would not have approved the settlements, because I do not think the proposed Plan of Allocation is fair and reasonable and in the best interests of the class. I also would not have approved Class Counsel's fees because the settlements would not have been approved.

2. *The Test for Approving a Distribution Plan*

56 In the situation where there is a judgment in a certified class action, the court's authority to determine or approve a plan of distribution comes from s. 26 of the *Class Proceedings Act, 1992*, which states:

> *Judgment distribution*
>
> 26.(1) The court may direct any means of distribution of amounts awarded under section 24 or 25 that it considers appropriate.
>
> *Idem*
>
> (2) In giving directions under subsection (1), the court may order that,
>
> (a) the defendant distribute directly to class members the amount of monetary relief to which each class member is entitled by any means authorized by the court, including abatement and credit;
> (b) the defendant pay into court or some other appropriate depository the total amount of the defendant's liability to the class until further order of the court; and
> (c) any person other than the defendant distribute directly to class members the amount of monetary relief to which each member is entitled by any means authorized by the court.
>
> *Idem*
>
> (3) In deciding whether to make an order under clause (2) (a), the court shall

consider whether distribution by the defendant is the most practical way of distributing the award for any reason, including the fact that the amount of monetary relief to which each class member is entitled can be determined from the records of the defendant.

Idem

(4) The court may order that all or a part of an award under section 24 that has not been distributed within a time set by the court be applied in any manner that may reasonably be expected to benefit class members, even though the order does not provide for monetary relief to individual class members, if the court is satisfied that a reasonable number of class members who would not otherwise receive monetary relief would benefit from the order.

Idem

(5) The court may make an order under subsection (4) whether or not all class members can be identified or all of their shares can be exactly determined.

Idem

(6) The court may make an order under subsection (4) even if the order would benefit,

(a) persons who are not class members; or
(b) persons who may otherwise receive monetary relief as a result of the class proceeding.

Supervisory role of the court

(7) The court shall supervise the execution of judgments and the distribution of awards under section 24 or 25 and may stay the whole or any part of an execution or distribution for a reasonable period on such terms as it

considers appropriate.

Payment of awards

(8) The court may order that an award made under section 24 or 25 be paid,

(a) in a lump sum, forthwith or within a time set by the court; or
(b) in instalments, on such terms as the court considers appropriate.

Costs of distribution

(9) The court may order that the costs of distribution of an award under section 24 or 25, including the costs of notice associated with the distribution and the fees payable to a person administering the distribution, be paid out of the proceeds of the judgment or may make such other order as it considers appropriate.

Return of unclaimed amounts

(10) Any part of an award for division among individual class members that remains unclaimed or otherwise undistributed after a time set by the court shall be returned to the party against whom the award was made, without further order of the court.

57 It may be noted that under s. 26(1) of the *Class Proceedings Act, 1992*, the court may direct any means of distribution of amounts awarded that it considers appropriate. I am not aware of any caselaw actually applying s. 26(1), although numerous cases have suggested that the court has ample discretion and ample scope for creativity in employing s. 26.

58 In the case at bar, as noted above, the court's authority to approve the plan of distribution comes from the settlement agreements, where the plan of distribution is referred to as a Plan of Allocation, and, as noted above, as I interpret the settlement agreements, I can determine or fix the Plan of Allocation as I think appropriate.

59 In determining what is appropriate, I intend to apply the same test or standard that the court applies when deciding whether to approve a settlement. Thus, a plan of distribution will be appropriate if in all the circumstances, the plan of distribution is fair, reasonable, and in the best interests of the class.

3. The Proposed Plan of Allocation

60 For reasons that I will set out below, I do not approve of the Plan of Allocation proposed by the parties, but I shall vary it and approve a different plan of distribution.

61 Class Counsel, with Mr. Mulholland's assistance, developed the Plan of Allocation. This plan was structured to reflect Mr. Mulholland's opinion that Zungui suffered two share price falls that were statistically significant, net of external market factors. These events occurred on: (1) June 2, 2011, when Muddy Waters LLC issued a report about Sino-Forest Corporation in which a fraud was alleged; and (2) August 22, 2011, when Zungui issued the press release announcing the suspension of 2011 audit procedures by Ernst & Young LLP.

62 The Plaintiffs' damages theory is that the value of Zungui's common shares was at all times artificially inflated by misrepresentation and that the artificial inflation, equivalent to $1.52 per share, was removed from the share value by the close of TSX-V trading on August 22, 2011. The Plaintiff's theory is that the artificial inflation was removed: in part, on June 2, 2011, in an amount of $0.26; and in balance, on August 22, 2011, in an amount of $1.26.

63 The amount of each Class Member's compensation will depend upon: whether the Class Member is a Primary Market Purchaser and/or a Secondary Market Purchaser and/or Share Exchange Acquiror; the number and price of Zungui common shares purchased by the Class Member during the Class Period; whether and when the Class Member sold Zungui common shares purchased during the Class Period, and the price at which these common shares were sold; whether the Class Member continues to hold some or all of the Zungui common shares purchased during the Class Period; and the total number and value of all claims for compensation filed with the Administrator.

64 The Plan of Allocation provides that no compensation shall be paid for any shares disposed of before June 2, 2011, which is consistent with Mr. Mulholland's opinion that June 2, 2011 was the first time that Zungui's common shares were subject to a statistically significant event, net of external market factors.

65 The Plan of Allocation provides that no compensation shall be paid for any shares purchased after the time of the making of the alleged corrective disclosure on August 22, 2011. The main rationale for the disqualification of these shares is that they purchased when it was publicly known that audit issues existed. I note, however, that it was not until another month later that E&Y disavowed that Zungui's financial statements were GAAP compliant.

66 In any event, although a purchaser of Zungai shares on Aug 22, 2011 is a Class Member, under the proposed Plan of Allocation, he or she is not entitled to receive compensation.

67 These background circumstances bring me to the written objection to the Plan of Allocation delivered by Dr. Christopher Lane, which I set out below:

> My name is Dr. Christopher Lane (psychologist) and I would like to register an objection to the terms of the proposed "Plan of Allocation," particularly under the heading "Secondary Market Purchasers," and under "VII" which states: "No Nominal Entitlement shall be recognized for any Eligible Shares purchased after the time of the making of the alleged corrective disclosure on August 22, 2011." This statement appears to eliminate the right of anyone who purchased shares of ZUN on August 22, 2011 to receive any compensation whatsoever and to thereby lose 100% of their investment. I happen to be one of those individuals who purchased shares on that fateful August 22, 2011 day, as did my brother, Brian Lane. Indeed, I bought a total of 117,000 shares of ZUN that day at a "book value" (according to my bank statements) of $47,735.83 (average cost per share of 40.8 cents). As one might expect, I am very upset by the wording of the proposed "Plan of Allocation" and would like to offer a suggestion of a fairer settlement, as the one proposed is, in my mind, overly punitive and leaves investors in my position with a feeling of defeat and lack of justice.
>
> ... While it is true that the announcement indicated that Ernst & Young suspended procedures until Zungui "clarifies and substantiates its position with respect to issues pertaining to the current and prior year" this does not clearly foreshadow the events that followed, which turned out to be devastating to the investors who held the stock and represented a "worst case scenario" with the stock never trading again after August 22, 2011. Clearly this was bad news and sent the stock tumbling from approximately 1.50 down to trading around 40 cents per share for most of the day on August 22, 2011 and ending the day around 34 cents per share. Of course, in hindsight it is easy to suggest that one shouldn't have bought stock in ZUN that day, but at that time there were also many who felt the negative reaction was entirely overblow and that clarification of the issues could logically prevail and substantiate the position of the company. In short, there was no way of knowing that the worst possible outcome would come to pass, with investors unable to trade their shares ever again.
>
> I submit that eliminating shareholders who bought ZUN stock on August 22, 2011 from any form of compensation is overly harsh and punitive. It was clear that an important issue existed at that time but issues emerge with Venture Exchange listed stocks quite frequently but without these catastrophic consequences. And it is important to note that investors such as myself have suffered considerably due to this loss of capital. In my case, I lost all of my

RRSP, almost all of my cash trading account holdings and a good part of my TFSA. With children entering university I am hard-pressed to pay my part of the costs as well as funding home and business expenses. Indeed, these losses have had a significant negative effect on my quality of life and that of my family and have led to me working long hours to pay for our needs, thereby creating significant hardship.

Hence, I ask that the court consider changing the section dealing with ZUN purchasers of August 22, 2011 to include them in providing some compensation in the class action lawsuit. Of course, I believe that to be fair, the compensation for purchasers on August 22, 2011 should be much less than for those who purchased earlier at prices of $1.52 per share or higher. I would suggest that a discount of 80% of the amount often quoted in the "Plan of Allocation" ($1.52) would be appropriate, which would amount to payment of 30.4 cents per share for individuals who bought shares of ZUN on August 22, 2011. I ask that the court consider this proposal to be fair to all shareholders of ZUN without singling out any in a harsh or punitive manner. We all lost money in this investment and have suffered as a result and it's unfair to single out a subsection of individuals for exclusion of all compensation.

68 The Plan of Allocation contemplates that for some Class Member's entitlements, a notional amount of damage based on the application of the calculations in the Plan of Allocation before distribution proration, will be discounted to reflect the risks facing the claimants. Class Counsel considered that the question of whether a discount to a Nominal Entitlement ought to apply for a particular type of acquisition should be determined by considering the particular strengths and weaknesses of the common law and statutory claims are common to all groups

69 With a view to ensuring that any discount was arrived at in a manner that was objective and fair, a formal mediation session was held on April 29, 2013. Joel Wiesenfeld was the mediator. Mr. Wiesenfeld practiced law as a broker/dealer litigation and securities regulatory counsel for 31 years.

70 At the mediation, the claimant groups were represented by Class Members holding Eligible Shares as follows: (a) the Plaintiffs, who bought substantially all of their shares in Zungui's IPO, represented Primary Market Purchasers; (b) Nick Angellotti CA, IFA and President and Managing Director of Williams & Partners Forensic Accountants Inc., the representative of a partnership that purchased Zungui's shares in the secondary market, represented Secondary Market Purchasers; and (c) Avi Grewal, President and Chief Executive Officer of Cinaport Capital Inc., a private investment firm which acts as advisor for the Cinaport China Opportunity Fund, a fund with investments in private and public PRC based companies, represented Share Exchange Acquirors.

71 The representatives were represented by counsel; namely: Charles Wright and Nicholas Baker of Siskinds LLP for the Plaintiffs; Kirk Baert of Koskie Minsky LLP for Mr. Angellotti; and John J. Longo of Aird & Berlis LLP for Mr. Grewal.

72 I pause here to note that nobody represented the interests of secondary market purchasers who, like Dr. Lane, purchased shares on August 22, 2011.

73 The negotiations were all conducted at arm's length and the position of each claimant group was advanced by their counsel. The full-day mediation session concluded with the Primary Market Purchasers and Secondary Market Purchasers reaching agreement that the proposed Plan of Allocation should provide for the Nominal Entitlements of primary market purchasers to be <u>un</u> discounted and the Nominal Entitlements of secondary market purchasers should be discounted by 8%.

74 The representatives were unable to agree on a discount to be applied to the claims of Share Exchange Acquirors at the mediation, and so the Plaintiffs proposed (and posted on Class Counsel's website) a draft Plan of Allocation with a discount of 60% for Share Exchange Acquiror claims. Subsequently, Class Counsel agreed, to amend the Share Exchange Acquiror Discount to 40 %.

75 Class Counsel submits that an 8% discount for secondary market purchasers is fair and reflects that: (a) the secondary market purchasers were required to obtain leave under Part XXIII.1 of the Ontario *Securities Act* before asserting the right of action for misrepresentation in Zungui's secondary market disclosure documents, and such leave would be contested; (b) Part XXIII.1 provides defendants with a number of defences to liability for secondary market misrepresentation, and in this case, the secondary market purchasers could expect to face the "reasonable investigation" defence, an expert reliance defence, and a due diligence; and (c) the secondary market purchasers may not be able to recover the full estimated damages they have suffered, due to liability limits.

76 Class Counsel submits that no discount for primary market purchasers is fair because it reflects that: (a) these purchasers did not need to obtain leave of the Court to assert their claim; (b) damages are not limited for primary market purchasers in the same way as they are limited for secondary market purchasers; (c) if a prospectus is found to have contained a misrepresentation, then the issuer is strictly liable, (d) certain defendants, such as the issuer's directors and officers, are generally liable, unless they demonstrate on a balance of probabilities that they exercised reasonable diligence prior to issuance of the prospectus; and (e) liability is joint and several and damages can be recovered from any defendant with the means to pay.

77 Class Counsel initially considered that a 60% discount for Share Exchange Acquirors was fair. However, the Significant Shareholder Group through their counsel at Aird and Berlis LLP, and certain members of the Significant Shareholder Group indicated that they had higher expectations than a settlement with the Underwriting Syndicate at $750,000.00, in part, based on the fact that the Underwriting Syndicate had earned fees of approximately $2.75 million for underwriting the IPO.

78 However, the Significant Shareholder Group were prepared to support the proposed settlement with the Underwriting Syndicate if two (2) conditions were met: (1) Class Counsel would limit their request for Class Counsel Fees to an agreed amount; and (2) the discount applicable to Share Exchange Acquirors under the proposed Plan of Allocation would be amended from 60% to 40%.

79 Class Counsel estimates that the impact on the combined settlement fund of the amendment to the discount applicable to Share Exchange Acquirors under the proposed Plan of Allocation will be at most $262,200.00 and more likely the impact will be less, because the maximum impact assumes no proration, which is unlikely to be the case.

80 Class Counsel communicated with each Class Member who participated in the mediation relating to the Plan of Allocation, and they have instructed that the proposed amended discount applicable to Share Exchange Acquirors is acceptable.

81 The Plan of Allocation provides for the possibility of a *cy près* distribution to the Small Investor Protection Association Canada in the event that less than $25,000.00 remains in the Allocation Pool 180 days from the date on which the Administrator distributes the Net Settlement Amount to Authorized Claimants.

82 Notwithstanding the objection to the Plan of Distribution, Class Counsel is of the view that the Plan of Allocation was carefully considered and promotes the interests of the class as a whole, and that it is fair and reasonable and ought to be approved.

83 At the argument of the fairness hearing, Class Counsel argued that should the court consider it appropriate to have purchasers like Dr. Lane participants in the Plan of Allocation, their claims should be discounted by 98.5%.

4. Discussion and Analysis of the Proposed Plan of Allocation

84 I do not regard the Proposed Plan of Allocation as appropriate, fair, reasonable, or in the best interests of the class.

85 In my opinion, Dr. Lane's objection to the Plan of Allocation and his suggestion as to how the plan should be revised has considerable merit.

86 Although perhaps unlikely to occur, it seems inappropriate and unfair to me that the proposed Plan of Allocation provides for a *cy près* distribution to a small investor association and does not provide any compensation for an investor like Dr. Lane, who is a member of the class. More to the point, in my opinion, it is inappropriate and unfair to include August 22, 2011 purchasers as Class Members and then exclude them from the Plan of Allocation.

87 Notwithstanding that it was the Defendants who urged that these purchasers be included as Class Members as part of the bargaining for the settlements, once Class Counsel and the

Representative Plaintiffs agreed to the joinder of these Class Members, it was unfair and inappropriate for Class Counsel and the Representative Plaintiffs to advocate a theory of the case that August 22, 2011 purchasers were not eligible for any compensation at all.

88 If Dr. Lane, his brother, and other August 22, 2011 purchasers had appreciated that the parties had included them in the class as a bargaining chip but had excluded them from the theory of the claim and would exclude them from the Plan of Allocation, these putative class members sensibly should have opted-out of the class action rather than add the unrequited value of their releases to the consideration or *quid quo pro* that the Defendants will be receiving for the settlement payments. As it stands, Dr. Lane and those similarly situated are bound by the settlement but receive nothing themselves for being a Class Member.

89 In my opinion, the appropriate Plan of Allocation is the one proposed by Dr. Lane.

90 Accordingly, I shall revise the Plan of Allocation in accord with Dr. Lane's suggestion, which I regard as fair and reasonable, and I approve the Plan of Allocation as revised.

F. ADMINISTRATION OF THE SETTLEMENT

91 Class Counsel proposes the appointment of NPT RicePoint Class Action Services as the Administrator. NPT has already served as the Notice Advisor in the Action. NPT has also been administering bilingual class action settlements for over 9 years. In Class Counsel's opinion, NPT has the experience and resources that make them capable of administering the Settlements.

92 NPT's administration proposal provides for a minimum administration fee of $35,000, and a maximum administration fee cap of $195,000.00, before taxes.

93 I approve the appointment of NPT RicePoint Class Action Services as the Administrator.

G. FEE APPROVAL

94 Turning to the matter of Class Counsel's fee request of $2,807,037.56.

95 The Retainer Agreements with the Plaintiffs provide that Class Counsel may seek a fee of up to 30% of the recovery. Class Counsel are seeking a recovery of 20.75% (a 3.3 multiplier).

96 As at August 12, 2013, Class Counsel had docketed time of $648,386.00, excluding applicable taxes, disbursements of $226,670.44, exclusive of applicable taxes.

97 Class Counsel is not seeking to recover, and will not return to request payment of the time and disbursements required to complete the administration of the settlement, which is estimated to be at least $50,000.00.

98 Class Counsel has agreed to pay, from Class Counsel's fee award the accounts of Aird &

Berlis LLP rendered to the Significant Shareholder Group in the amount of $105,796.50, taxes in the amount of $13,896.73 and disbursements in the amount of $1,101.36.

99 Class Counsel proposes to pay Wolf Popper LLP $105,689.00 (US$) in fees, and (US$) $1,466.73 in disbursements from the Class Counsel's fee award. Mr. Clarke, a representative plaintiff, initially contacted this U.S. law firm to investigate his potential claim. Ms. Patricia Avery, of Wolf Popper LLP, has been a member of the Class Counsel team prosecuting the Action, and Wolf Popper LLP undertook certain tasks that were within the competence of the firm, such as researching risk disclosure practices in North American securities offering documents for issuers with substantial operations in the People's Republic of China.

100 The disbursements included $40,465.42 in agent fees for investigations in the People's Republic of China, location of the Cai Brothers, translation of correspondence and pleadings, Hague Convention service on the Cai Brothers and the cost of paying for independent counsel to attend at the Plan of Allocation mediation.

101 The disbursements include $156,842.05 in expert fees and mediation fees for Mr. Mulholland, Mr. Mak, William H. Purcell, a U.S. investment banking expert, in relation to underwriting due diligence practices for companies with substantially all operations in the People's Republic of China, and Mr. Wisenfeld.

102 The fairness and reasonableness of the fee awarded in respect of class proceedings is to be determined in light of the risk undertaken by the lawyer in conducting the litigation and the degree of success or result achieved: *Parsons v. Canadian Red Cross Society*, [2000] O.J. No. 2374 (S.C.J.), at para. 13; *Smith v. National Money Mart*, [2010] O.J. No. 873 (S.C.J.), at paras. 19-20; *Fischer v. I.G. Investment Management Ltd.*, [2010] O.J. No. 5649 (S.C.J.), at para 25.

103 Factors relevant in assessing the reasonableness of the fees of class counsel include: (a) the factual and legal complexities of the matters dealt with; (b) the risk undertaken, including the risk that the matter might not be certified; (c) the degree of responsibility assumed by class counsel; (d) the monetary value of the matters in issue; (e) the importance of the matter to the class; (f) the degree of skill and competence demonstrated by class counsel; (g) the results achieved; (h) the ability of the class to pay; (i) the expectations of the class as to the amount of the fees; (j) the opportunity cost to class counsel in the expenditure of time in pursuit of the litigation and settlement: *Smith v. National Money Mart, supra*, at paras. 19-20; *Fischer v. I.G. Investment Management Ltd., supra,* at para 28.

104 Having regard to these various factors, I approve Class Counsel's request for approval of its legal fees.

H. <u>CONCLUSION</u>

105 Orders accordingly.

P.M. PERELL J.

cp/e/qlcct/qlrdp/qlpr

IN RE WORLDCOM, INC. SECURITIES LITIGATION; This Document Relates to ALL ACTIONS

MASTER FILE 02 Civ. 3288 (DLC)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

388 F. Supp. 2d 319; 2005 U.S. Dist. LEXIS 20630

September 21, 2005, Decided
September 21, 2005, Filed

SUBSEQUENT HISTORY: Motion denied by In re Worldcom, Inc., Sec. Litig., 2005 U.S. Dist. LEXIS 21771 (S.D.N.Y., Sept. 30, 2005)

PRIOR HISTORY: In re WorldCom, Inc. Sec. Litig., 2005 U.S. Dist. LEXIS 7958 (S.D.N.Y., May 5, 2005)

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff investors sued defendants, a corporation et al., alleging securities fraud. Parties seeking approval of year 2005 settlements petitioned for approval of those settlements reached in the class action. These settlements included the series of settlements between the lead plaintiff and the 17 underwriter defendants, the 12 director defendants, the corporation's former auditor, its former CEO, former CFO, and two other corporate officers.

OVERVIEW: The settlements at issue (the year 2005 settlements) totaled $ 3.558 billion. Together with an approved 2004 settlement, the class would recover $ 6.133 billion, plus interest. Very few class members filed objections to the 2005 settlements. No one objected to the amounts of the 2005 settlements, and there was only a single objection to the request for attorneys' fees and expenses. Only a brief, conclusory objection was made to the plans of allocation. Most objections addressed the scope of the claims release. The court's opinion first reviewed significant events in the class action litigation since the announcement of the aforementioned 2004 settlement. Then, it noted that under Fed. R. Civ. P. 23(e), any class action settlement had to be approved by the court. Overall, the court had to carefully scrutinize the settlement to ensure its fairness, adequacy and reasonableness, and that it was not a product of collusion. Procedurally, not a modicum of doubt existed as to the fact that the 2005 settlements were achieved after painstaking negotiations between extraordinarily well-represented adversaries. Substantively, consideration of the Grinnell factors strongly supported approval.

OUTCOME: With three modifications to the Supplemental Plan described by the court, the petition for approval of all of the 2005 settlements was granted. Lead counsel's application for attorneys' fees and expenses was also granted.

CORE TERMS: settlement, class members, notice, underwriter, supplemental, class action, offerings, stock, purchaser, attorneys' fees, billion, investor, lodestar, formula, objector, proofs of claim, summary judgment, settlement funds, audit, allocated, citation omitted, disclosure, discovery, announced, causation, opt, financial statements, misrepresentation, misstatement, settling

LexisNexis(R) Headnotes

Civil Procedure > Class Actions > Compromises
Civil Procedure > Settlements > Settlement Agreements > General Overview
Pensions & Benefits Law > Employee Retirement Income Security Act (ERISA) > General Overview
[HN1] Pursuant to Fed. R. Civ. P. 23(e), any settlement of a class action must be approved by the court.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN2] In determining whether to approve a class action settlement, a district court must carefully scrutinize the settlement to ensure its fairness, adequacy and reasonableness, and that it was not a product of collusion. In so doing, the court must eschew any rubber stamp approval yet simultaneously stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN3] A district court determines a settlement's fairness by examining the negotiating process leading up to the settlement as well as the settlement's substantive terms. A court should analyze the negotiating process in light of the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves. A court must ensure that the settlement resulted from arm's-length negotiations and that plaintiffs' counsel engaged in the discovery necessary to effective representation of the class's interests.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Prerequisites > General Overview
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN4] In evaluating the substantive fairness of a settlement, a district court must consider factors enumerated initially in Grinnell: (1) the complexity, expense and likely duration of the litigation, (2)

the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible recovery, and (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN5] Public policy favors settlement, especially in the case of class actions. There are weighty justifications, such as the reduction of litigation and related expenses, for the general policy favoring the settlement of litigation.

Antitrust & Trade Law > U.S. Department of Justice Actions > Criminal Actions > General Overview
Securities Law > Liability > Secondary Liability > Controlling Persons > General Overview
[HN6] See 15 U.S.C.S. § 78t(a).

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Notices
Civil Procedure > Class Actions > Prerequisites > General Overview
[HN7] The standard for measuring the adequacy of a settlement notice in a class action is reasonableness. There are no rigid rules to determine whether a settlement notice to the class satisfies constitutional or Fed. R. Civ. P. 23(e) requirements; the settlement notice must fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with the proceedings. Notice is adequate if it may be understood by the average class member.

Civil Procedure > Justiciability > Standing > General Overview
[HN8] For standing to exist, a would-be litigant must have sustained a palpable injury that is likely to be redressed by a favorable decision.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Prerequisites > Adequacy of Representation
Civil Procedure > Settlements > Releases From Liability > General Overview
[HN9] Practically speaking, class action settlements simply will not occur if the parties cannot set definitive limits on defendants' liability. The scope of a settlement release is limited by the "identical factual predicate" and "adequacy of representation" doctrines. The law is well-established in the United States Court of Appeals for the Second Circuit and others that class action releases may include claims not presented and even those which could not have been presented as long as the released conduct arises out of the "identical factual predicate" as the settled conduct. Adequate

representation of a particular claim is determined by the alignment of interests of class members, not proof of vigorous pursuit of that claim.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Notices
Civil Procedure > Class Actions > Prerequisites > General Overview
[HN10] There is obviously no legal requirement that a notice of the pendency of a class action include a description of a release that may someday be negotiated to resolve claims brought in the class action.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Releases From Liability > General Overview
Immigration Law > Admission > Visas > Issuance
[HN11] The U.S. Court of Appeals for the Second Circuit has explicitly rejected the contention that class members must be given a second opportunity to opt out after the terms of a settlement are announced.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
Governments > Legislation > Statutes of Limitations > General Overview
[HN12] Settlement proceeds may be allocated according to the strengths and weaknesses of the various claims possessed by class members.

Civil Procedure > Settlements > Releases From Liability > General Overview
Civil Procedure > Settlements > Settlement Agreements > General Overview
Governments > Legislation > Overbreadth
[HN13] The fact that a release covers claims not actually pursued by a plaintiff in a class action does not render the release overbroad.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN14] To warrant approval, a plan of allocation must also meet the standards by which the settlement was scrutinized--namely, it must be fair and adequate. An allocation formula need only have a reasonable, rational basis, particularly if recommended by experienced and competent class counsel.

Securities Law > Liability > Remedies > Actual Damages
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Torts > Negligence > Causation > Proximate Cause > Foreseeability
[HN15] Under § 10(b) (15 U.S.C.S. § 78j(b)) of the Securities Exchange Act of 1934, loss causation is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff. It is often compared to the tort law concept of proximate cause, meaning that the damages

suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission. The U.S. Court of Appeals for the Second Circuit has reiterated two requirements for establishing loss causation. A plaintiff must prove both that the loss was foreseeable and that the loss was caused by the materialization of the concealed risk.

Antitrust & Trade Law > Clayton Act > Defenses
Securities Law > Liability > Remedies > Actual Damages
Securities Law > Liability > Securities Act of 1933 Actions > Civil Liability > General Overview
[HN16] The loss causation analysis under § 11 (15 U.S.C.S. § 77k) of the Securities Act of 1933 is a mirror image of that under § 10(b) (15 U.S.C.S. § 78j(b)) of the Securities Exchange Act of 1934. Under 15 U.S.C.S. § 77k, that a plaintiff's losses were attributable to factors other than disclosure of the alleged misstatements is an affirmative defense; that the alleged misstatements caused the plaintiff's losses is an element of an offense under 15 U.S.C.S. § 78j(b).

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > General Overview
[HN17] Normally, an inflated purchase price will not itself constitute or proximately cause the relevant economic loss. Private securities actions are available, after all, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause.

Civil Procedure > Settlements > Releases From Liability > General Overview
[HN18] A release may bar causes of action other than those litigated in the class action.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Reliance > Fraud on the Market
[HN19] The "fraud on the market" theory applies to transaction causation, not loss causation.

Civil Procedure > Remedies > Judgment Interest > Prejudgment Interest
Securities Law > Liability > Private Securities Litigation > Attorney Fees
Securities Law > Liability > Remedies > Interest
[HN20] When attorneys create a common fund from which members of a class are compensated for a common injury, they are entitled to a reasonable fee--set by the court--to be taken from the fund. 15 U.S.C.S. § 78u-4(a)(6) states that in Securities Exchange Act of 1934 cases governed by the Private Securities Litigation Reform Act, total attorneys fees and expenses awarded by the court to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class. Determination of "reasonableness" is within the discretion of the district court. There are two methods by which the court may calculate reasonable attorneys' fees in a class action, the lodestar method and the percentage method. Applying either method, a court should consider the following factors, known as the Goldberger

factors: (1) the time and labor expended by counsel; (2) the magnitude and complexities of the litigation; (3) the risk of the litigation; (4) the quality of representation; (5) the requested fee in relation to the settlement; and (6) public policy considerations.

Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
Legal Ethics > Client Relations > Attorney Fees > Excessive Fees
[HN21] The lodestar method calculates attorneys' fees by multiplying hours reasonably expended against a reasonable hourly rate. A court may determine that an enhancement of the lodestar is warranted based on factors such as the riskiness of the litigation and the quality of attorneys.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
[HN22] Under the percentage method, the fee award is simply some percentage of the fund created for the benefit of the class. The trend in the United States Court of Appeals for the Second Circuit is toward the percentage method, which directly aligns the interests of the class and its counsel and provides a powerful incentive for the efficient prosecution and early resolution of litigation. This method has been found to be a solution to various problems inherent in the lodestar method, which creates an unanticipated disincentive to early settlements, tempts lawyers to run up their hours, and compels district courts to engage in a gimlet-eyed review of line-item fee audits.

Antitrust & Trade Law > Private Actions > Costs & Attorney Fees > Clayton Act
Civil Procedure > Class Actions > Class Counsel > Fees
Securities Law > Liability > Private Securities Litigation > Attorney Fees
[HN23] The Private Securities Litigation Reform Act express contemplation that the percentage method will be used to calculate attorneys' fees in securities fraud class actions, 15 U.S.C.S. § 78u-4(a)(6).

Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
[HN24] Where the lodestar fee is used as a mere cross-check to the percentage method of determining reasonable attorneys' fees, the hours documented by counsel need not be exhaustively scrutinized by a district court.

Commercial Law (UCC) > Negotiable Instruments (Article 3) > Negotiation, Transfer & Indorsement > General Overview
Legal Ethics > Client Relations > Attorney Fees > Fee Agreements
Securities Law > Liability > Private Securities Litigation > Lead Plaintiff
[HN25] A district court is not required to adhere to a retainer agreement such as the one used to determine the fee amount requested here. Nonetheless, when class counsel in a securities lawsuit have negotiated an arm's length agreement with a sophisticated lead plaintiff possessing a large

stake in the litigation, and when that lead plaintiff endorses the application following close supervision of the litigation, a court should give the terms of that agreement great weight. The establishment of criteria for the appointment of a lead plaintiff capable of exercising a significant supervisory role in the litigation, including management of the fees and costs, was an important innovation of the Private Securities Litigation Reform Act.

Civil Procedure > Class Actions > Judicial Discretion
Securities Law > Liability > Private Securities Litigation > Lead Plaintiff
[HN26] 15 U.S.C.S. § 78u-4(a)(3)(B)(iii)(I)(bb) lists, as one of three factors establishing a rebuttable presumption of "most adequate plaintiff" status, the largest financial interest in the relief sought by the class.

Civil Procedure > Remedies > Costs & Attorney Fees > Costs > General Overview
Securities Law > Liability > Private Securities Litigation > Lead Plaintiff
[HN27] See 15 U.S.C.S. § 78u-4(a)(4).

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JUDGES: DENISE COTE, United States District Judge.

OPINION BY: DENISE COTE

OPINION

[*322] ***OPINION & ORDER***

DENISE COTE, District Judge:

This Opinion considers the fairness of settlements reached this year in the securities class action litigation arising from the collapse of telecommunications giant WorldCom, Inc. ("WorldCom"). These settlements include the series of settlements between the Lead Plaintiff **[**3]** and the seventeen Underwriter Defendants; [1] and those between the Lead Plaintiff and the twelve Director Defendants, [2] WorldCom's former auditor Arthur Andersen LLP ("Andersen"), former WorldCom CEO Bernard J. Ebbers ("Ebbers"), former WorldCom CFO Scott D. Sullivan ("Sullivan"), and former WorldCom officers Buford Yates ("Yates") and David Myers ("Myers") (collectively, the "2005 Settlements"). The 2005 Settlements total $ 3.558 billion. Together with the settlement between the Lead Plaintiff and the Citigroup Defendants (the "Citigroup Settlement"), which received final approval on November 14, 2004, the Class will recover $ 6.133 billion, plus interest.

1 The seventeen Underwriter Defendants consist of ABN/AMRO Inc. ("ABN Amro"); Banc of America Securities LLC ("BOA"); Blaylock & Partners, L.P. ("Blaylock"); BNP Paribas Securities Corp. ("BNP"); Caboto Holding SIM S.p.A. ("Caboto"); Credit Suisse First Boston Corp. ("CSFB"); Deutsche Bank Securities, Inc. ("Deutsche Bank"), f/k/a Deutsche Bank Alex. Brown, Inc.; Fleet Securities Inc. ("Fleet"); Goldman, Sachs & Co. ("Goldman Sachs"); J.P. Morgan Securities, Ltd. and J.P. Morgan Securities, Inc. (now including Chase Securities Inc.) ("JP Morgan"); Lehman Brothers Inc. ("Lehman Brothers"); Mizuho International plc ("Mizuho"); Mitsubishi Securities International plc ("Mitsubishi"), f/k/a Tokyo-Mitsubishi

International plc; UBS Warburg LLC ("UBS"); Utendahl Capital ("Utendahl"); and Westdeutsche Landesbank Girozentrale ("West LB").

[**4]

2 The Director Defendants are James C. Allen, Judith Areen, Carl J. Aycock, Max E. Bobbitt, Clifford L. Alexander, Jr., Francesco Galesi ("Galesi"), Stiles A. Kellett, Jr. ("Kellett"), Gordon S. Macklin, John A. Porter ("Porter"), Bert C. Roberts ("Roberts"), the Estate of John W. Sidgemore, and Lawrence C. Tucker.

[*323] Very few Class Members have filed objections to the 2005 Settlements. No one has objected to the amounts of the 2005 Settlements and there is only a single objection to the request for attorneys' fees and expenses submitted by Lead Counsel for the Class. [3] Only a brief, conclusory objection was made to the Plans of Allocation, which determine according to claim type how settlement funds will be distributed. Most of the objections address the scope of the claims release to be imposed pursuant to the 2005 Settlements and the proposed Supplemental Plan of Allocation distributed to the Class with a July 1, 2005 Notice.

3 One Class Member filed a timely objection to the requested attorneys' fees, but the objection was later withdrawn. Another individual filed a late objection to the attorneys' fees, but she has provided no evidence to rebut Lead Plaintiff's contention that she is not a Class Member. The substance of her objection will nevertheless be addressed.

[**5] With the three modifications to the Supplemental Plan described below, the petition for approval of all of the 2005 Settlements is granted. Lead Counsel's application for attorneys' fees and expenses is also granted.

Background

The relevant history of the *Securities Litigation* through November 12, 2004 is described in an Opinion pertaining to the Citigroup Settlement. *See In re WorldCom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 22992, No. 02 Civ. 3288 (DLC), 2004 WL 2591402, at *1-*9 (S.D.N.Y. Nov. 12, 2004). That description, and the definitions therein, are incorporated by reference into this Opinion.

In brief, WorldCom announced a massive restatement of its financial statements for 2000 and 2001 on June 25, 2002 (the "Restatement"), spurring numerous class actions and other lawsuits. [4] Virtually all federal litigation was transferred to this Court by the Judicial Panel on Multi-District Litigation. The securities class actions were consolidated on August 15, 2002, and the New York State Common Retirement Fund ("NYSCRF") was selected as the Lead Plaintiff. The Lead Plaintiff filed a Consolidated Class Action Complaint on October 11, 2002. The securities class action, scores of actions **[**6]** filed by individual plaintiffs (the "Individual Actions"), many of them large pension funds, and other related securities actions were consolidated on December 23, 2002 for pretrial purposes and are referred to as the *Securities Litigation.*

4 The litigation even preceded the June 25 announcement: the first securities class action was filed in this district on April 30, 2002.

An Opinion of May 19, 2003 decided various motions to dismiss addressed to the class action complaint. *In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 431 (S.D.N.Y. 2003); *see also In re WorldCom, Inc. Sec. Litig.*, 2003 U.S. Dist. LEXIS 10863, No. 02 Civ. 3288 (DLC) 2003 WL 21488087 (S.D.N.Y. June 25, 2003) (deciding Andersen's motions to dismiss); *In re WorldCom, Inc. Sec. Litig.*, 2003 U.S. Dist. LEXIS 21363, No. 02 Civ. 3288 (DLC), 2003 WL 23174761 (S.D.N.Y. Dec. 3, 2003) (deciding motions to dismiss by members of the Audit Committee of WorldCom's board of directors). An Amended Complaint was filed on August 1, 2003; a Corrected Amended **[**7]** Complaint was filed on December 1, 2003.

An Opinion of October 24, 2003 certified a class consisting of all persons and entities who purchased or otherwise acquired publicly traded securities of WorldCom during the period beginning April 29, 1999 through and including June 25, 2002, and who were injured thereby. *See In re WorldCom, Inc., Sec. Litig.*, 219 F.R.D. 267, 274-75 (S.D.N.Y. 2003). Putative Class Members received a December 11, **[*324]** 2003 Notice of Class Action (the "December 2003 Notice"). That notice informed Class Members that they could opt out of the class action by February 20, 2004, a date which was later extended to September 1, 2004. [5] *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *5.

5 Prior to February 20, approximately 6,400 investors opted out of the Class; in total, approximately 14,220 investors opted out. Counsel in the class action attribute the number of optouts to the aggressive solicitation of Class Members by attorneys, but Lead Counsel nonetheless characterizes the number of opt-outs as "small" given the large number of WorldCom investors.

[8]** The $ 2.575 billion Citigroup Settlement was announced in May 2005. *Id.* Class Members received an August 2, 2004 Notice of the proposed Citigroup Settlement (the "Citigroup Settlement Notice"), which also informed them that the opt-out date had been extended to September 1 and gave them instructions on how to submit proofs of claim. A fairness hearing regarding the Citigroup Settlement was held on November 5, 2004, and that settlement was approved in a November 12, 2004 Opinion. *WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *9, *11. The following is an overview of the significant events in the class action litigation since the announcement of the Citigroup Settlement.

Completion of Discovery

The Citigroup Defendants settled with the Lead Plaintiff just weeks before the conclusion of fact discovery. A three-week stay was entered to allow the Lead Plaintiff and the Underwriter Defendants an opportunity to determine whether they could also resolve the litigation. The Underwriter Defendants rejected an offer to settle with the Class using the same formula that resolved Securities Act of 1933 ("Securities Act") claims in the Citigroup Settlement (the "Citigroup Formula"). Fact discovery **[**9]** resumed and was concluded on July 9, 2004. During June and July, the Lead Plaintiff took forty-one depositions.

During the late summer and fall, the parties exchanged expert reports and conducted expert discovery. The Lead Plaintiff produced reports from five experts.

Summary Judgment Opinion Regarding the Underwriter Defendants

The Underwriter Defendants faced Securities Act Section 11 and Section 12(a)(2) liability stemming from massive bond offerings in 2000 (the "2000 Offering") and 2001 (the "2001 Offering"). They filed motions for partial summary judgment on several grounds, including their reliance defense under Section 11. They argued that they were entitled to rely on WorldCom's audited financial statements and had no duty to investigate their reliability unless they had reasonable grounds to believe that the statements were not accurate. A December 15, 2004 Opinion denied summary judgment on the reliance defense, noting that, while underwriters generally may rely on audited financial statements, a jury could find that one or more "red flags" triggered a duty for the Underwriter Defendants to conduct further investigation of WorldCom's financial status. *See* **[**10]** *In re WorldCom Sec. Litig.*, 346 F. Supp. 2d 628, 678-81 (S.D.N.Y. 2004). The Opinion also ruled that the Underwriter Defendants were not entitled to summary judgment because of their receipt of Andersen's comfort letters for the unaudited quarterly financial statements incorporated into the Registration Statements for the 2000 and 2001 Offerings. Rather, although the comfort letters were one factor a jury could consider, the Underwriter Defendants still had to establish that they had performed a reasonable investigation regarding any unaudited financials in order **[*325]** to establish their due diligence defense under Section 11. *See id.* at 681-85.

The Lead Plaintiff filed its own motion for partial summary judgment against the Underwriter Defendants. It succeeded on the issue of whether the Registration Statement for the 2001 Offering was false and misleading, but was denied summary judgment in regard to the 2000 Offering. *Id.* at 661.

Initial Settlement with the Director Defendants

Following settlement discussions spanning more than twenty months, the Lead Plaintiff and ten of the twelve Director Defendants executed a Memorandum of Agreement in **[**11]** May 2004. In the following months, the Lead Plaintiff reviewed detailed financial information provided by those ten directors, and the negotiations between the directors and several insurers that had issued excess directors and officers insurance policies to WorldCom (the "Excess Insurers") continued. [6] On January 6, 2005, a settlement was reached between the Lead Plaintiff, the ten Director Defendants, and the Excess Insurers. The settlement was for a total of $ 54 million; notably, the settlement amount included $ 18 million paid personally by the settling Director Defendants, representing more than twenty percent of those individuals' cumulative net worth, excluding their primary residences, retirement accounts, and certain joint marital property. [7] The balance of the settlement amount, $ 36 million, represented the Excess Insurers' contribution.

6 The Excess Insurers had taken the position that the policies they had issued were null and void.

7 The Court makes no judgment as to the wisdom of making personal monetary contributions by outside directors a condition of settlement. Commentators have noted that this tactic may "trouble some executives so much that they may think twice about serving on boards," Joann S. Lublin et al., *Directors Are Getting the Jitters: Recent Settlements Tapping Executives' Personal Assets Put Boardrooms on Edge*, Wall St. J., Jan. 13, 2005, at B1, a development that would not bode well for shareholders in the long run.

[12]** Portions of the January 6 settlement agreement that were conditioned on the Court's staying the lawsuit brought by Roberts, a non-settling Director Defendant, against the Excess Insurers and deferring a decision on Roberts' application for an order to advance defense costs were rejected by the Court in a conference on January 11. [8] The parties to the settlement submitted a revised Stipulation of Settlement that omitted those provisions on January 18 (the "January 18 Stipulation").

8 An Opinion mandating that the Excess Insurers advance Roberts' defense costs was issued on February 3, 2005. *In re WorldCom, Inc. Secs. Litig.*, 354 F. Supp. 2d 455 (S.D.N.Y. 2005).

The January 18 Stipulation retained a provision known as a judgment reduction formula (the "Judgment Reduction Formula") that provided, in essence, that any damages awarded against nonsettling defendants would be reduced by the greater of the settlement amount or the proportionate liability of the settling Director Defendants, as found **[**13]** at trial, adjusted to reflect any limitation on the financial capability of the settling Director Defendants to pay. The settlement was conditioned on approval of the Judgment Reduction Formula, which paralleled a formula that had received the Court's approval in the WorldCom *ERISA Litigation. See In re WorldCom, Inc. ERISA Litig.*, 339 F. Supp. 2d 561, 571 (S.D.N.Y. 2004). Several non-settling defendants objected to the portion of the Judgment Reduction Formula that took into account settling Director **[*326]** Defendants' ability to pay, arguing that it violated 15 U.S.C. § 78u-4(f)(7)(B)(i), the applicable provision of the Private Securities Litigation Reform Act of 1995 ("PSLRA").

In an Order of February 2, the Court ruled that the Judgment Reduction Formula in the January 18 Stipulation was impermissible under the PSLRA. An Opinion of February 10 explained this ruling in detail; a Corrected Opinion was issued soon thereafter. *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 1805, No. 02 Civ. 3288 (DLC), 2005 WL 335201 (S.D.N.Y. Feb. 14, 2005). That Opinion lamented the fact that the applicable PSLRA provision rendered it highly unlikely that plaintiffs **[**14]** bringing Securities Act claims would be willing to settle with outside directors before reaching settlements with "deep pockets" such as underwriters. *See* 2005 U.S. Dist. LEXIS 1805, [WL] *id.* at *14-*15. This policy concern was well-founded. Soon after the Judgment Reduction Formula ruling was announced, the Lead Plaintiff exercised its right to withdraw from the settlement. The Director Defendants were given until February 25 to file a pretrial order for the rapidly approaching trial, which was then scheduled to begin on February 28, 2005.

Summary Judgment Opinion Regarding Andersen

Andersen, which was facing claims under Securities Act Section 11 and Securities Exchange Act of 1934 ("Exchange Act") Section 10(b), filed a motion for partial summary judgment on August 23, 2004. It argued that Lead Plaintiff had failed to present sufficient evidence that the 1999 WorldCom financial statements audited by Andersen contained a material misstatement. In addition, Andersen contended that there was no evidence of scienter sufficient to support a finding under Section 10(b) that Andersen certified the 1999, 2000, and 2001 WorldCom financial statements recklessly or with knowledge that material misstatements **[**15]** or omissions were present.

A January 18, 2005 Opinion denied summary judgment for Andersen. It ruled that whether various accounting treatments, including WorldCom's use of purchase method accounting for its 1998 acquisition of MCI, Inc. ("MCI") and its assignment of a forty-year lifespan to the MCI goodwill, complied with Generally Accepted Accounting Principles (GAAP) and thus did not constitute misstatements, were issues of fact for a jury to decide, precluding summary judgment on the 1999 financials. *See In re WorldCom, Inc. Secs. Litig.*, 352 F. Supp. 2d 472, 493-94 (S.D.N.Y. 2005). That Opinion also ruled that issues of fact existed regarding whether Andersen's audits of WorldCom financials were so deeply flawed that Andersen acted with reckless disregard and whether certain "red flags" should have prompted Andersen to reevaluate its audit plans. *See id.* at 497-98.

Motions in Limine

On January 7, 2005, motions *in limine* and the Joint Pretrial Order were filed by the Lead Plaintiff and various non-settling defendants. The Lead Plaintiff filed six motions *in limine*; the Underwriter Defendants filed eleven, as well as a motion to **[**16]** phase the trial; Andersen filed eight; Director Defendant Galesi filed thirty. On February 8, an Order was issued denying the Underwriter

Defendants' motion to phase the trial and providing preliminary rulings on most of the Lead Plaintiff's and Underwriter Defendants' motions. Full Opinions regarding most of the pending motions *in limine* were issued on February 17. *See In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 2214, No. 02 Civ. 3288 (DLC) 2005 WL 375315 (S.D.N.Y. Feb. 17, 2005) (Lead Plaintiff's motions *in limine* and Underwriter Defendants' motion to phase the **[*327]** trial); *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 2216, No. 02 Civ. 3288 (DLC) 2005 WL 375314 (S.D.N.Y. Feb. 17, 2005) (Underwriter Defendants); *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 2215, No. 02 Civ. 3288 (DLC) 2005 WL 375313 (S.D.N.Y. Feb. 17, 2005) (Andersen). Several pending motions were further addressed at pretrial conferences and in later Opinions. Motions *in limine* by Galesi were addressed on March 4, *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 3144, No. 02 Civ. 3288 (DLC) 2005 WL 517333 (S.D.N.Y. Mar. 4, 2005), and those brought by other Director Defendants were decided in a Memorandum Opinion **[**17]** of March 16, 2005.

Significant motions *in limine* included that of the Lead Plaintiff to exclude evidence from the plenary trial relating to individualized issues of the class representatives. The Lead Plaintiff's motion was granted in an Opinion of February 22. *See In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 2603, No. 02 Civ. 3288 (DLC), 2005 WL 408137 (S.D.N.Y. Feb. 22, 2005). Motions brought by both the Underwriter Defendants and Andersen to preclude Lead Plaintiff's expert from presenting an aggregate damages calculation to the jury were denied. *See WorldCom*, 2005 U.S. Dist. LEXIS 2216, 2005 WL 375314 at *7-*8; *WorldCom*, 2005 U.S. Dist. LEXIS 2215, 2005 WL 375313 at *2-*5; *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 3143, No. 02 Civ. 3288 (DLC), 2005 WL 491397 (S.D.N.Y. Mar. 3, 2005). Andersen filed a motion to exclude evidence of the Restatement, arguing, *inter alia*, that the Restatement was irrelevant and based on hearsay. Andersen's motion was denied on the basis that the Restatement was clearly relevant to, and in fact highly probative of, the issues being tried. The Restatement was ruled an admissible business record under Rule 803(6), Fed. R. Evid. **[**18]** *See WorldCom*, 2005 U.S. Dist. LEXIS 2215, 2005 WL 375313 at *6-*9.

Andersen also moved to preclude evidence of corporate wrongdoing, including evidence of its indictment in connection with its role as Enron's auditor and evidence of other litigation in which Andersen had been involved. An Opinion of March 4 ruled that references to most other litigation against Andersen would be barred, but that decision would be deferred on references to Enron, as the Lead Plaintiff had pointed to evidence that the Enron scandal directly affected certain decisions made by WorldCom's management in regard to Andersen. *See In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 3391, No. 02 Civ. 3288 (DLC), 2005 WL 578109, at *1*2 (S.D.N.Y. Mar. 4, 2005). That Opinion also deferred a ruling on the Underwriter Defendants' motion to bar evidence of the spinning of "hot" IPO shares by Salomon Smith Barney ("SSB"), a co-lead underwriter in the 2000 and 2001 Offerings and one of the Citigroup Defendants. *See* 2005 U.S. Dist. LEXIS 3391, [WL] *id.* at *2-*4.

Extension of Trial Date

In October 2004, in light of a two-month delay in the date of Ebbers' criminal trial, the class action trial date was moved from January 10, 2005 to February 28, 2005. In **[**19]** a pretrial conference of February 18, 2005, the trial was rescheduled for March 17, 2005. The delay was attributable to the Government's reluctance to allow several "embargoed" witnesses who were testifying in Ebbers' criminal trial to submit to depositions by counsel for parties to the class action until the evidentiary portion of the criminal trial had concluded. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *4.

Underwriters' Settlements

In early February 2005, the Lead Plaintiff commenced settlement negotiations with BOA and several junior underwriters who had participated in the 2000 Offering only, and after those proved successful, opened negotiations with the remaining Underwriter Defendants. The seventeen Underwriter Defendants had coordinated their litigation strategy; as trial approached, however, they procured separate **[*328]** settlement counsel and broke rank. [9] In the period from March 3 through March 16, 2005, settlements totaling $ 3,427,306,840 were achieved between the Lead Plaintiff and each of the Underwriter Defendants (the "Underwriters' Settlements").

9 SSB, which was also a lead underwriter for both Offerings, was separately represented and had settled with the Lead Plaintiff as part of the Citigroup Settlement.

[20]** On March 3, the Lead Plaintiff informed the Court that it had reached a settlement with BOA and Fleet, two Underwriter Defendants that had combined after their participation in the 2000 and 2001 Offerings, for a total of $ 460.5 million (the "BOA Settlement"). Of this amount, 13.61% has been allocated to Class Members who purchased bonds in the 2000 Offering ("2000 Purchasers"), and 86.39% to those who purchased bonds in the 2001 Offering ("2001 Purchasers"). The Plan of Allocation for the BOA Settlement and each of the subsequent settlements is based on the number of bonds the Underwriter Defendant was allocated in each Offering, as well as the Securities Act Section 11 damages provision, 15 U.S.C. § 77k(e). The BOA Settlement amount was calculated using the Citigroup Formula. As already noted, all Underwriter Defendants had been offered the opportunity to settle at the Citigroup Formula rate in May 2004, at the time the Citigroup Settlement was announced.

On March 4, four more settlements were announced (the "March 4 Settlements"): Lehman Bros. settled for $ 62,713,582, and CSFB, Goldman Sachs, and UBS Warburg each agreed to pay $ 12,542,716. Those defendants **[**21]** participated only in the 2000 Offering, so all recovery from the March 4 Settlements will go to 2000 Purchasers. The March 4 Settlements likewise followed the Citigroup Formula. With two minor exceptions, all of the settlements with the Underwriter Defendants that followed included a premium over the Citigroup Formula. The Lead Plaintiff reached settlements with four more Underwriter Defendants on March 9 (the "March 9

Settlements"): ABN AMRO agreed to pay $ 278,365,600; Mitsubishi agreed to pay $ 75 million; and BNP and Mizuho settled for $ 37.5 million each. On March 10, Deutsche Bank settled for $ 325 million; Caboto settled for $ 37.5 million; and WestLB agreed to pay $ 75 million (the "March 10 Settlements"). With the exception of Deutsche Bank, all defendants involved in the March 9 and March 10 Settlements participated only in the May 2001 Offering; recovery from those settlements will thus go only to 2001 Purchasers. Of the Deutsche Bank settlement monies, 4.15% is to be distributed to 2000 Purchasers, and 95.85% to 2001 Purchasers.

A conference was held on March 9 to address preliminary approval of the BOA Settlement and the March 4 Settlements. Preliminary approval was delayed, **[**22]** however, until the Court could address objections by JP Morgan to the Judgment Reduction Formula and Bar Order in the BOA Settlement. JP Morgan was a co-lead underwriter with SSB in both the 2000 and 2001 Offerings. A March 15 Opinion rejected JP Morgan's objections. *In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 3791, No. 02 Civ. 3288 (DLC), 2005 WL 613107 (S.D.N.Y. Mar. 15, 2005). That Opinion performed a theoretical but detailed calculation of the damages faced by JP Morgan should it proceed to trial. *See* 2005 U.S. Dist. LEXIS 3791, [WL] *id.* at *7. All settlements that had been announced through March 10 received preliminary approval in a March 16 conference.

On March 16, JP Morgan settled for $ 2 billion. This was $ 630 million more than **[*329]** the Lead Plaintiff had been willing to accept in settlement in May 2004, at the time of the Citigroup Settlement, and thus represents a significant premium over the Citigroup Formula. Of the $ 2 billion sum, 22.75% will go to 2000 Purchasers, and 77.25% to 2001 Purchasers. The same day, Blaylock and Utendahl agreed to pay $ 572,840 and $ 234,000, respectively. [10] The amount recovered from Utendahl will go entirely to 2001 Purchasers, while 43.02% of the Blaylock monies will **[**23]** be distributed to 2000 Purchasers and 56.98% to 2001 Purchasers. The final three settlements received preliminary approval in a March 18 conference.

10 The Blaylock and Utendahl Settlements were below the Citigroup Formula.

Because the Underwriter Defendants faced only Securities Act claims stemming from the 2000 and 2001 Offerings, the amounts recovered in the Underwriters' Settlements are allocated solely to those claims. [11] Thus, the recovery will go to Class Members who purchased bonds in the 2000 and 2001 Offerings, not to purchasers of WorldCom stock or bonds issued prior to those Offerings. The Underwriters' Settlements, and almost all settlements in the class action litigation, were achieved with significant involvement by the Honorable Robert W. Sweet, U.S. District Judge for the Southern District of New York, and the Honorable Michael H. Dolinger, U.S. Magistrate Judge of the Southern District of New York.

11 Some of the Underwriter Defendants participated in only one of the two bond offerings at issue in the case, and, as already noted, proceeds from those settlements are allocated accordingly.

[**24] *Severance of the Claims Against Ebbers, Sullivan, Myers, and Yates*

An Order of March 16, 2005 severed the claims against defendants Ebbers, Sullivan, Myers, and Yates pursuant to Rule 21, Fed. R. Civ. P. [12] Severance was granted in light of the criminal prosecution of those four defendants; the class action litigation against them had previously been stayed for the same reason. In addition, the Order deemed that any testimony given by the four severed defendants at Ebbers' criminal trial would be admissible in the class action trial. No party to the class action litigation had objected to this accommodation.

12 The same Order severed the claims against Porter, one of the Director Defendants, because he had filed for bankruptcy.

Director Defendants' Settlement

After the Underwriter Defendants had settled with the Lead Plaintiff, the Director Defendants and Excess Insurers were able to resurrect their settlement agreement (the "Directors' Settlement"). **[**25]** On March 16, the Court was informed that a settlement with the Director Defendants was imminent; a Stipulation of Settlement was executed on March 18, 2005. Former directors Galesi and Roberts, neither of whom had been a party to the original Director Defendants' settlement, joined the settlement -- Galesi in the first instance, and Roberts on March 21. Roberts' personal contribution was $ 4.5 million, which Lead Counsel represents to be significantly more than twenty percent of Roberts' personal net worth, thus representing a premium over what was obtained from the other directors.

The total amount of the Directors' Settlement is $ 60.75 million. Of that amount, $ 24.75 million was paid by the Director Defendants personally, and $ 36 million was contributed by the Excess Insurers. With a prior payment of $ 15 million, this contribution is approximately one-half of the available insurance proceeds. Unlike the January 18 Stipulation to which ten of the **[*330]** twelve Director Defendants were parties, the March 21 Stipulation contains a Judgment Reduction Formula that conforms to the PSLRA. The Directors' Settlement was granted preliminary approval on March 21, 2005.

The Plan of Allocation **[**26]** for the Directors' Settlement provides that 80% of the funds are to be allocated to purchasers of WorldCom stock and other publicly traded debt securities. The remaining

20% will be distributed to purchasers of bonds in the 2000 and 2001 Offerings. Of this amount, 4.774% will go to purchasers in the 2000 Offering, and 15.226% to purchasers in the 2001 Offering. The Directors' Settlement also reserved other funds from the Excess Insurers for the Director Defendants' defense of the claims pending against them in the various Individual Actions.

Summary Judgment Opinion Regarding Roberts

Roberts, chairman of the WorldCom board of directors throughout the Class Period and one of the Director Defendants, had also filed a summary judgment motion. Roberts argued that he had established his due diligence defense under Securities Act Section 11; that he was not a "controlling person" under Exchange Act Section 20(a); and that he had established his affirmative defenses under Section 20(a) and Securities Act Section 15. In an Opinion of March 21, 2005, which was issued hours before Roberts agreed to join the Directors' Settlement, Roberts' summary judgment motion was denied on all counts. **[**27]** *See In re WorldCom, Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 4193, No. 02 Civ. 3288 (DLC), 2005 WL 638268 (S.D.N.Y. Mar. 21, 2005).

Andersen Trial and Settlement

Jury selection in the class action trial against Andersen, the only remaining defendant against which the litigation had not been severed, began on March 23, 2005. [13] Individualized voir dire was conducted on March 28, and opening statements began the following morning. The Lead Plaintiff presented eleven fact witnesses, three of whom testified live at trial, and four expert witnesses. Andersen presented a number of fact witnesses, including two Andersen audit and engagement partners, and one expert witness. Only two more experts were set to testify on Andersen's behalf when the jury was dismissed because the Lead Plaintiff and Andersen had reached a settlement. [14] The jury was remarkably attentive throughout the proceedings.

13 In a conference on March 16, 2005, the trial date was further delayed for approximately a week pending preliminary approval of the Directors' Settlement and several of the Underwriters' Settlements. On March 23, members of the venire completed a brief questionnaire addressed to questions such as any burden imposed by the anticipated length of the trial and ownership of WorldCom or MCI securities.

[28]**

14 Time limits of fifty hours apiece had been imposed on the Class and Andersen for opening statements and presentation of evidence (whether through direct or cross-examination). When the trial ended, the Class was set to use every minute of that time; Andersen was expected to complete its presentation of evidence with hours of its allotted time to spare.

The testimony from three of the Lead Plaintiff's witnesses was particularly memorable. Richard Roscitt, the former president of AT&T Business Services from December 1999 to January 2001, described his amazement at WorldCom's E/R ratio as reported in its quarterly and annual financial statements, and the concerted efforts he and his team made over a period of months to try to understand why WorldCom's reported performance of such a critical indicator was so superior to AT&T's **[*331]** comparable ratio. [15] The Lead Plaintiff offered this testimony, a videotaped deposition which had been noticed by underwriter defendants in an Individual Action, to establish that a "red flag" existed which put Andersen on notice that WorldCom might not be accurately recording **[**29]** its line costs, which were its largest operating expense. If the E/R ratio constituted a red flag, it required Andersen to conduct a reasonable audit of the WorldCom records associated with the reporting of its E/R ratio. The Lead Plaintiff also offered the evidence to show that Andersen had acted in willful blindness to WorldCom's financial condition and in abrogation of its duty as an auditor, rendering it liable under Exchange Act Section 10(b).

15 A discussion of WorldCom's reported E/R ratio and why it raised an issue of fact as to whether it constituted a "red flag" that imposed on the Underwriter Defendants a duty to investigate the reliability of these figures in WorldCom's audited financial statements is contained in the Opinion addressing the Underwriter Defendants' summary judgment motion. *See WorldCom*, 346 F. Supp. 2d at 678-80.

Eugene Morse ("Morse"), who worked in WorldCom's Internal Audit department, was the single most important individual in the discovery of the scheme at WorldCom **[**30]** to capitalize line costs in order to improve WorldCom's reported revenue and E/R ratio. WorldCom's Internal Audit department did not perform financial audits until early 2002. In May 2002, Morse noticed a discrepancy of well over $ 1 billion between the numbers reflected in the capital expenditures report he was reviewing and WorldCom's publicly reported numbers. The executive director of the capital budget attributed the discrepancy to "prepaid capacity." Morse searched for the source of the so-called prepaid capacity using a computer software called Essbase that allows one to navigate the company's general ledger, and quickly found a series of entries of large round-number entries such as $ 500 million. After further investigation, often performed alone at night in WorldCom's offices, he found that the amounts were transfers originating from line costs. Line costs were the company's largest operating expense and therefore not an item that should be capitalized. The suspicious entries were made after the closing of the quarters they affected and directly preceded the dates on which WorldCom issued press releases announcing its financial results. Morse found $ 1.7 billion of fraud **[**31]** in the first few days of his investigation, and a total of $ 3 billion, dating as far back as the first quarter of 2001, within a couple of weeks. Cynthia Cooper, the head of the Internal Audit department, encouraged Morse throughout his investigation and reported the findings to the audit committee of WorldCom's board of directors on June 20, 2002. The fraud at WorldCom was disclosed to the public several days later.

Finally, Ralph Stark testified as one of the Lead Plaintiff's experts. In December 2004, the Lead

Plaintiff obtained access to WorldCom's computerized general ledger for the year 2001. [16] In just half an hour, using a protocol to examine using Essbase the largest categories in WorldCom's balance sheet and income statement for any large, post-closing adjustments, Stark and his team found the first "unusual" journal entry, or financial input, in WorldCom's general ledger. Within hours, he found many large, round-number, post-closing **[*332]** entries. Stark testified that a junior financial analyst, accountant, or auditor with basic training in Essbase could have readily discovered the same entries in an audit of the general ledger. The Lead Plaintiff offered this evidence to illustrate **[**32]** how easily Andersen could have discovered the WorldCom fraud if it had audited WorldCom's general ledger for post-closing adjustments. The Lead Plaintiff's examination at trial of Andersen's auditors showed that Andersen's audit planning had identified post-closing adjustments to the general ledger as one of the ways in which WorldCom could commit fraud, but that Andersen did not access the computerized general ledger to perform such an audit during the years in question.

16 MCI, the successor to WorldCom, granted experts from Lead Plaintiff and Andersen access to the WorldCom general ledger for the year 2001. Andersen had initiated the request for this access but did not seek to offer at trial any testimony about its expert's examination of the general ledger.

At the end of two weeks of trial testimony, the Court asked the parties to renew their settlement negotiations. The next week Andersen shared information regarding its financial condition with the Lead Plaintiff for the first time. On April 22, 2005, at **[**33]** the end of the fourth week of trial and a few short days before closing arguments, the Lead Plaintiff and Andersen reached a settlement (the "Andersen Settlement"). In an April 22 Stipulation of Settlement, Andersen agreed to pay $ 65 million in cash, plus contingent payments equivalent to 20% of any amount paid out by Andersen to present or former partners and certain other individuals in repayment of any subordinated notes issued in respect of paid-in capital or subordinated loans. The Stipulation of Settlement also contained a "most favored nation clause" entitling the Class to receive an additional amount if Andersen pays from its own funds more than $ 65 million in any other settlement.

On April 26, preliminary approval of the Andersen Settlement was granted, the money was transferred to Lead Plaintiff's escrow account, and the jury was dismissed. The Plan of Allocation for the Andersen Settlement distributes the settlement funds between Exchange Act and Securities Act claims in the same proportion as the Directors' Settlement Plan of Allocation. Because the first alleged misstatement by Andersen was made on March 30, 2000, however, Exchange Act monies will only be allocated **[**34]** to Class Members who purchased WorldCom securities on or after that date. Judge Sweet and Magistrate Judge Dolinger released an April 22, 2005 Mediators' Statement attesting that, based on the information available to them and their discussions with the parties, "this Settlement was negotiated in good faith, and . . . the Settlement and the allocation between the Securities Act and Exchange Act claims are in the public interest."

Notice to the Class

A Hearing Order of June 14, 2005 (the "Hearing Order") established the schedule for final approval of the settlements with the Underwriter Defendants, the Director Defendants, and Andersen, and approved a Summary Notice of Class Settlements ("Summary Notice"); a Summary of Supplemental Plan of Allocation ("Summary Supplemental Plan"); and a full-length Notice of Settlements of Class Action ("Class Notice"), which included the proposed Supplemental Plan of Allocation (the "Supplemental Plan"). It also extended the deadline by which Class Members could file proofs of claim from March 4, 2005 to August 26, 2005. The Hearing Order required the Lead Plaintiff to begin mailing the Class Notice (with the Supplemental Plan) by July 1, 2005 to **[**35]** those members of the Class who had already filed a proof of claim. Beginning on June 28, the mailings of these documents were made to over 800,000 Class Members who had filed proofs of claim. The Class Notice and Summary Supplemental Plan **[*333]** were mailed at the same time to approximately 3.5 million other potential Class Members. [17] Summary Notices were published in the *Wall Street Journal* and the *New York Times* and over the PR Newswire and Bloomberg News in early July.

17 The Summary Supplemental Plan ran two pages, while the Supplemental Plan itself was eighty-five pages long.

The Class Notice presented the definition of the Class, which encompasses "all persons or entities who purchased or acquired publicly traded securities of WorldCom . . . during the period from April 29, 1999 through and including June 25, 2002, and who were injured thereby" (the "Class Definition"). It gave a detailed Statement of Potential Outcome, which described the issues confronting the parties and the various risks involved **[**36]** in prosecuting the class claims against the settling defendants, and recounted the history of the litigation. It set forth the language of the Release to be imposed pursuant to the settlements and defined the Settling Defendant Releasees. Released Claims are defined as

> *all claims and causes of action of every nature* and description, known and unknown, whether under federal, state, common, or foreign law, whether brought directly or derivatively, *based upon*, arising out of, or relating in any way to *investments* (including, but not limited to, purchases, sales, exercises, and decisions to hold) *in securities issued by WorldCom*, including without limitation all claims arising out of or relating to any disclosures, public filings, registration statements or other statements by WorldCom, as well as all claims asserted by or that could have been asserted by Plaintiffs or any member of the Class in the Action against the Settling Defendant Releasees. [18]

(Emphasis supplied.)

18 The Release also states that Class Members are not precluded from claiming with respect to funds made available from the WorldCom bankruptcy or WorldCom's settlement with the Securities and Exchange Commission ("SEC") or any other regulatory agency fund.

[37]** The Class Notice outlined the Underwriters', Directors', and Andersen Settlements, listing settlement dates and dollar amounts and setting forth the Plans of Allocation. It also specified the maximum amount of attorneys' fees and costs that Lead Counsel would seek. It set a deadline of August 12, 2005 for any objections to the settlements and announced a September 9, 2005 fairness hearing (the "Fairness Hearing"). The Class Notice informed Class Members that they would receive no further mailing if settlements were reached with Ebbers, Sullivan, Myers, and/or Yates unless they submitted a request to the Claims Administrator for written notice of any additional settlements. Rather, notice of further settlements would be provided on www.worldcomlitigation.com, the website maintained by Lead Counsel ("Lead Counsel Website"), and in several specified publications. This method of notice was approved in light of the fact that any settlement with the remaining defendants would not materially increase recovery for the Class, whereas another mailed notice would constitute a significant expenditure. [19]

19 The expense associated with providing notice to every member of the WorldCom class can be gleaned from these figures, which reflect only some of the costs of notice. The cost of disseminating the July 1, 2005 Class Notice and Supplemental Plan to 600,000 Class Members was $ 588,000; the cost of disseminating the Class Notice and Summary Supplemental Plan to approximately 3.5 million other potential class members was $ 2,360,000.

[38]** The Supplemental Plan specifies the methodology for calculating a "Recognized **[*334]** Amount" for each Class Member's losses, based on the type of security purchased and the date it was sold or redeemed. It also specifies that there will be no recovery for WorldCom securities sold or redeemed on or before January 28, 2002, explaining that the first decline in the price of WorldCom securities that could be said to be caused by WorldCom's misrepresentation of its financial condition was a decline on or after January 29, 2002. [20] The tables accompanying the Supplemental Plan lay out the dollar amount of artificial inflation inhering in the market price of each type of WorldCom security for each day of the Class Period, as estimated by the Lead Plaintiff.

20 The Lead Plaintiff has proposed that this provision be altered to allow a small recovery for Class Members who sold their securities on or before January 28, 2002. This proposed

modification to the Supplemental Plan is discussed in detail below.

Ebbers Settlement

[39]** The Lead Plaintiff reached a settlement with Ebbers on July 6, 2005 (the "Ebbers Settlement"). The settlement results in the surrender of substantially all of Ebbers' assets. Pursuant to the Ebbers Settlement, the Class will receive $ 5,636,543.69 in cash. The Class is also entitled to approximately 75% of the net proceeds from the sale of various assets held by Ebbers, including a house, several plots of land, certain farm equipment, and interests in various businesses, and will receive approximately two-thirds of the net proceeds from the sale of the Joshua Timberlands, another Ebbers asset. The balance of the proceeds from the sale of Ebbers' assets will go to settle debts Ebbers owes to MCI. The Lead Plaintiff estimates that the sale of Ebbers' assets will result in an additional $ 18 million to $ 28 million of recovery for the Class. The Ebbers Settlement also includes a Confidential Supplemental Stipulation allowing Ebbers to retain a specified amount to pay legal bills, to fund his defense in other litigation, and to pay $ 450,000 owed on a note to the class plaintiffs in the WorldCom *ERISA Litigation*. The Plan of Allocation for the Ebbers Settlement is identical to those **[**40]** proposed for the Directors' and Andersen Settlements. Lead Counsel have chosen not to apply for any additional attorneys' fees on the basis of the Ebbers Settlement. A hearing regarding preliminary approval of the Ebbers Settlement was held on July 11, and a Preliminary Approval Order was issued on the same date.

Ebbers was indicted on criminal charges for his involvement in the WorldCom fraud on March 2, 2004; a jury convicted him of nine felony counts on March 15, 2005, after a trial before the Honorable Barbara S. Jones, U.S. District Judge for the Southern District of New York. In recognition of the Ebbers Settlement, the Office of the U.S. Attorney for the Southern District of New York ("U.S. Attorney's Office") agreed not to seek further monetary restitution from Ebbers. In addition, the New York State Attorney General agreed to dismiss certain claims against Ebbers that were pending in a New York state court. On July 13, Judge Jones sentenced Ebbers to twenty-five years in prison.

Myers, Yates, and Sullivan Settlements

On July 21, 2005, the Lead Plaintiff reached a settlement agreement with Myers and Yates (the "Myers-Yates Settlement"), embodied in a Stipulation **[**41]** of Settlement of July 26. It does not require either Myers or Yates to pay money to the Class, as the Lead Plaintiff determined that both defendants lack adequate financial resources and that the expense of further prosecution of the claims against **[*335]** those defendants would thus be detrimental to the Class.

A settlement with Sullivan was announced on July 25, 2005 (the "Sullivan Settlement"). As was true for the Ebbers Settlement, the Sullivan Settlement results in the surrender of substantially all of Sullivan's assets. Pursuant to the terms of the Stipulation of Settlement with Sullivan, dated July 26, 2005, the Class will receive 90% of Sullivan's MCI 401(k) account, representing approximately $

200,000. It will also receive approximately 90% of the net proceeds from the sale of a Boca Raton, Florida house owned by Sullivan. Five percent of the proceeds of the sale of the Boca Raton house will be held in escrow by Sullivan's attorneys to fund his defense in other litigation, including the WorldCom Individual Actions. The balance of the proceeds from the 401(k) and the sale of the house will be distributed to the plaintiff class in the WorldCom *ERISA Litigation*. The sale of the **[**42]** Florida house is expected to result in a net payment of between $ 4 and $ 5 million to the Class.

The Plan of Allocation for the Sullivan Settlement is identical to those for the Directors' Settlement, Andersen, and Ebbers Settlements. As with the Ebbers Settlement, Lead Counsel chose to forego any request for attorneys' fees based on the Sullivan Settlement. Preliminary approval was given to the Sullivan and Myers-Yates Settlements in a hearing on July 28.

Sullivan, Myers, and Yates had all pleaded guilty to criminal charges pending against them. In light of the Sullivan Settlement, the U.S. Attorney's Office did not seek further monetary restitution from him. On August 9, Judge Jones sentenced Yates to a year and a day in prison, and the following day, Myers received a one-year sentence. On August 11, Sullivan was sentenced to five years in prison. Yates', Myers', and Sullivan's sentences were significantly reduced because they had cooperated with the Government in its prosecution of Ebbers.

Notice to the Class of the Ebbers, Myers-Yates, and Sullivan Settlements

As provided in the Hearing Order, no notice of the Ebbers, Myers-Yates, and Sullivan Settlements (collectively, **[**43]** the "Officers' Settlements") was mailed to the Class. A Notice of Proposed Settlements of Class Action ("Officers' Settlement Notice") appeared through the channels prescribed by the Hearing Order. That document once again set forth the definition of the Class, described the Officers' Settlements and the corresponding Plans of Allocation by claim, announced that the Officers' Settlements would be considered at the previously scheduled September 9, 2005 Fairness Hearing, and informed Class Members of the sources from which they could receive previous Notices and proof of claim forms. As of the very end of August, only eighteen class members had contacted the Claims Administrator to request that a copy of the Officers' Settlement Notice be mailed to them directly.

Reaction of the Class to the 2005 Settlements

Over four million putative Class Members were sent notice of the 2005 Settlements. Approximately 834,000 Class Members ultimately filed proofs of claim. [21] Despite the significant participation of the Class in the claims process, only seven Class Members -- a minuscule percentage -- filed timely objections to the 2005 **[*336]** Settlements. Notably, the objectors did not attack **[**44]** the amounts obtained in the settlements; by and large, their objections addressed the scope of the Release and the provisions of the Supplemental Plan. The objectors are Roslyn Berger ("Berger"), who objects to the scope of the Release; Cerberus Partners, L.P., Cerberus International Ltd., Cerberus Institutional Partners, L.P. - Series Two, and Cerberus Institutional Partners America, L.P. (the "Cerberus Objectors"), who object to four aspects of the Supplemental Plan; Kenneth D. Laub

("Laub"), who objects to the Supplemental Plan; [22] Cynthia R. Levin Moulton ("Moulton"), who objects to the Class Notice, the scope of the Release, and the Plans of Allocation; W. Caffey Norman, III, who objects to the Supplemental Plan; Richard F. Reynolds ("Reynolds"), who objects to the scope of the Release; and Charles Lee Thomason ("Thomason"), who objects to the format of the Proof of Claim Form. [23] Their objections are discussed in detail below.

21 Approximately 535,000 Class Members had submitted proofs of 21 claim by March 4, 2005, the original deadline.

22 Although they did not file objections, several Class Members, Dennis G. Baxter, Larry Kolko, and Tom Roberts, submitted correspondence to the Court and/or to Lead Counsel voicing a similar objection to those briefed by Laub: namely, that the allocation of settlement funds only to those Class Members who sold or held their WorldCom securities on or after January 29, 2002 is unfair. The fairness of that allocation is discussed below with respect to the Laub objection.

[45]**

23 An eighth objection, which was filed late by a WorldCom investor who has provided no proof of class membership and who submitted her claim form after the deadline, addresses the issue of attorneys' fees and is described below.

Fairness Hearing

The Fairness Hearing was held on September 9, 2005. Lead Counsel and counsel for additional Named Plaintiffs Fresno County Employees Retirement Association; the County of Fresno, California; and HGK Asset Management, Inc. appeared at the hearing, as did Alan P. Lebowitz, General Counsel for the Comptroller of the State of New York, representing the NYSCRF; and Liaison Counsel for the Individual Actions. Also present were counsel for various Underwriter Defendants, the Citigroup Defendants, Andersen, various Director Defendants, and Ebbers. The Cerberus Objectors, Laub, Moulton, Norman, and Reynolds were also represented by counsel at the Fairness Hearing; these objectors were all given the opportunity to be heard.

Discussion

Judicial Approval of Class Action Settlements Under Rule 23(e)

[HN1] Pursuant to Rule 23(e), Fed. R. Civ. P. **[**46]** , any settlement of a class action must be approved by the court. The following discussion of the requirements of Rule 23(e) draws heavily from an October 18, 2004 Opinion approving a settlement in the WorldCom *ERISA Litigation, see In re WorldCom ERISA Litig.*, 2004 U.S. Dist. LEXIS 20671, No. 02 Civ. 4816 (DLC), 2004 WL

2338151, at *5-*6 (S.D.N.Y. Oct. 18, 2004), and from the November 12 Opinion approving the Citigroup Settlement, *see WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *10.

[HN2] In determining whether to approve a class action settlement, the district court must "carefully scrutinize the settlement to ensure its fairness, adequacy and reasonableness, and that it was not a product of collusion." *D'Amato v. Deutsche Bank*, 236 F.3d 78, 85 (2d Cir. 2001) (citation omitted); *see also Joel A. v. Giuliani*, 218 F.3d 132, 138 (2d Cir. 2000). In so doing, the court must "eschew any rubber stamp approval" yet simultaneously "stop short of the detailed and thorough investigation that it would undertake if it were actually **[*337]** trying the case." *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 462 (2d Cir. 1974).

[HN3] A district court determines a settlement's **[**47]** fairness "by examining the negotiating process leading up to the settlement as well as the settlement's substantive terms." *D'Amato*, 236 F.3d at 85. The court should analyze the negotiating process in light of "the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves." *Malchman v. Davis*, 706 F.2d 426, 433 (2d Cir. 1983) (citation omitted). A court must ensure that the settlement resulted from "arm's-length negotiations" and that plaintiffs' counsel engaged in the discovery "necessary to effective representation of the class's interests." *D'Amato*, 236 F.3d at 85.

[HN4] In evaluating the substantive fairness of a settlement, a district court must consider factors enumerated initially in *Grinnell*:

> (1) the complexity, expense and likely duration of the litigation, (2) the reaction of the class to the settlement, (3) the stage of the proceedings and the amount of discovery completed, (4) the risks of establishing liability, (5) the risks of establishing damages, (6) the risks of maintaining the class action through the trial, (7) the ability **[**48]** of the defendants to withstand a greater judgment, (8) the range of reasonableness of the settlement fund in light of the best possible recovery, [and] (9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

D'Amato, 236 F.3d at 86 (citation omitted).

Finally, [HN5] public policy favors settlement, especially in the case of class actions. "There are weighty justifications, such as the reduction of litigation and related expenses, for the general policy favoring the settlement of litigation." *Weinberger v. Kendrick*, 698 F.2d 61, 73 (2d Cir. 1982).

Procedurally, not a modicum of doubt exists as to the fact that the 2005 Settlements were achieved after painstaking negotiations between extraordinarily well-represented adversaries. In addition, Lead Counsel attests that a thorough investigation of the financial status of the Director Defendants, Andersen, and the Officer Defendants was performed to assess what resources these defendants could contribute to their respective settlements. Substantively, consideration of the *Grinnell* factors strongly supports approval of the **[**49]** settlements.

1. Complexity, expense, and likely duration of the litigation

The litigation was extraordinarily complex, and even though the Court made every effort to conduct the litigation as efficiently as possible, it was a costly undertaking for all parties, particularly given the late stages in which the 2005 Settlements were reached. Nevertheless, further litigation would have resulted in considerable additional expense. By settling when they did, all defendants but Andersen avoided the expense of conducting a full trial, and all parties avoided the expense of the nearly inevitable post-trial briefing and appeals. Particularly with respect to the less-wealthy defendants, further litigation would have only served to extinguish the funds available to settle the Class claims.

2. Reaction of the Class

Out of some four million potential Class Members, more than 830,000 of whom submitted proofs of claim, only seven filed timely formal objections to the 2005 Settlements. The very low number of objections **[*338]** evidences the fairness of those settlements. *See Grinnell*, 495 F.2d at 462.

3. Stage of the proceedings and the risk of further litigation

The Underwriters' **[**50]** and Directors' Settlements were accomplished on the eve of trial; the Andersen Settlement, after several weeks of trial, immediately preceding closing arguments; and the Officers' Settlements, after those defendants had testified in the criminal case against Ebbers [24] and after the Andersen trial had ceased. All parties were thus superbly equipped to evaluate the strengths and weaknesses of their cases.

24 Ebbers took the stand in his own defense, and Sullivan, Myers, and Yates were Government witnesses.

Even at these late stages of the litigation, however, there were significant risks on all sides, many of which were described in the Class Notice. With respect to both Securities Act and Exchange Act claims, the falsity of many alleged misstatements was in dispute. All active defendants [25] facing Securities Act Section 11 claims stemming from the 2000 and 2001 Offerings had asserted due diligence defenses and might have been successful at establishing the adequacy of their efforts at trial. Active Section 11 **[**51]** defendants, with the exception of Andersen, might have been able to establish that no "red flags" put them on notice of wrongdoing and that they were thus entitled rely on WorldCom's audited financial statements. Defendants facing Securities Act Section 12(a)(2) claims might have been able to establish that they exercised reasonable care. [26] In addition, the Lead Plaintiff might not have been able to establish that Andersen and Kellett, who faced Exchange Act 10(b) claims, acted knowingly or recklessly with respect to the misstatements. *See* 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5. (Such a state of mind clearly existed on the part of the Officer Defendants, however, who were found guilty of or pleaded guilty to criminal charges.) The Director Defendants, all of whom faced liability under Exchange Act Section 20(a), might have been able to prove that they [HN6] "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." 15 U.S.C. § 78t(a). The Director Defendants and Andersen also argued that their proportionate share of responsibility was minimal **[**52]** compared to the WorldCom insiders who perpetrated the fraud. [27] In addition, with respect to both Securities Act and Exchange Act claims, the defendants contested the extent to which the decline in the prices of WorldCom securities was due to the WorldCom accounting fraud as opposed to other market forces.

25 As noted above, by the time the 2005 Settlements were achieved, the claims against Ebbers, Sullivan, Myers, and Yates had been severed.

26 The various Securities Act defenses are described in the Opinion pertaining to the Underwriter Defendants' summary judgment motion. *See WorldCom*, 346 F. Supp. 2d at 662-63.

27 The proportionate liability scheme of the Exchange Act is described in *WorldCom*, 2005 U.S. Dist. LEXIS 1805, 2005 WL 335201 at *6-*8.

4. The range of reasonableness of the settlement fund and the ability of defendants to withstand a greater judgment

The 2005 Settlements are, in virtually each instance, of historic proportions. Purchasers of the WorldCom bonds issued in **[**53]** the 2000 and 2001 Offerings, who accordingly possessed Securities Act claims against all defendants, will recover approximately $ 4.852 billion -- $ 3.452 billion from **[*339]** the present settlements, and $ 1.4 billion from the Citigroup Settlement. The bonds issued in the 2000 and 2001 Offerings were worth approximately $ 16.9 billion, of which $ 15.3 billion was still outstanding at the end of the Class Period, and Lead Plaintiff's damages model attributed some $ 10.6 billion of damages to the alleged misstatements in the Registration Statements for the offerings. The Lead Plaintiff estimates that the average recovery per $ 1000 face amount of the bonds issued in the 2000 and 2001 Offerings will be $ 426.66, based on the total funds recovered through the Citigroup Settlements and the 2005 Settlements, the number of bonds outstanding at the end of the Class Period, and the estimated amount of bonds held by persons who opted out of the Class. This recovery does not include the significant amount that bondholders have already recovered through the WorldCom bankruptcy proceedings. [28] Given the risks that would have been inherent in proceeding with the trial and any appeals, the settlement amount **[**54]** that will be allocated to the Securities Act claims is more than reasonable; it is remarkable. The Underwriter Defendants obviously have the financial resources to pay more than they have, but the Underwriters' Settlements have contributed to a total recovery that goes a long way toward making bondholders whole.

28 The amount of the bankruptcy recovery will be discussed below in respect to the objection by the Cerberus Objectors.

Purchasers of other WorldCom securities stand to recoup a far smaller percentage of their losses. [29] Even combined with the approximately $ 1.175 billion allocated to Exchange Act claims in the Citigroup Settlement, the funds received in the 2005 Settlements represent only a fraction of the recovery achieved for purchasers of bonds in the 2000 and 2001 Offerings.

29 As one Class Member, S. Kaiser, expressed in an e-mail message to the Victim/Witness Coordinator at the U.S. Attorney's Office, WorldCom shareholders will receive "peanuts" in comparison to purchasers of bonds issued in the 2000 and 2001 Offerings.

[55]** The only defendants involved in the 2005 Settlements who faced Exchange Act claims are Andersen, now defunct and retaining limited assets; the Director Defendants, [30] who have collectively given up twenty percent of certain personal assets and whose settlements were supplemented by $ 36 million in contested insurance funds; and the Officer Defendants. Of the Officer Defendants, Ebbers and Sullivan have contributed substantially all of their personal assets to this and other settlements, and Yates and Myers are effectively insolvent. Thus, the pool of resources from which the Lead Plaintiff could seek recovery through this round of settlements for purchasers of stock and pre-existing bonds was relatively shallow, and because purchasers of stock and pre-existing bonds incurred aggregate losses many times greater than those of bond purchasers in the 2000 and 2001 Offerings, the recovered sums will be diffused much more widely. [31]

30 The Director Defendants faced control-person claims under the Exchange Act. A single Director Defendant, Kellett, also faced an Exchange Act Section 10(b) claim.

[56]**

31 The Lead Plaintiff estimates that approximately 2.49 billion shares of WorldCom common stock were capable of being traded during the Class Period, which conveys some idea of how thinly the recovery must be spread. Holders of bonds issued prior to the 2000 and 2001 Offerings may recover on Exchange Act claims as well.

The Lead Plaintiff has included protections in the settlement agreements with the Exchange Act defendants providing **[*340]** recourse for the Class should these defendants' financial representations be false. The Lead Plaintiff -- who, it should be noted, was not a purchaser of bonds in the 2000 and 2001 Offerings and thus will recoup the same proportion of its losses as all other

Class Members with only Exchange Act claims -estimates that Class Members will recover only an average of $ 0.56 per share of common stock. It has nonetheless still recovered a fair and, when the Citigroup Settlement is considered, even a remarkable amount for shareholders, given the circumstances.

Objections by Class Members

1. Objection to the Class Notice [32]

32 A number of objectors make arguments relating to the Class Notice. All but one of these are more appropriately addressed in the discussions of the Release and Supplemental Plan that follow.

[57]** [HN7] The standard for measuring the adequacy of a settlement notice in a class action is reasonableness. *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96, 113 (2d Cir. 2005). "There are no rigid rules to determine whether a settlement notice to the class satisfies constitutional or Rule 23(e) requirements; the settlement notice must fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with the proceedings." *Id.* at 114 (citation omitted). "Notice is adequate if it may be understood by the average class member." *Id.* (citation omitted).

Moulton, who purchased a total of 54 shares of WorldCom stock during the Class Period, resulting in a loss of approximately $ 404, argues that the Class Notice was defective because the Class Definition is vague. Moulton did not file a proof of claim and therefore does not have standing to bring her objections. [33] *See State of New York by Vacco v. Reebok Int'l, Ltd.*, 96 F.3d 44, 47 (2d Cir. 1996) [HN8] ("For standing to exist, a would-be litigant must have sustained a palpable injury that is likely to be redressed **[**58]** by a favorable decision."). In any event, Moulton's objections are frivolous.

33 Several days after the Fairness Hearing, Moulton submitted a "Notice Regarding the Court's Inquiry Regarding Standing" reaffirming that Moulton had an out-of-pocket loss arising from her purchase of WorldCom securities during the Class Period, but she still does not contradict the Lead Plaintiff's contention that she did not submit a proof of claim.

Moulton contends that the phrase "who were injured thereby" necessitates "a subjective, merits-based inquiry far beyond a simple determination of whether a given person did or did not purchase or acquire WorldCom, Inc. securities during the class period," rendering Class membership "unknowable." She also argues in conclusory form and without explanation that the relief described in the Class Notice regarding the settlement is "vague and confusing." Acknowledging that the 2005 Settlements achieved a "remarkable" recovery for the class, Moulton's attorney elaborated on her objection at **[**59]** the Fairness Hearing, explaining that the Class Definition might be confusing to a person who had isolated losses but net gains from securities purchased during the Class Period, or who faced divergent results from purchases of different types of securities.

A purchaser of WorldCom securities who believed that she had a legally cognizable injury attributable to those purchases would have been on notice that she was included in the Class. It is sufficient that the Class Definition gave putative Class Members who believed they had colorable legal claims arising from purchases **[*341]** of WorldCom securities enough information to alert them that they needed to opt out of the Class if they wished to pursue their claims separately. Moulton's objection based on the alleged vagueness of the Class Definition is accordingly rejected.

Moulton's objection to the description of the relief provided by the Class Notice must likewise be rejected. The Class Notice and the Executives' Settlement Notice together listed the amounts of all of the 2005 Settlements. The Supplemental Plan describes in detail the allocation of the settlement proceeds among Class Members who filed proofs of claim.

2. Objections **[**60]** to the Scope of the Release

Three Class Members, Berger, Reynolds, and Moulton, have objected to the scope of the Release to be imposed pursuant to the 2005 Settlements. As the Second Circuit recently noted, [HN9] "Practically speaking, class action settlements simply will not occur if the parties cannot set definitive limits on defendants' liability." *Visa*, 396 F.3d at 106 (citation omitted). The scope of a settlement release is limited by the "identical factual predicate" and "adequacy of representation" doctrines. *Id.* "The law is well-established in this Circuit and others that class action releases may include claims not presented and even those which could not have been presented as long as the released conduct arises out of the 'identical factual predicate' as the settled conduct." *Id.* at 107. "Adequate representation of a particular claim is determined by the alignment of interests of class members, not proof of vigorous pursuit of that claim." *Id.* at 113.

a. Berger

Berger, who purchased 250 shares of WorldCom stock in 1998 and 100 shares on September 20, 2000, [34] contends that the Release is overinclusive because it bars **[**61]** claims against settling defendants arising from the purchase of WorldCom securities prior to the Class Period, which began on April 29, 1999, and that Class Members were not given adequate notice that such claims would be barred. Berger, who has filed a Statement of Claim against SSB, one of the Citigroup Defendants, with the National Association of Securities Dealers ("NASD"), [35] represents that she did not opt out of the Class because she did not believe claims arising from her 1998 purchases would be barred by the Release. Additionally, Berger argues that the 2005 Settlements do not provide adequate consideration for the release of claims arising from purchases made prior to the Class Period.

34 Berger sold 75 shares of WorldCom stock on December 28, 2001. She presumably held the rest until they were exchanged for MCI stock pursuant to the WorldCom bankruptcy reorganization.

35 Berger's arbitration claims against SSB were enjoined by this Court after a show cause hearing on August 26, 2005, on the grounds that they are barred by the claims release imposed pursuant to the Citigroup Settlement. All of Berger's arbitration claims concerning her WorldCom investments unquestionably arise from the identical factual predicate that forms the core of the allegations brought by the Class against SSB. Berger has filed a proof of claim in the class action.

[62]** To the extent that Berger objects to the Release imposed pursuant to the Citigroup Settlement, her objection is untimely and has been waived. Moreover, because the Release may only be applied to bar claims based on the same factual predicate as those brought by the Lead Plaintiff in the class action, its scope is entirely appropriate under the standards set forth in *Visa* **[*342]** and earlier cases. [36]

36 The Release does not state that its application is bounded by the "identical factual predicate" doctrine, but the addition of language releasing claims "arising from the same facts," or similar formulations, would be unnecessary and redundant. It is, after all, a given that the Release will only be applied insofar as its application conforms to the law. For example, on numerous occasions, parties have litigated before this Court whether claims may be enjoined pursuant to the Citigroup Settlement release. That the "identical factual predicate" and "adequate representation" doctrines limit the effect of that identically worded release has never been disputed. Because the determination whether a given claim is predicated on identical facts as the class action claims is inherently an individualized, fact-specific one, adding broad language specifying that only claims arising from an identical factual predicate are to be released would certainly not reduce litigation over the release of specific claims and may even be more likely to produce claims that Class Members were confused or misled. Nor, given the numerous factual allegations in the complaint, would it be feasible to provide in the Release a full description of the factual scenarios on which the class action claims were based. It should be noted that the Lead Counsel Website gave Class Members access to all of the class action pleadings and the Opinions issued in the *Securities Litigation*, among many other documents.

[63]** Berger and other Class Members were given fair and adequate notice that they were members of the Class and that they would be bound by the terms of any settlement in the litigation. The Class Definition has featured prominently in every notice sent out to date, including the December 2003 Notice. That Notice set forth the Class Definition in its very first lines and stated, underscored and in bold: "If you do not request to be excluded from the Class . . . you will be bound by the decisions and outcome of this lawsuit." No representation was ever made that the dates bounding the Class Period would correspond to any release, or to anything other than the definition of the Class. Class Members were given an extraordinarily long period of time in which to opt out. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *5.

[HN10] There is obviously no legal requirement that a notice of the pendency of a class action include a description of a release that may someday be negotiated to resolve claims brought in the class action, and the Class did not receive notice of the Release to be applied pursuant to the 2005 Settlements prior to the optout date. Nevertheless, because of the extension of the **[**64]** opt-out period, Class Members effectively *did* have the opportunity to opt out upon knowledge of the scope of the Release: the Class received notice of the identical claims release imposed pursuant to the Citigroup Settlement approximately a month prior to the opt-out date. At the time of the Citigroup Settlement, only one Class Member objected to the scope of the claims release, and that objection was of a different nature. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *12-*13. In any event, [HN11] the Second Circuit has explicitly rejected the contention that Class Members must be given a second opportunity to opt out after the terms of a settlement are announced. *See Visa*, 396 F.3d at 114. Given the notices distributed to the Class, and the opportunities granted to the Class to opt out and later to object to the 2005 Settlements, there is no reason here to permit a second opportunity to opt out.

Nor is there any merit to the contention that Berger and those Class Members who also made pre-Class Period purchases of WorldCom securities are receiving inadequate compensation for their claims, as it appears highly unlikely that they could establish a factual basis **[**65]** for recovery. At the Fairness Hearing, Lead Counsel confirmed that April 29, 1999 was chosen as the beginning of the Class Period because it was the first date on which the Lead **[*343]** Plaintiff could point to evidence of a misstatement by WorldCom of its financial information. [37] Lead Counsel noted that the SEC chose the same date for its civil enforcement proceedings against WorldCom for the same reason.

37 While the statute of limitations for the class action allowed claims to be brought for the three-year period before April 30, 2002, the defendants never challenged the choice of a class period beginning one day earlier.

Additionally, the inflation in WorldCom's stock price, as allocated by the Lead Plaintiff based on its experts' evaluation of the relevant evidence, was concentrated toward the end of the Class Period. It is telling in this regard that no one in the Class has objected to that portion of the Supplemental Plan, explained at Paragraph 14 and demonstrated in various charts appended to the Supplemental **[**66]** Plan, which calculates that the inflation started with relatively smaller percentages during the first quarters of the Class Period and gradually increased to nearly 100% toward the end of 2001. [38] This allocation of inflation reflects the relationship that each quarter's earnings overstatement bore to the total amount of the earnings overstatements in WorldCom's SEC filings.

38 For example, the artificial inflation was approximately $ 1 of the $ 55.90 closing price of WorldCom common stock as of April 29, 1999, but $ 12.50 of the $ 14 closing price on December 31, 2001.

Thus, in addition to other barriers an investor may face in obtaining recovery for losses from WorldCom investments purchased prior to the Class Period, including the statute of limitations, there is compelling evidence that WorldCom's manipulations of its financial reporting did not impact prior periods in any material way that requires compensation in order for the settlements to be approved as fair. [HN12] Settlement proceeds may be allocated according **[**67]** to the strengths and weaknesses of the various claims possessed by Class Members. *See In re Holocaust Victim Assets Litig.*, 413 F.3d 183, 186, 14 Fed. Appx. 132 (2d Cir. 2001) (reissued 2005) ("Any allocation of a settlement of this magnitude and comprising such different types of claims must be based, at least in part, on the comparative strengths and weaknesses of the asserted legal claims."). Fairness does not require that Class Members be compensated for losses stemming from purchases at prices that it would be extraordinarily difficult to argue were inflated by the malfeasance alleged in the complaint.

Had Berger wished to press her claims outside the confines of the class action, she had an opportunity to opt out. Because she chose to remain a Class Member, there is no unfairness in applying the Release to all of her claims, even if they involve securities purchased prior to the Class Period, so long as they are predicated on the same facts alleged in the class action complaint. Her objection is thus rejected.

b. Reynolds

Reynolds is another Class Member who has pursued separate litigation against WorldCom (the "Reynolds Action"). Reynolds' lawsuit was enjoined in April 2005 **[**68]** by Judge Arthur J. Gonzales of the U.S. Bankruptcy Court for the Southern District of New York, who oversaw the WorldCom bankruptcy proceedings, on the ground that Reynolds' claims are derivative and are therefore the exclusive property of the bankruptcy estate. *See In re WorldCom, Inc.*, 323 B.R. 844, 856 (Bankr. S.D.N.Y. 2005). Reynolds' appeal of that injunction is pending.

The Reynolds Action alleged that the WorldCom board of directors declared a **[*344]** dividend for shares of MCI Tracking Stock on March 6, 2002, and later, on July 11, 2002, announced that the dividend would not be paid. It pleaded four claims against certain of the Director Defendants in the class action, two of which Reynolds represents to be premised on the shareholders' right to receive the withdrawn dividend, two of which regard "conduct . . . affecting the individual right of the holders of [WorldCom and MCI Tracking Stock shares] to make voting and investment decisions based upon accurate information." Reynolds argues that the Reynolds Action claims were not based on factual predicates identical to those underlying the class action claims. He argues that the scope of the Release should thus be **[**69]** modified to exclude his claims.

The Release is not overly broad in its present form. As noted above, the effect of the Release is limited by the "identical factual predicate" and "adequacy of representation" requirements that the Second Circuit has imposed. Given that Reynolds will only be able to litigate his Reynolds Action claims if he succeeds on his appeal of the bankruptcy court's determination, his objection to the Release is based on highly speculative concerns. Whether the specific claims pleaded in the Reynolds Action are barred by the Release is not a determination that needs to be made at this time. It should be noted, however, that Reynolds' complaint relies on allegations that WorldCom's board of directors had knowledge that WorldCom's financial statements were inaccurate and declared the dividend in March 2002 anyway. Such allegations fall squarely within the Class Period and concern the same financial wrongdoing addressed by the class action.

c. Moulton

Moulton contends that the Release is overly broad in that it releases claims "that were never investigated nor prosecuted against the released parties." She also argues that the Release is improper because it extends **[**70]** to persons and entities never sued. Each objection is made generally and without identifying any specific claim or person. Moreover, Moulton's counsel pursued neither contention during his oral presentation at the Fairness Hearing. Moulton contends that, based on these arguments, the breadth of the Release renders the 2005 Settlements unfair due to lack of consideration.

As *Visa* makes clear, [HN13] the fact that a release covers claims not actually pursued by a plaintiff in a class action does not render the release overbroad. *See Visa*, 396 F.3d at 107. Moulton's argument that the Release applies to claims against persons and entities uninvolved in the class action litigation is inaccurate; the Release applies by its terms only in respect to certain Settling Defendant Releasees, each of whom is properly released because of a direct connection to a settling defendant or because of its contribution to the settlements. Accordingly, her argument that the settlements are unfair lacks merit.

3. Objections to the Supplemental Plan

[HN14] "To warrant approval, the plan of allocation must also meet the standards by which the settlement was scrutinized -- namely, it must be fair and **[**71]** adequate." *Maley v. Global Technologies Corp.*, 186 F. Supp. 2d 358, 367 (S.D.N.Y. 2002) (citation omitted). "An allocation formula need only have a reasonable, rational basis, particularly if recommended by experienced and competent class counsel." *Id.* (citation omitted).

a. Laub

Laub is a Class Member who purchased WorldCom securities during the Class Period and sold them on a series of **[*345]** dates prior to January 29, 2002. Laub's purchases add up to $ 59.2 million; his losses total more than $ 5 million. The Supplemental Plan, as originally proposed by the Lead Plaintiff and described in the Class Notice, provides no recovery to Class Members who sold securities prior to January 29, 2002, which is the earliest date on which Lead Plaintiff found evidence that a partial disclosure of WorldCom's prior financial misstatements was made. Laub argues, first, that Class Members should have had notice before the opt-out period closed that damages would be allocated in this manner. The fact that Class Members who sold prior to January 29, 2002 would not recover was not apparent to the Class until the Supplemental Plan was mailed out in July 2005, well after the opt-out date **[**72]** of September 1, 2004. Second, Laub argues that this allocation of damages is unfair, citing the loss causation analysis in *In re Parmalat Securities Litigation*, 375 F. Supp. 2d 278, 305-06 (S.D.N.Y. 2005).

In response to these objections, the Lead Plaintiff has proposed an alternative allocation for Exchange Act claimants that it opines would also be fair and reasonable. This alternative would provide recovery for losses incurred in sales of WorldCom securities prior to January 29, 2002, but would limit the Recognized Amount for such losses to ten percent of the Recognized Amount for losses from sales on or after that date. It would be entirely reasonable to adhere to the Supplemental Plan as originally proposed by the Lead Plaintiff and provide recovery under the Exchange Act to only those Class Members who sold or held securities on or after January 29, 2002. As discussed below, it is unlikely that any losses sustained in the trading of WorldCom securities before that date can as a matter of law or fact be attributed to the filing of false financial statements by WorldCom. Nonetheless, it is also reasonable and perhaps fairer to give some modest recovery to Class **[**73]** Members who suffered losses prior to January 29, 2002.

One plea from a Class Member illustrates the problem. In an e-mail message to the U.S. Attorney's Office Victim/Witness Coordinator that was forwarded to the Court, Class Member Tom Roberts argues that fraud was occurring while he held his stock and justifies some recompense. He believed something was wrong about WorldCom's reported performance and "tried to be proactive" by selling promptly. He sold all of his WorldCom stock by January 21, 2000, suffering losses of approximately $ 174,000, and would have suffered an even greater loss if he had waited until 2002 to sell. He feels he should not be excluded from all recovery because of his prescience and diligence.

None of the notices sent to the Class before the opt-out period closed advised Class Members that January 29, 2002, or any other date, might be the cut-off date for recovery. While it was not feasible or necessary to give such notice, in its absence, Class Members may have formed an expectation that they could participate in any recovery that the Lead Plaintiff would be able to achieve for the Class.

The Lead Plaintiff's proposal that the recovery for those who sold **[**74]** before January 29, 2002 be limited to ten percent of the settlement fund strikes the proper balance. [HN15] Under Exchange Act Section 10(b), [39] loss causation "is the causal link **[*346]** between the alleged misconduct and the economic harm ultimately suffered by the plaintiff." *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir. 2005) (citation omitted); *see also* 15 U.S.C. § 78u-4(b)(4). It is "often compared . . . to the tort law concept of proximate cause, meaning that the damages suffered by plaintiff must be a foreseeable consequence of any misrepresentation or material omission." *Emergent Capital Investment Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 1993) (citation omitted). In *Lentell*, the Second Circuit reiterated two requirements for establishing loss causation. A plaintiff must prove "both that the loss [was] foreseeable *and* that the loss [was] caused by the materialization of the concealed risk." *Lentell*, 396 F.3d at 173 (emphasis in original).

39 [HN16] The loss causation analysis under Securities Act Section 11 is a "mirror image" of that under Section 10(b). *WorldCom*, 2005 U.S. Dist. LEXIS 2216, 2005 WL 375314 at *6. Under Section 11, that a plaintiff's losses were attributable to factors other than disclosure of the alleged misstatements is an affirmative defense; that the alleged misstatements caused the plaintiff's losses is an element of a Section 10(b) offense. *See id.*

[75]** Laub's counsel indicated in a reply brief and at the Fairness Hearing that Laub objected to the ten percent allocation, so Laub's original objection will be construed as one to the revised Supplemental Plan. In *Parmalat*, the case on which Laub relies, the court concluded that evidence of a corrective disclosure, such as that to which the January 29, 2002 date is tied in this class action, is not necessary to establish loss causation under Exchange Act Section 10(b). *See Parmalat*, 375 F. Supp. 2d at 305. *Parmalat* cited *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 98 (2d Cir. 2001), for the proposition that no corrective disclosure is needed when "plaintiffs allege that the *subject* of the misrepresentations and omissions caused their loss." *Parmalat*, 375 F. Supp. 2d at 306 (emphasis added). In *Suez Equity*, the alleged misrepresentations regarded the skills and experience of the principal of the company in question. The court ruled that "since defendants reasonably could have foreseen that [the individual's] concealed lack of skill would cause the company's eventual liquidity problems, defendants' **[**76]** misrepresentations may be the causal precursor to the [company's] final failure." *Suez Equity*, 250 F.3d at 98. In *Lentell*, the Second Circuit explicitly stated that interpreting *Suez Equity* to stand for the proposition that a plaintiff need not prove that investors' losses were caused by the materialization of a concealed risk would be a misreading of the case. *Lentell*, 396 F.3d at 173. *Parmalat* was wholly consistent with *Lentell*, making clear that the risk disguised by the misrepresentation alleged in that case had materialized -- Parmalat, which had massive undisclosed debt, began defaulting in its payments to bondholders -- and hence had "arguably caused the decline in shareholder and bondholder value." *Parmalat*, 375 F. Supp. 2d at 307.

Neither Laub nor any other objector has identified any partial disclosure of the WorldCom fraud that occurred earlier than January 29, 2002. At the Andersen trial, Lead Plaintiff's expert attributed all declines in the market price of WorldCom's stock before January 29, 2002 to market conditions or industry factors, and Lead Counsel has submitted charts in connection with its application **[**77]** for approval of the modified Supplemental Plan which show that the declines in the price of WorldCom stock [40] prior to January 29, 2002 were consistent with the declines in the stock prices of AT&T and Sprint, WorldCom's chief competitors. Moreover, Laub does not point to an earlier date on which a concealed risk materialized in *any* manner. His arguments for why the reasoning of *Parmalat* should apply here are thus unconvincing.

40 Since the price of WorldCom bonds did not fall below par until after January 29, 2002, those Class Members who sold bonds before that date did not sustain any compensable loss and are unaffected by this dispute.

[*347] Laub argues that WorldCom's fraudulent reporting of its line costs, its misclassification of assets in connection with acquisitions to inflate earnings, its failure to record timely impairment in the value of goodwill, and a dubious analytical model used by SSB securities analyst Jack Grubman [41] to tout WorldCom securities "were all subjects of Defendants' material **[**78]** misrepresentations and omissions that caused WorldCom investors' losses and it was foreseeable that they would eventually do so." Without materialization of a concealed risk, however, such allegations are insufficient to prove loss causation, as all that they establish is that the price of WorldCom securities was inflated by the misrepresentations. As the Supreme Court recently confirmed in *Dura Pharmaceuticals, Inc. v. Broudo*, 161 L. Ed. 2d 577, U.S. , 125 S. Ct. 1627 (2005), [HN17] "normally . . . an inflated purchase price will not itself constitute or proximately cause the relevant economic loss." *Id.* at 1631. Unless Laub can establish that his losses were attributable to some form of revelation to the market of the wrongfully concealed information, they are not recoverable in a private securities action. Such actions are available, after all, "not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause." *Id.* at 1633.

41 Grubman was one of the Citigroup Defendants.

[79]** In light of this loss causation analysis, the new Supplemental Plan providing ten percent of the normal recovery to those who sold their stock before January 29, 2002 is fair. It would be highly unlikely, based on the facts unearthed through significant investigation and discovery in this case, that a plaintiff could establish that losses from the sale of WorldCom securities prior to that date were attributable to the WorldCom fraud. Indeed, the financial manipulation at WorldCom kept the prices of its securities artificially inflated and illegally protected WorldCom investors to some degree before the corrective disclosures were made. The Lead Plaintiff would have been highly motivated to find evidence of disclosures of the WorldCom fraud to the market prior to January 29, 2002, as such evidence would have allowed it to submit a damages calculation under which a smaller proportion of the decline in the price of WorldCom stock was attributable to other factors. [42] The Court is thus confident that the interests of Laub and similarly situated Class Members were well-represented in this regard.

42 Even the defendants, who were highly motivated to locate the earliest "inquiry notice" date possible to support their statute of limitations motion brought against certain WorldCom Individual Actions, only argued that investors were on notice of the fraud as of April 20, 2002. *See In re WorldCom, Inc. Sec. Litig.*, 294 F. Supp. 2d 431, 446-47 (S.D.N.Y. 2003).

[80]** Laub argues that his substantial losses from trading that ended by January 11, 2000 deserve equal treatment with losses incurred by investors who sold or held securities after January 29, 2002. Lead Counsel points out that all of Laub's trading occurred when WorldCom was still trading above $ 40 per share, while after January 29, 2002, WorldCom traded from approximately $ 10 to $ 1 per share. Depending on when they had purchased their shares, the Class Members who sold their shares in the latter period (or who retained their shares) suffered devastating losses.

Laub argues that only speculators bought WorldCom securities after January 29, 2002, and that speculators are less entitled to recovery than investors like him. Laub, who made ten purchases between **[*348]** May 1999 and January 2000, buying between $ 2 million and $ 9 million of stock on each occasion, sold his WorldCom stock within a few weeks or even a few days of purchase. This is not the pattern of a long-term investor. In any event, the Supplemental Plan distinguishes among Class Members by their date of sale, not their date of purchase. Laub has provided no basis to find that the investors who sold after January 29, 2002 also **[**81]** purchased their securities after that date, or any other basis to denigrate this entire category of investors as speculators. Moreover, the Supplemental Plan provides the larger recovery not just to those investors who sold their shares after January 28, 2002, but also to those who still held their shares as of June 25, 2002.

As noted above with respect to the Berger objection, settlement proceeds may be allocated with respect to the strengths and weaknesses of various claims. *In re Holocaust Victim Assets Litig.*, 413 F.3d at 186. The Lead Plaintiff cites at least four cases that approve a much smaller settlement distribution to class members with pre-disclosure sales of securities. *See Global Techs. Corp.*, 186 F. Supp. 2d at 367 (awarding twenty percent of their recognized losses); *In re MicroStrategy, Inc. Sec. Litig.*, 148 F. Supp. 2d 654, 668 (E.D. Va. 2001) (ten percent); *In re Ikon Office Solutions, Inc. Securities Litigation*, 194 F.R.D. 166, 184 (E.D. Pa. 2000) (ten percent and less); *In re Sapiens Secs. Litig.*, 1996 U.S. Dist. LEXIS 17644, No. 94 Civ. 3315 (RPP), 1996 WL 689360, at *2 (S.D.N.Y. Nov. 27, 1996) **[**82]** (thirty percent); *cf. also Stoneridege Inv. Partners LLC v. Charter Communs., Inc. (In re Charter Communs., Inc.)*, No 4:02-CV-1186 CAS, 2005 U.S. Dist. LEXIS 14772, at *33 (E.D. Mo. June 30, 2005) (allocating settlement funds on basis of the relative strengths and weaknesses of class members' individual claims and the timing of purchases and sales of the securities at issue); *In re Gulf Oil/Cities Serv. Tender Offer Litig.*, 142 F.R.D. 588, 596 (S.D.N.Y. 1992) (same).

Laub argues in his reply brief that the proposed allocation of ten percent of the regular Recognized Amount for sales prior to January 29, 2002 is entirely arbitrary. There is no mathematical formula that can be used to determine precisely how much of the Exchange Act settlement funds should be shared with investors who have only a very remote probability of any recovery through litigation but who for the reasons already explained deserve a modest share of recovery. The Lead Plaintiff has chosen a figure that is fair and reasonable in the circumstances.

Finally, Class Members had fair and adequate notice that they would be bound by the terms of any judgment or settlement unless they opted out of the class action by the prescribed date. **[**83]** As Laub notes, the December 2003 Notice stated that "If you choose to remain in the Class, you will be entitled to your share of any money awarded to the Class either through a settlement with the defendants . . . ." The December 2003 Notice also specified, however, that "in the event of a settlement, Lead Plaintiff will be required to obtain preliminary approval of such a settlement from the Court, including preliminary approval for a proposed plan of allocation for settlement proceeds. . . . The Court will only give final approval to a proposed settlement and plan of allocation if the Court finds them to be fair, adequate, and reasonable to the members of the Class." In the Citigroup Settlement Notice, mailed prior to the September 1, 2004 opt-out deadline, Class Members were informed that the Supplemental Plan, to be submitted to the Court "at a future time," would determine "how each portion of the Settlement proceeds shall be allocated" to the Class. Class Members were also advised on the first page of the Citigroup Settlement Notice that "some Class Members may recover more or less . . . depending on, among **[*349]** other factors, when their shares and bonds were purchased or sold." None **[**84]** of these statements can be construed as a promise to Class Members that all claims would be treated as if equal in merit. Laub's objection must accordingly be rejected. [43]

43 At the Fairness Hearing, Laub's attorney intimated that the Lead Plaintiff had intentionally

delayed disclosure of the Supplemental Plan. There is absolutely no basis for such an accusation. It was prudent and entirely reasonable to delay development of the Supplemental Plan until expert damages reports had been served, and indeed, until after the 2005 Settlements had been achieved.

Laub's attorney also argued that the allocation of ten percent of the normal recovery to Class Members who sold their securities prior to January 29, 2002 disadvantages Class Members who elected not to submit proofs of claim because they believed they would not recover, and that another notice period is therefore necessary. This argument has no merit, however, in light of the fact that the original deadline for filing a proof of claim was March 4, 2004, a date before the Supplemental Plan had been developed and distributed to Class Members and before the announcement in the Hearing Order that Class Members would have a second opportunity to submit proofs of claim. Any Class Member, regardless of the date on which she sold her securities, who wished to preserve her right to share in the eventual recovery should have filed a proof of claim before the March deadline; the second opportunity was essentially a windfall.

On September 15, 2005, Laub submitted an objection to the proposed Order approving the modified Supplemental Plan of Allocation. Laub argues that the modified Supplemental Plan was not supported by documents and affidavits showing its reasonableness and fairness to Class Members. Counsel for the Lead Plaintiff did attest to its fairness in a supplemental declaration accompanying Lead Plaintiff's reply brief, as well as at the Fairness Hearing. Laub also makes several arguments to the effect that no evidentiary basis exists for a finding that the Supplemental Plan is reasonable as modified. These arguments have already been addressed.

[85]** b. The Cerberus Objectors

The Cerberus Objectors, who purchased more than $ 140 million of WorldCom securities during the Class period, have two objections to the Supplemental Plan. Both of these have been resolved by agreement with the Lead Plaintiff.

First, the Cerberus Objectors contend that, in Paragraphs 18 and 19 of the Supplemental Plan, the methodology for determining Recognized Amounts for bonds purchased in the 2000 and 2001 Offerings overvalues the "aggregate value of consideration received" for the bonds in the WorldCom bankruptcy proceeding. The Supplemental Plan currently states the amount of consideration as $ 357 per $ 1000 face amount. The Cerberus Objectors argue that the amount of consideration is actually $ 255 per $ 1000 face amount for bonds exchanged for new common stock in accordance with WorldCom's Plan of Reorganization, as the $ 255 represents the corresponding market value of the common stock on the date the bonds were actually exchanged.

In WorldCom's Second Amended Joint Plan of Reorganization, approved by the bankruptcy court on October 21, 2003, WorldCom bondholders were given the choice of exchanging their notes for 14.28 shares of newly issued **[**86]** MCI common stock per $ 1000 face amount, new notes in a principal amount equal to $ 357 per $ 1000 face amount, or some combination of MCI common stock and new notes. Bondholders overwhelmingly opted for the notes, however, so the notes were oversubscribed. According to a September 13, 2005 submission by Lead Counsel, bondholders who requested notes in fact received only 46.85% of the notes that they sought; the remaining value of their distribution was in the form of MCI stock. Based on this ratio, the Lead Plaintiff proposes that the Supplemental Plan be altered to use a value of $ 302 per $ 1000 **[*350]** face amount of bonds to reflect the consideration received by bondholders in the WorldCom bankruptcy. Lead Plaintiff's proposal is fair and reasonable, and is approved.

Second, the Cerberus Objectors note that Paragraph 24 of the Supplemental Plan defines WorldCom Predecessor Bonds to include bonds issued by Intermedia, an entity acquired by WorldCom in September 2000, but does not provide a methodology for determining Recognized Amounts relating to purchases of Intermedia 13 1/2% Preferred Stock due 2009 ("Intermedia 13 1/2% Preferred Stock"). In response to this objection, the Lead Plaintiff **[**87]** notes that it did not originally have sufficient trading data for Intermedia 13 % Preferred Stock but has since acquired more information. It has accordingly proposed a modification to the Supplemental Plan allowing Recognized Amounts to be calculated for purchases of this stock using the same methodology used in the Supplemental Plan to calculate Recognized Amounts for other forms of Intermedia preferred stock. Lead Plaintiff's proposal to allow Recognized Amounts to be calculated for the Intermedia 13 % Stock is approved. [44]

44 The Cerberus Objectors dropped two of the four objections they originally filed. They argued that Paragraph 27.b. of the Supplemental Plan should be altered to reflect that the Net Market Loss (or Net Market Profit) of each claimant is to be determined by netting profits and losses only on securities purchased or acquired during the Class Period, rather than subsequent to the Class Period. At the Fairness Hearing, their counsel agreed that this alteration is unnecessary, as the Supplemental Plan, at Paragraphs 2 and 27, clearly indicates that Recognized Amounts are only calculated for purchases or acquisitions made during the Class Period.

The Cerberus Objectors also took issue with the fact that the Supplemental Plan does not provide a mechanism to dispute or appeal the Claims Administrator's determination of a claimant's Aggregate Recognized Amounts or Claim Form Amounts. As the Lead Plaintiff's reply brief explains, the Hearing Order prescribes a dispute resolution mechanism pursuant to which each Class Member who is determined to have a deficient or rejected claim will be sent a letter informing her of this determination and will have thirty days from the date of the letter to supply documentation or an explanation to the Claims Administrator. If the Class Member does not respond, the Class Member's claim will be considered finally rejected. If the Class

Member timely responds to the letter, Lead Counsel, through the Claims Administrator, will determine if the documentation or explanation has remedied the deficiency or rejection. If it has not, the claim will be deemed finally rejected at that time. All such finally rejected claims will be submitted to the Court when the Lead Plaintiff moves for an Order approving distribution of the settlement funds. Notice of any hearing on such a motion will be provided to all Class Members whose claims are disputed. In addition, Lead Plaintiff contemplates making two distributions of the settlement funds. The first distribution will be of approximately ninety percent of the overall funds, while ten percent will be held back to assure that sufficient funds remain in the event that a Class Member successfully objects to a distribution. At the Fairness Hearing, counsel for the Cerberus Objectors indicated that the procedures specified by the Lead Plaintiff were satisfactory.

[88]** c. Moulton

Moulton contends that "intraclass conflicts" exist between purchasers of bonds in the 2000 and 2001 Offerings, who have Securities Act claims against the various defendants, and purchasers of other WorldCom securities. Since she characterizes her objection as one to the Plan of Allocation, she presumably does not intend to argue that conflicts of interest existed between these classes of securities holders in the prosecution of the action itself. Moulton's objection is entirely conclusory, and her attorney did not elaborate on it at the Fairness Hearing, but she appears to **[*351]** be objecting to the allocation of settlement funds between purchasers of bonds giving rise to Securities Act claims and purchasers of other securities on which Exchange Act claims are premised.

Moulton is correct that there is tension between the interests of Class Members with Securities Act and Exchange Act claims. With respect to the Underwriters' Settlements, however, it would be manifestly unfair to allocate those monies to purchasers of stock and pre-existing bonds with only Exchange Act claims, as the Underwriter Defendants faced only Securities Act claims arising from their participation in **[**89]** the 2000 and 2001 Offerings. The proceeds of the Directors', Andersen, Ebbers, and Sullivan Settlements are to be allocated in a 4:1 ratio of Exchange Act to Securities Act claims. [45] Although this ratio favors Class Members with Exchange Act claims, it is entirely appropriate given the very substantial recovery obtained for Class Members who purchased bonds in the 2000 and 2001 Offerings. The Class was represented by four named defendants, each with different stakes in the litigation. The Lead Plaintiff did not purchase bonds from the 2000 and 2001 Offerings, while the remaining three named defendants did do so. Their agreement that the 4:1 ratio is appropriate adequately addresses any concerns about the existence of a conflict. It is noteworthy that the Settlement Judges endorsed this ratio in their statement in support of the Andersen Settlement.

45 This Opinion will not address the Plan of Allocation for the Citigroup Settlement, as the

allocation of those funds was announced to the Class at the time of that settlement, and objections to the terms of the Citigroup Settlement that were not timely raised are now waived.

[90]** d. Norman

Norman is the proposed class representative for a lawsuit brought by persons who participated in SSB's Guided Portfolio Management ("GPM") program (the "GPM Action"). The accounts in the GPM program were discretionary accounts, for which brokers rather than account holders made the investment decisions. Norman alleges claims of breach of contract and breach of fiduciary duty, as well as a claim under the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6, against SSB, one of the Citigroup Defendants. According to Norman, "the core of [the GPM Action] complaint is that SSB invested its GPM customers' accounts based on research and ratings of securities SSB knew to be unreliable and provided by analysts who had a conflict of interest." The Norman action is pending before the Honorable Gerard E. Lynch. No class has been certified in the action. On June 9, 2004, finding that the complaint did not contain any allegation of fraud or misrepresentation, Judge Lynch denied a motion to dismiss the action that had argued that Norman's state law causes of action were preempted by Securities Litigation Uniform Standards Act (SLUSA). *Norman v. Salomon Smith Barney, Inc.*, 350 F. Supp. 2d 382, 386 (S.D.N.Y. 2004). **[**91]**

Despite the filing of his separate action, Norman did not opt out of the WorldCom class action. Norman objects to Paragraph 17 of the Supplemental Plan on the basis that it provides no recovery for GPM program members who sold securities before January 29, 2002. While he believes it may be appropriate to deny recovery to other Class Members who sold before that date, he contends that GPM program members should be treated differently. Although, as discussed above, Paragraph 17 of the Supplemental Plan is to be revised to provide Class Members who sold their WorldCom securities prior to January 29, 2002 with ten percent of the Recognized **[*352]** Amounts for other losses sustained by Class Members, Norman's attorney indicated at the Fairness Hearing that Norman continued to object to the allocation insofar as it does not adequately compensate GPM program members. In addition, Norman asks for a set-aside of $ 50 million on behalf of all GPM program members who are Class Members to compensate them for what he estimates were their $ 500 million in trading losses. He argues that GPM program members deserve special treatment because of the uniqueness and strength of their claims.

The November 12, 2004 Opinion **[**92]** approving the Citigroup Settlement allowed Norman to renew a request for a set-aside when the Supplemental Plan was issued. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *13 n.35. That Opinion also determined that, to the extent Norman's claims were based on the purchase of WorldCom securities, they were based on the "same underlying factual allegations against SSB that are at the heart of the [class action complaint]" and thus were properly barred by the claims release imposed pursuant to the Citigroup Settlement. 2004 U.S. Dist. LEXIS 22992, [WL] at *13. This Court's reasoning was recently confirmed in an opinion by Judge Lynch regarding Norman's objection to a virtually identical claims release in another securities litigation. *See In re Global Crossing Sec. Litig.*, 2005 U.S. Dist. LEXIS 14245, No. 02 Civ. 910 (GEL), 2005 WL 1668532, at *4 (S.D.N.Y. July 12, 2005) (concluding that, to the extent Norman's claims could be fairly characterized as arising out of or relating to a decision to invest in Global Crossing securities, their release was "entirely appropriate"). To the extent Norman's objection is a renewed attack on the Release, and the well-established principle that [HN18] a release may bar causes of action other **[**93]** than those litigated in the class action, it is rejected.

Norman contends that the theory of damages applicable to the GPM Action is fundamentally different than the concept of loss causation applicable to the class action, and that the January 29, 2002 disclosure date on which the Supplemental Plan relies should thus not determine the distribution of settlement proceeds to GPM customers. [46] Norman is still unable to identify his theory of damages, however. [47] To the extent that Norman's claims are based on investments in securities issued by WorldCom, the damages calculation would certainly be based on a theory of loss due to the misrepresentations of WorldCom's financial condition and SSB's alleged complicity in that fraud. These factors explain the decline in the market price of WorldCom securities, a decline experienced by all securities holders regardless of where or how they held their securities. In this regard, the Supplemental Plan is as fair to GPM customers who sold their WorldCom securities prior to January 29, 2002 as it is to other Class Members who sold their securities prior to that date, because the loss causation analysis is the same. As explained with regard to **[**94]** the Laub objection, January 29, 2002 was the first date upon which the Lead Plaintiff could point to a partial corrective disclosure. The decline in the price of WorldCom securities prior to that date must therefore be attributed to factors other than the fraud.

46 Norman also notes that the GPM class action does not rest on the "fraud on the market" theory of causation. [HN19] The "fraud on the market" theory applies to transaction causation, however, not loss causation. *See WorldCom*, 219 F.R.D. at 291.

47 Norman could not identify his theory of damages at the September 9 Fairness Hearing or at the Citigroup Settlement fairness hearing. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *12.

[*353] As for Norman's request for a set-aside, it is completely lacking in merit. Norman provides no basis whatsoever for his damages figure on behalf of a class that has not even been certified. Moreover, he has provided no basis to find that the GPM claims are stronger than those prosecuted by the Class. Had **[**95]** that been his genuine belief, one would have expected someone seeking to represent a class of GPM account holders to opt out. Instead, he seeks to recover twice for losses associated with investments in WorldCom securities. It is telling that no other Class Member who purchased WorldCom securities through SSB is seeking special compensation. Because SSB's Jack Grubman was both the leading telecommunications analyst and cheerleader for WorldCom, SSB's recommendations were widely disseminated and can be fairly presumed to have affected the market for WorldCom securities and thus every investor in WorldCom. There is no principled basis to make a distinction in the amount of damages suffered based on the identity of a Class Member's broker. Norman's request for special treatment must accordingly be rejected.

4. Objection to the Proof of Claim Form

Thomason makes a narrow objection to the form of the Proof of Claim form. He notes that the Proof of Claim Form only has spaces for a Class Member to list direct purchases of WorldCom securities, and that there is no place to enter purchases of stock that were made for his benefit through an SSB Unit Investment Trust. Lead Counsel represents **[**96]** that such claims can be entered on the same form, with supporting documentation attached, and that the Claims Administrator will process such claims in the same manner as if the stock had been purchased directly by the Class Member. It represents that it has passed this information on to the few Class Members in Thomason's situation who have inquired. As such, Thomason's objection has been addressed.

Attorneys' Fees and Costs

When the Citigroup Settlement was approved in November 2004, Lead Counsel were awarded $ 141.5 million in attorneys' fees. Lead Counsel have applied for $ 194,600,000 in attorneys' fees for the 2005 Settlements, an amount which constitutes just under 5.5% of the total amount of the Underwriters', Directors', and Andersen Settlements. [48] Fees will be calculated separately for the Underwriters' Settlements and the Directors' and Andersen Settlements [49] so that no Class Member possessing solely Exchange Act claims (that is, claims arising from purchases of WorldCom securities other than those bonds issued in the 2000 and 2001 Offerings) will bear any part of the fee awarded on the basis of the Underwriters' Settlements. Broken down, the fee request is $ 187,720,000 **[**97]** for the Underwriters' Settlements, or approximately 5.5% of the $ 3,427,306,840 gained from those settlements, and $ 6,880,000 from the Directors' and Andersen Settlements, or approximately 5.5% of the $ 125,750,000 million recovered in those settlements. The total lodestar calculation submitted by Lead Counsel totals $ 83,183,238.70 through June 30, 2005. **[*354]** When combined with the attorneys' fees awarded pursuant to the Citigroup Settlement, the amount sought is equivalent to a lodestar multiple of 4.0. [50]

48 Lead Counsel obtained approval from the Lead Plaintiff, and from the Court on September 22, 2003, to employ a few other law firms to assist with document review and other discrete tasks under the supervision of Lead Counsel. This fee award will also compensate those assisting firms.

49 Lead Counsel request no fees whatsoever for the Officers' Settlements, although those

hours are used in the calculation of the total lodestar amount. Lead Counsel represents that, even if the time expended with respect to the Officers' Settlements was subtracted from the lodestar, the lodestar multiple would remain 4.0.

[98]**

50 Lead Counsel note that the Lead Counsel firms agreed to sustain their 2004 rates in 2005. If the firms had implemented a five percent fee increase, the lodestar multiple would be approximately 3.8. Moreover, fees are not requested for work that was performed by Lead Counsel after June 30, 2005, including filing papers in support of the settlements, plans of allocation, and supplemental plan; responses to objections; and the briefing of appeals.

In support of the application for attorneys' fees, Lead Counsel have provided an affidavit by Lebowitz [51] and a summary of time records, including hourly rates and number of hours worked, for all attorneys and paraprofessionals assigned to the case. The total number of hours worked was 277,862. Two firms, Barrack Rodos & Bacine ("Barrack Rodos") and Bernstein Litowitz Berger & Grossmann LLP ("Bernstein Litowitz"), accounted for 84,934 and 129,642 of these hours, respectively. The billing rates for Barrack Rodos, a firm based in Philadelphia, ranged from $ 350 to $ 580 per hour for partners, from $ 225 to $ 420 for associates, and from $ 90 to $ 175 **[**99]** for paralegals. The rates for Bernstein Litowitz, a New York City firm, ranged from $ 450 to $ 695 for partners, from $ 250 to $ 450 for associates, and from $ 155 to $ 185 for paralegals. [52]

51 As previously noted, Lebowitz is General Counsel for the Comptroller of the State of New York.

52 The Bernstein Litowitz summary reflects that one hour was worked by an associate billing at $ 500 an hour.

Despite full disclosure in the Class Notice that Lead Counsel would be requesting a fee not in excess of $ 195.4 million and payment of expenses in an amount not in excess of $ 12.5 million, no institutional investor has objected to this request, and many such investors are participating in the recovery achieved by the Class. Only one objection, that of Jane B. Selfe, remains to the attorneys' fees sought by Lead Counsel. [53] Selfe objects that 5.5% of such a large settlement fund is an unreasonable fee, citing *In re Domestic Air Transportation Antitrust Litigation*, 148 F.R.D. 297, 351 n.76 (N.D. Ga. 1993). **[**100]**

53 An objection to attorneys' fees and expenses filed by Moulton was withdrawn by her counsel at the Fairness Hearing.

It is unclear whether Selfe has standing to object to the application for attorneys' fees and expenses. The Lead Plaintiff represents that its records indicate that Selfe's only Class Period Acquisition of WorldCom Securities was through a stock split on December 31, 1999, a transaction that does not qualify as a true acquisition, and that Selfe did not file a proof of claim. Selfe submitted a reply stating that she did indeed "acquire" WorldCom securities during this period, but she submits nothing to substantiate this claim. Selfe also notes that she filed a proof of claim, but that it was late "through oversight." In any event, this Opinion must consider the question whether the attorneys' fees sought are reasonable, and thus, the substance of Selfe's objection is squarely addressed.

The Court is also in receipt of a letter from Gary L. Soderberg, who states, "I understand that there are many reasons for these [attorneys'] fees but this quantity appears prodigious." The substance of his concerns is likewise addressed in the discussion below.

[101]** [HN20] When attorneys create a common fund from which members of a class are compensated for a common injury, they are entitled to "a reasonable fee -- set by the court -- to be taken from the fund." *Goldberger v. Integrated Resources, Inc.*, 209 F.3d 43, 47 (2d Cir. 2000) (citation omitted); *see also* 15 U.S.C. § 78u-4(a)(6) (In Exchange Act cases governed by the PSLRA, "total attorneys fees and expenses awarded by the court to counsel for **[*355]** the plaintiff class shall not exceed a reasonable percentage of the amount of any damages and prejudgment interest actually paid to the class."). Determination of "reasonableness" is within the discretion of the district court. *Goldberger*, 209 F.3d at 47. There are two methods by which the court may calculate reasonable attorneys' fees in a class action, the lodestar method and the percentage method. Applying either method, the court should consider the following factors, known as the *Goldberger* factors: (1) the time and labor expended by counsel; (2) the magnitude and complexities of the litigation; (3) the risk of the litigation; (4) the quality of representation; (5) the requested fee in **[**102]** relation to the settlement; and (6) public policy considerations. *Visa*, 396 F.3d at 121 (citing *Goldberger*, 209 F.3d at 50).

[HN21] The lodestar method "calculates attorneys' fees by multiplying hours reasonably expended against a reasonable hourly rate." *Id.* at 123 n.27. The court may determine that an enhancement of the lodestar is warranted "based on factors such as the riskiness of the litigation and the quality of attorneys." *Id.*; *see also Savoie v. Merchants Bank*, 166 F.3d 456, 460 (2d Cir. 1999) (applying the lodestar steps).

[HN22] Under the percentage method, the fee award is simply "some percentage of the fund created for the benefit of the class." *Savoie*, 166 F.3d at 460. "The trend in this Circuit is toward the percentage method, which directly aligns the interests of the class and its counsel and provides a powerful incentive for the efficient prosecution and early resolution of litigation." *Visa*, 396 F.3d at 121 (citation omitted). This method has been found to be a solution to various problems inherent in the lodestar method, which "creates an unanticipated disincentive to early **[**103]** settlements, tempts lawyers to run up their hours, and compels district courts to engage in a gimlet-eyed review of line-item fee audits." *Id.* at 121. Because of the practical and policy advantages of the percentage method, as well as [HN23] the PSLRA's express contemplation that the percentage method will be used to calculate attorneys' fees in securities fraud class actions, 15 U.S.C. § 78u-4(a)(6), this Opinion will apply the percentage method, with the lodestar used only as a cross-check of the reasonableness of the percentage of fees requested. *Cf. Visa*, 396 F.3d at 123. [HN24] Where the lodestar fee is used as "a mere cross-check" to the percentage method of determining reasonable attorneys' fees, "the hours documented by counsel need not be exhaustively scrutinized by the district court." *Goldberger*, 209 F.3d at 50.

Like the attorneys' fees awarded to Lead Counsel pursuant to the Citigroup Settlement, the fee request considered here accords with the retainer agreement negotiated in 2003 by the NYSCRF and Lead Counsel (the "Retainer Agreement") and has been submitted with the approval of the Lead Plaintiff. The Retainer **[**104]** Agreement was described in the December 11, 2003 notice to the class of the pendency of the class action, as well as in the notice of the proposed Citigroup Settlement mailed to Class Members in August 2004, and is posted on the Lead Counsel Website. The grid allows Lead Counsel to collect a higher fee for recoveries achieved in later stages of the litigation, but at the same time, provides for a lower percentage of recovery as the amount of recovery for the Class increases. The Retainer Agreement also adopted a lodestar ceiling for attorney's fees. For any recovery for the Class that exceeds $ 500 million, the attorney's fee is not to exceed the lesser of the grid amount or five times the lodestar. At the conclusion of the litigation, the NYSCRF may under certain circumstances adjust the fee so that it does not exceed four times the lodestar figure. The **[*356]** Retainer Agreement also imposes caps on certain expenses.

[HN25] A district court is not required to adhere to a retainer agreement such as the one used to determine the fee amount requested here. *See Visa*, 396 F.3d at 123-24. Nonetheless, when class counsel in a securities lawsuit have negotiated an arm's length agreement **[**105]** with a sophisticated lead plaintiff possessing a large stake in the litigation, and when that lead plaintiff endorses the application following close supervision of the litigation, the court should give the terms of that agreement great weight. *See In re Cendant Sec. Litig.*, 264 F.3d 201, 282 (3d Cir. 2001) (concluding that fee agreements between class counsel and the lead plaintiff enjoy "a presumption of reasonableness" under the PSLRA); *WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *20 (applying presumption of reasonableness where the Lead Plaintiff conscientiously supervised the work of Lead Counsel and endorsed the fee request). The establishment of criteria for the appointment of a lead plaintiff capable of exercising a significant supervisory role in the litigation, including management of the fees and costs, was an important innovation of the PSLRA. *See* Jill E. Fisch, *Lawyers on the Auction Block: Evaluating the Selection of Class Counsel by Auction*, 102 Colum. L. Rev. 650, 702-03 (2002) ("The lead plaintiff provision [of the PSLRA] was designed to enable large, sophisticated investors to investigate, negotiate with, and monitor class **[**106]** counsel."); 15 U.S.C. § 78u-4(a)(3)(B)(1) (providing that the lead plaintiff shall be "the member . . . of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members"); *id.* [HN26] §

78u-4(a)(3)(B)(iii)(I)(bb) (listing, as one of three factors establishing a rebuttable presumption of "most adequate plaintiff" status, "the largest financial interest in the relief sought by the class").

The NYSCRF is the second largest public pension fund in the United States and lost over $ 300 million on WorldCom investments. *See WorldCom*, 219 F.R.D. at 275. It has been actively involved in overseeing every aspect of the litigation. Lebowitz attests that his office "carefully reviewed and analyzed" Lead Counsel's daily time and expense records and the hourly rates for each attorney and paraprofessional who worked in the case. The NYSCRF did not shy away from exercising its negotiating power to rein in attorneys' fees; as noted above, it refused to allow the Lead Counsel firms to raise their rates for 2005 for purposes of calculating the lodestar fee -- "a significant concession," according **[**107]** to Lebowitz. Furthermore, the Retainer Agreement was not finalized until June 2003, after indictments had been filed against WorldCom officers and after a significant ruling had been issued on the motions to dismiss. *WorldCom*, 294 F. Supp. 2d 392. The risks and rewards of the litigation were therefore clearer than they would have been at the inception of the lawsuit, further informing negotiations regarding the fee grid. All these facts weigh in favor of abiding by the Retainer Agreement.

The *Goldberger* factors similarly weigh in favor of approval of Lead Counsel's fee request. The fee request is well within the range of other awards courts have approved in mega-fund litigation. [54] *Visa* **[*357]** itself approved attorneys' fees that constituted 6.5% of $ 3.383 billion in compensatory relief recovered for the class. The lodestar multiple in that case was 3.5, but the court cited a district court's statement that multipliers of between 3 and 4.5 are common. *See Visa*, 396 F.3d at 123 (quoting *In re NASDAQ Market-Makers Antitrust Litigation*, 187 F.R.D. 465, 489 (S.D.N.Y. 1998)). A number of other cases cited by Lead Counsel support the **[**108]** appropriateness of Lead Counsel's fee request on a percentage basis. *See, e.g., Reinhart v. Lucent Techs., Inc. (In re Lucent Techs., Inc. Sec. Litig.)*, 327 F. Supp. 2d 426, 445 (D.N.J. 2004) (approving a fee constituting 17% of a $ 517 million common fund); *Shaw v. Toshiba Am. Info. Sys., Inc.*, 91 F. Supp. 2d 942, 988 (E.D. Tex. 2000) (approving a fee of 7% of a common fund valued at $ 2.1 billion); *NASDAQ*, 187 F.R.D. at 488-89 (approving a fee constituting 14%, or a 3.97 lodestar multiple, of a $ 1.027 billion common fund); *see also* cases cited *id.* at 487. *But see In re Cendant Corp. Litig.*, 243 F. Supp. 2d 166, 172 (D.N.J. 2003) (in "a simple case in terms of liability . . . settled at an early stage, after little formal discovery," awarding only 1.7% of a $ 3.2 billion settlement (citation omitted)). [55]

54 It is noteworthy that William Lerach, who is now a named partner in the law firm Lerach Coughlin Stoia Geller Rudman Robbins LLP, actively solicited pension funds across the country to opt out of the WorldCom class action and file individual actions under a retainer agreement that provided a base fee of 12 or 13%, plus expenses, and a cap of 17%. *In re WorldCom Sec. Litig.*, 2003 U.S. Dist. LEXIS 20748, 2003 WL 22701241, at *4 (S.D.N.Y. Nov. 17, 2003). Those pension funds which accepted that solicitation run the risk of paying a

hefty premium to their counsel over and above the attorneys' fees and expenses that will be paid by those who remained Class Members.

[109]**

55 The case cited by objector Selfe, *In re Domestic Air Transportation Antitrust Litigation*, 148 F.R.D. 297, awarded attorneys' fees equivalent to 5.25% of a $ 305 million settlement fund. That case noted that, although fees of twenty to thirty percent are awarded in the typical common fund case, "fees in the range of 6-10% and even lower are common in [the] context [of megafund cases]." *Id.* at 351. The fee awards cited by the court in the accompanying footnote range from 3.5% for a $ 618 million settlement fund to 15% for a $ 171 million settlement. *Id.* at 351 n.76. Nothing in that case's analysis commands a finding that Lead Counsel's fee request is unreasonable.

The magnitude and complexity of this litigation are well-recognized. The Lead Plaintiff asserted damages claims of over $ 10 billion for bondholders and scores of billions of dollars in losses to WorldCom stockholders. The disclosure of the fraud led to the largest bankruptcy in American history and spurred an extraordinary quantity of litigation, the centerpiece of which was **[**110]** this class action. Because there was so much at stake, the parties in the class action fought long and hard. The ferocity with which the parties fought to the eve of trial, and in one instance, through trial, are described in the many Opinions issued to resolve the parties' active motion practice. While the criminal and regulatory investigations were of enormous assistance to the Lead Plaintiff in its prosecution of this action, particularly in the description of the accounting manipulations, since those investigations concentrated on wrongdoing by WorldCom's insiders, they were of little assistance in the development of the Lead Plaintiff's claims against the Underwriter Defendants or even Andersen, which required the Lead Plaintiff to explain how Andersen's audits failed to comply with Generally Accepted Auditing Standards (GAAS).

The impressive extent and superior quality of Lead Counsel's efforts as of May 2004 were described in detail in the Opinion approving the Citigroup Settlement. *See In re WorldCom, Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402, at *17-*20 (S.D.N.Y. Nov. 12, 2004). At the conclusion of this litigation, more than ever, it remains true that "the quality of representation that Lead Counsel has provided **[**111]** to the class has been superb." *WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402 at *20. The risks faced by the Class in obtaining further significant recovery in this litigation have already been described. Despite the existence of these risks, Lead **[*358]** Counsel obtained remarkable settlements for the Class while facing formidable opposing counsel from some of the best defense firms in the country. As Judge Sweet, one of the Settlement Judges in this litigation, aptly stated it in the *NASDAQ* case:

> The quality of opposing counsel is . . . significant in considering the quality of services rendered by plaintiff's counsel, as measured by the result achieved. . . . The ability of Class Counsel to obtain record-breaking settlements in the face of a stubborn and well executed defense further evidences the excellent quality of petitioners' work.

NASDAQ, 187 F.R.D. at 488. Even with the absence of the Citigroup Defendants from the case, this litigation remained enormously complex, and much of the heavy lifting by Lead Counsel came after the Citigroup Settlement. In addition to completing fact discovery, preparing experts, undertaking discovery of the defendants' **[**112]** experts, and addressing a thicket of legal issues in opposition to the Underwriters', Andersen, and Roberts motions for summary judgment and the motions *in limine*, Lead Counsel faced the practical and tactical challenges of readying the cases against the Underwriter Defendants, Director Defendants, and Andersen for trial. [56] At trial against Andersen, the quality of Lead Counsel's representation remained first-rate. Lead Counsel and counsel for Andersen waged a vigorous courtroom battle, which included the submission of numerous letters to the Court and oral argument regarding evidentiary issues nearly every single day, while exhibiting impressive cordiality and professionalism toward each other and toward the Court.

56 As noted above, the Underwriters' and Directors' Settlements occurred on the eve of trial, and the Andersen settlement at the close of the fourth week of trial.

The Lead Counsel firms also performed excellently on behalf of the Class in settlement negotiations. The Underwriters' Settlements **[**113]** were achieved after intensive negotiations with counsel for the individual Underwriter Defendants or small subsets of those defendants, and most settlements yielded funds exceeding the Citigroup Formula amount for Securities Act claims. To reach settlement agreements with the Director Defendants and the Officer Defendants, Lead Counsel and the Lead Plaintiff conducted a thorough examination of the financial status of each individual; a similar examination, performed in a flurry of activity over several short days near the end of the trial, made the Andersen Settlement possible. When negotiating the Ebbers Settlement, Lead Counsel negotiated not merely with Ebbers, but also with the U.S. Attorney's Office, MCI, and the WorldCom *ERISA Litigation* class plaintiffs' counsel, all entities with their own claims on Ebbers' resources, to construct an agreement that ultimately proved satisfactory to all concerned. Lead Counsel similarly worked with the U.S. Attorney's Office and ERISA counsel to achieve the Sullivan Settlement, and with the U.S. Attorney's Office to craft an agreement with insolvent defendants Myers and Yates. Again, Lead Counsel has not requested attorneys' fees in connection **[**114]** with the Ebbers, Sullivan, or Myers-Yates Settlements. The Citigroup Settlement Opinion mentioned the "cooperative spirit" that existed between Lead Counsel and Liaison Counsel for the Individual Actions. *See WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402 at *19. Lead Counsel have proven themselves adept at working with other counsel representing clients with varying, sometimes competing interests in the settlement context as well.

[*359] Public policy also supports the approval of this fee request. The size of the recovery achieved for the class which has been praised even by several objectors -- could not have been achieved without the unwavering commitment of Lead Counsel to this litigation. Several of the lead attorneys for the Class essentially devoted years of their lives to this litigation, with the personal sacrifices that accompany such a commitment. If the Lead Plaintiff had been represented by less tenacious and competent counsel, it is by no means clear that it would have achieved the success it did here on behalf of the Class. In order to attract well-qualified plaintiffs' counsel who are able to take a case to trial, and who defendants understand are able and willing to do so, **[**115]** it is necessary to provide appropriate financial incentives. After all, this litigation was conducted on an entirely contingent fee basis, and Lead Counsel paid millions of dollars to fund the litigation. While some significant recovery in a case of this magnitude may seem a foregone conclusion now, the recovery achieved here was never certain. It is only the size of the Citigroup and Underwriters' Settlements that make this recovery so historic, and it is likely that less able plaintiffs' counsel would have achieved far less.

There is yet another public policy benefit to be acknowledged. In this case, the work performed by Lead Counsel also inures to the benefit of those who opted out of the Class. It was Lead Counsel who developed, led, and took the bulk of the discovery in the *Securities Litigation*. Under the terms of the Consolidation and Coordination Orders entered in the *Securities Litigation*, that discovery is available to plaintiffs' counsel in all Individual Actions. Moreover, the settlements that Lead Counsel and Lead Plaintiff achieved serve as benchmarks for recoveries in all of the Individual Actions.

Finally, the fact that an active and well-qualified Lead Plaintiff **[**116]** has approved this fee and that the Class has not objected to it are also appropriate to consider when judging the public policy of approving a fee award that in its aggregate gives Lead Counsel $ 336.1 million in fees based on a total lodestar of approximately $ 83.2 million. This endorsement may reflect their judgment about the integral role that competent plaintiffs' counsel play in insuring the integrity of U.S. securities markets and supplementing the enforcement work of the SEC in that regard.

Costs and Expenses

Lead Counsel also seeks $ 10,736,948.25, plus interest, for reimbursement of expenses incurred since the Citigroup Settlement. Of this amount, $ 5,389,994.17 is for payment of expenses by Lead Counsel; $ 2,365,301.37 is owing from a litigation fund to which Lead Counsel and certain of the assisting firms had contributed; [57] $ 11,063.54 is for payment of the Lead Plaintiff's expenses; [58] and $ 2,970,589.17 is for payment to the Garden City Group, the Claims Administrator in the case, for the costs of mailing notices and processing claims for the class. In **[*360]** support of the application for reimbursement of expenses, the Lead Counsel firms have submitted, in addition **[**117]** to the Lebowitz Affidavit mentioned above, summaries of allowed expenses from September 1, 2004, to June 30, 2005 for each Lead Counsel firm, and at the Court's request, a summary of payments to experts and consultants.

57 The Citigroup Settlement had provided for the creation of a $ 5 million Litigation Fund out of the settlement proceeds to finance the continued prosecution of the class action against

the remaining defendants, *see WorldCom*, 2004 U.S. Dist. LEXIS 22992, 2004 WL 2591402 at *22, but that Litigation Fund was never funded.

58 Reimbursement of Lead Plaintiff's expenses is appropriate. *See* 15 U.S.C. § 78u-4(a)(4) [HN27] ("Nothing in this paragraph shall be construed to limit the award of reasonable costs and expenses . . . directly releating to the representation of the class to any representative party serving on behalf of a class.").

Reimbursement of the expenses sought by Lead Counsel is appropriate. *See LeBlanc-Sternberg v. Fletcher*, 143 F.3d 748, 763 (2d Cir. 1998). **[**118]** Lebowitz attests that the Lead Plaintiff has audited the expenses. In fact, it disallowed more than $ 200,000 in submitted expenses incurred since the Citigroup Settlement. The Lead Plaintiff approves of Lead Counsel's submission. As no objection remains to the amount of costs sought by Lead Counsel, and the expenses do not appear facially unreasonable, the application for reimbursement of expenses is approved.

Case Name:
Smith v. Sino-Forest Corp.

Between
Douglas Smith and Zhongjun Goa, Plaintiffs, and
Sino-Forest Corporation, Allen T.Y. Chan, James M.E. Hyde, Edmund Mak, W. Judson Martin, Simon Murray, Peter D.H. Wang, David J. Horsley, Ernst & Young LLP, BDO Limited, Credit Suisse Securities (Canada), Inc., TD Securities Inc., Dundee Securities Corporation, RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada, Inc., Canaccord Financial Ltd., and
Maison Placements Canada Inc., Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992
And between
The Trustees of the Labourers' Pension Fund of Central and Eastern Canada and the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario, Plaintiffs, and
Sino-Forest Corporation, Ernst & Young LLP, Allen T.Y. Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, William E. Ardell, Kai Kit Poon, David J. Horsley, James P Bowland James M.E. Hyde, Edmund Mak, Simon Murray, Peter Wang, Garry J. West, Pöyry (Beijing) Consulting Company Limited, Credit Suisse Securities (Canada), Inc., TD Securities Inc., Dundee Securities Corporation, RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada, Inc. Canaccord Financial Ltd., and
Maison Placements Canada Inc., Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992
And between
Northwest & Ethical Investments L.P., Comité Syndical National de Retraite Bâtirente Inc., Plaintiffs, and
Sino-Forest Corporation, Allen T.Y. Chan, W. Judson Martin, Kai Kit Poon, David J. Horsley, Hua Chen, Wei Mao Zhao, Alfred C.T. Hung, Albert Ip, George Ho, Thomas M. Maradin, William E. Ardell, James M.E. Hyde, Simon Murray, Garry J. West, James P. Bowland, Edmund Mak, Peter Wang, Kee Y. Wong, The Estate of

John Lawrence, Simon Yeung, Ernst & Young LLP, BDO Limited, Pöyry Forest Industry PTE Limited, Pöyry (Beijing) Consulting Company Limited, JP Management Consulting (Asia-Pacific) PTE Ltd., Dundee Securities Corporation, UBS Securities Canada Inc., Haywood Securities Inc., Credit Suisse Securities (Canada), Inc., TD Securities Inc., RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada, Inc. Canaccord Financial Ltd., Maison Placements Canada Inc., Morgan Stanley & Co. Incorporated, Credit Suisse Securities (USA), LLC, Merrill Lynch, Pierce, Fenner & Smith, Inc., Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992

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34 C.P.C. (7th) 76

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Court File Nos. 11-CV-428238CP, 11-CV-431153CP, 11-CV-435826CP

Ontario Superior Court of Justice

P.M. Perell J.

Heard: December 20 and 21, 2011.
Judgment: January 6, 2012.

(332 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Class counsel -- Definition of class -- Members of class or sub-class -- Representative plaintiff -- Motions by law firms for carriage of class action -- Carriage awarded to law firm acting in Labourers v. Sino-Forest -- There were three proposed class actions against Sino-Forest to recover alleged losses arising from crash in value of its shares and notes -- Determinative factors were characteristics of representative plaintiffs, definition of class membership, definition of class period, theory of case, causes of action, joinder of defendants and prospects of certification -- Neutral or non-determinative factors were attributes of class counsel; retainer, legal and forensic resources; funding; conflicts of interest; and plaintiff and defendant correlation.

Motions by law firms for carriage of a class action. Sino-Forest was a forestry plantation company. There were three proposed class actions against it to recover alleged losses arising from the crash in value of its shares and notes. The proposed class actions were Labourers v. Sino-Forest, Smith v. Sino-Forest and Northwest v. Sino-Forest. The proposed representative plaintiffs for Labourers v. Sino-Forest were three pension funds and two individuals. The proposed representative plaintiffs for Smith v. Sino-Forest were two individuals. The proposed representative plaintiffs for Northwest v. Sino-Forest were an investment management company, a non-profit financial services firm and a partnership that managed portfolios and investment funds. Labourers v. Sino-Forest included as class members shareholders and noteholders who purchased in Canada, but excluded non-Canadians who purchased in a foreign marketplace. Smith v. Sino-Forest included shareholders, but not bondholders. Northwest v. Sino-Forest included both, with no geographic limits. All proposed actions focused primarily on claims of negligence and negligent misrepresentation, but Northwest v. Sino-Forest also claimed fraudulent misrepresentation against all defendants. The law firms, in advancing their respective merits for carriage, made arguments raising as issues the characteristics of the representative plaintiffs; definition of class membership; definition of class period; theory of the case; causes of action; joinder of defendants; prospects of certification; attributes of class counsel; retainer, legal and forensic resources; funding; conflicts of interest; and the plaintiff and defendant correlation.

HELD: Carriage awarded to the law firm acting in Labourers v. Sino-Forest; stay of the other two proposed actions. The determinative factors were the characteristics of the representative plaintiffs, definition of class membership, definition of class period, theory of the case, causes of action, joinder of defendants and prospects of certification. The expertise and participation of the institutional candidates for representative plaintiffs, as investors in the securities marketplace, could contribute to the successful prosecution of the lawsuit on behalf of the class members. The institutional candidates were pursuing access to justice in a way that ultimately benefited other class members should their actions be certified as a class proceeding. The individual candidates might not be the best voice for their fellow class members. The institutional candidates could not opt out, which advanced judicial economy. They were already to a large extent representative plaintiffs as they were, practically speaking, suing on behalf of their own members, who numbered in the hundreds of thousands. Labourers v. Sino-Forest had the further advantage of individual investors who could give voice to the interests of similarly situated class members. The bondholders should be included as class members. They had essentially the same misrepresentation claims as the shareholders and it made sense to have their claims litigated in the same proceeding. This conclusion hurt the case for Smith v. Sino-Forest, even though it had the best class period. Reliance on fraudulent misrepresentation as a cause of action in Northwest v. Sino-Forest was a substantial weakness. That cause of action was less desirable than those used in the other two proposed actions. It added needless complexity and costs. It was far more difficult to prove. The class members were best served by the approach in Labourers v. Sino-Forest. Neutral or non-determinative factors for purposes of carriage were the attributes of class counsel; retainer, legal and forensic resources; funding; conflicts of interest; and the plaintiff and defendant correlation. There was little difference among the law firms in terms of their suitability for bringing a proposed class action against

Sino-Forest. The fact that the three institutional candidates for representative plaintiffs in Northwest v. Sino-Forest made their investments on behalf of others did not create a conflict of interest. Nor did allegations that they, having been involved in corporate governance matters associated with Sino-Forest, failed to properly evaluate the risks of investing in it. There was no conflict of interest based on the fact that Labourers' auditor was an international associate of a defendant. There was no conflict of interest between the bondholders and shareholders merely because the bondholders, unlike the shareholders, also had a cause in action in debt.

Statutes, Regulations and Rules Cited:

Act Respecting the Distribution of Financial Products and Services, R.S.Q., chapter D-9.2,

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 50(14)

Canada Business Corporations Act, R.S.C. 1985, c. C-44,

Class Proceedings Act, 1982, S.O. 1992, c. 6, s. 12, s. 13, s. 35

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1(2)

Courts of Justice Act, R.S.O. 1990, c. 43, s. 138

National Instrument 51-102,

Ontario Securities Act, R.S.O. 1990, c. S.5, s. 1(1), s. 138.1, s. 138.5, s. 138.14, Part XVIII, Part XXIII, Part XXIII.1, Part XXX.1

Private Securities Litigation Reform Act of 1995 (U.S.),

Public Sector Pension Plans Act,

Rules of Civil Procedure, S.O. 1992, c. 6, Rule 1.04, Rule 6

Counsel:

J.P. Rochon, J. Archibald and S. Tambakos, for the Plaintiffs in 11-CV-428238CP.

K.M. Baert, J. Bida, and C.M. Wright for the Plaintiffs in 11-CV-431153CP.

J.C. Orr, V. Paris, N. Mizobuchi, and A. Erfan for the Plaintiffs in 11-CV-435826CP.

M. Eizenga, for the defendant Sino-Forest Corporation.

P. Osborne and S. Roy, for the defendant Ernst & Young LLP.

E. Cole, for the defendant Allen T.Y. Chan.

J. Fabello, for the defendant underwriters.

[Editor's note: A corrigendum was released by the Court January 27, 2012; the corrections have been made to the text and the corrigendum is appended to this document.]

REASONS FOR DECISION

P.M. PERELL J.:--

A. INTRODUCTION

1 This is a carriage motion under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6. In this particular carriage motion, four law firms are rivals for the carriage of a class action against Sino-Forest Corporation. There are currently four proposed Ontario class actions against Sino-Forest to recover losses alleged to be in the billions of dollars arising from the spectacular crash in value of its shares and notes.

2 Practically speaking, carriage motions involve two steps. First, the rival law firms that are seeking carriage of a class action extoll their own merits as class counsel and the merits of their client as the representative plaintiff. During this step, the law firms explain their tactical and strategic plans for the class action, and, thus, a carriage motion has aspects of being a casting call or rehearsal for the certification motion.

3 Second, the rival law firms submit that with their talent and their litigation plan, their class action is the better way to serve the best interests of the class members, and, thus, the court should choose their action as the one to go forward. No doubt to the delight of the defendants and the defendants' lawyers, which have a watching brief, the second step also involves the rivals hardheartedly and toughly reviewing and criticizing each other's work and pointing out flaws, disadvantages, and weaknesses in their rivals' plans for suing the defendants.

4 The law firms seeking carriage are: Rochon Genova LLP; Koskie Minsky LLP; Siskinds LLP; and Kim Orr Barristers P.C., all competent, experienced, and veteran class action law firms.

5 For the purposes of deciding the carriage motions, I will assume that all of the rivals have delivered their Statements of Claim as they propose to amend them.

6 Koskie Minsky and Siskinds propose to act as co-counsel and to consolidate two of the actions. Thus, the competition for carriage is between three proposed class actions; namely:

* *Smith v. Sino-Forest Corp.* (11-CV-428238CP) ("*Smith v. Sino-Forest*") with Rochon Genova as Class Counsel
* *The Trustees of Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.* (11-CV-431153CP) ("*Labourers v. Sino-Forest*") with Koskie Minsky and Siskinds as Class Counsel (This action would be consolidated with "*Grant. v. Sino Forest*" (CV-11-439400-00CP)
* *Northwest & Ethical Investments L.P. v. Sino-Forest Corp.* (11-CV-435826CP) ("*Northwest v. Sino-Forest*") with Kim Orr as Class Counsel.

7 It has been a very difficult decision to reach, but for the reasons that follow, I stay *Smith v. Sino-Forest* and *Northwest v. Sino-Forest,* and I grant carriage to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest.*

8 I also grant leave to the plaintiffs in *Labourers v. Sino-Forest* to deliver a Fresh as Amended Statement of Claim, which may include the joinder of the plaintiffs and the causes of action set out in *Grant v. Sino-Forest, Smith v. Sino-Forest,* and *Northwest v. Sino-Forest,* as the plaintiffs may be advised.

9 This order is without prejudice to the rights of the Defendants to challenge the Fresh as Amended Statement of Claim as they may be advised. In any event, nothing in these reasons is intended to make findings of fact or law binding on the Defendants or to be a pre-determination of the certification motion.

B. METHODOLOGY

10 To explain my reasons, first, I will describe the jurisprudence about carriage motions. Second, I will describe the evidentiary record for the carriage motions. Third, I will describe the factual background to the claims against Sino-Forest, which is the principal but not the only target of the various class actions. Fourth, deferring my ultimate conclusions, I will analyze the rival actions that are competing for carriage under twelve headings and describe the positions and competing arguments of the law firms competing for carriage. Fifth, I will culminate the analysis of the competing actions by explaining the carriage order decision. Sixth and finally, I will finish with a concluding section.

11 Thus, the organization of these Reasons for Decision is as follows:

* Introduction
* Methodology
* Carriage Orders Jurisprudence
* Evidentiary Background
* Factual Background to the Claims against Sino-Forest
* Analysis of the Competing Class Actions

- The Attributes of Class Counsel
- Retainer, Legal and Forensic Resources, and Investigations
- Proposed Representative Plaintiffs
- Funding
- Conflicts of Interest
- Definition of Class Membership
- Definition of Class Period
- Theory of the Case against the Defendants
- Joinder of Defendants
- Causes of Action
- The Plaintiff and the Defendant Correlation
- Prospects of Certification

* Carriage Order

  - Introduction
  - Neutral or Non-Determinative Factors
  - Determinative Factors

* Conclusion

<u>C. CARRIAGE ORDERS JURISPRUDENCE</u>

12 There should not be two or more class actions that proceed in respect of the same putative class asserting the same cause(s) of action, and one action must be selected: *Vitapharm Canada Ltd. v. F. Hoffman-Laroche Ltd.*, [2000] O.J. No. 4594 (S.C.J.) at para. 14. See also *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2001] O.J. No. 3682 (S.C.J.), aff'd [2002] O.J. No. 2010 (C.A.). When counsel have not agreed to consolidate and coordinate their actions, the court will usually select one and stay all other actions: *Lau* v. *Bayview Landmark,* [2004] O.J. No. 2788 (S.C.J.) at para. 19.

13 Where two or more class proceedings are brought with respect to the same subject matter, a proposed representative plaintiff in one action may bring a carriage motion to stay all other present or future class proceedings relating to the same subject matter: *Setterington v. Merck Frosst Canada Ltd.*, [2006] O.J. No. 376 (S.C.J.) at paras. 9-11; *Ricardo v. Air Transat A.T. Inc.*, [2002] O.J. No. 1090 (S.C.J.), leave to appeal dismissed [2002] O.J. No. 2122 (S.C.J.).

14 The *Class Proceedings Act, 1992,* confers upon the court a broad discretion to manage the proceedings. Section 13 of the Act authorizes the court to "stay any proceeding related to the class proceeding," and s. 12 authorizes the court to "make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination." Section 138 of the *Courts of Justice Act*, R.S.O. 1990, c. 43 directs that "as far as possible, multiplicity of legal proceedings shall be avoided." See: *Setterington v. Merck Frosst Canada Ltd., supra,* at paras. 9-11.

15 The court also has its normal jurisdiction under the *Rules of Civil Procedure*. Section 35 of the *Class Proceedings Act, 1992,* provides that the rules of court apply to class proceedings. Among the rules that are available is Rule 6, the rule that empowers the court to consolidate two or more proceedings or to order that they be heard together.

16 In determining carriage of a class proceeding, the court's objective is to make the selection that is in the best interests of class members, while at the same time being fair to the defendants and being consistent with the objectives of the *Class Proceedings Act, 1992*: *Vitapharm Canada Ltd. v. F. Hoffman-La Roche Ltd.*, [2000] O.J. No. 4594 (S.C.J.) at para. 48; *Setterington v. Merck Frosst Canada Ltd., supra,* at para. 13 (S.C.J.); *Sharma v. Timminco Ltd.* (2009), 99 O.R. (3d) 260 (S.C.J.) at para. 14. The objectives of a class proceeding are access to justice, behaviour modification, and judicial economy for the parties and for the administration of justice.

17 Courts generally consider seven non-exhaustive factors in determining which action should proceed: (1) the nature and scope of the causes of action advanced; (2) the theories advanced by counsel as being supportive of the claims advanced; (3) the state of each class action, including preparation; (4) the number, size and extent of involvement of the proposed representative plaintiffs; (5) the relative priority of the commencement of the class actions; (6) the resources and experience of counsel; and (7) the presence of any conflicts of interest: *Sharma v. Timminco Ltd., supra* at para. 17.

18 In these reasons, I will examine the above factors under somewhat differently-named headings and in a different order and combination. And, I will add several more factors that the parties made relevant to the circumstances of the competing actions in the cases at bar, including: (a) funding; (b) definition of class membership; (c) definition of class period; (d) joinder of defendants; (e) the plaintiff and defendant correlation; and, (f) prospects of certification.

19 In addition to identifying relevant factors, the carriage motion jurisprudence provides guidance about how the court should determine carriage. Although the determination of a carriage motion will decide which counsel will represent the plaintiff, the task of the court is not to choose between different counsel according to their relative resources and expertise; rather, it is to determine which of the competing actions is more, or most, likely to advance the interests of the class: *Tiboni v. Merck Frosst Canada Ltd.*, [2008] O.J. No. 2996 (S.C.J.), sub. nom *Mignacca v. Merck Frosst Canada Ltd.*, leave to appeal granted [2008] O.J. No. 4731 (S.C.J.), aff'd [2009] O.J. No. 821 (Div. Ct.), application for leave to appeal to C.A. ref'd May 15, 2009, application for leave to appeal to S.C.C. ref'd [2009] S.C.C.A. No. 261.

20 On a carriage motion, it is inappropriate for the court to embark upon an analysis as to which claim is most likely to succeed unless one is "fanciful or frivolous": *Setterington v. Merck Frosst Canada Ltd., supra,* at para. 19.

21 In analysing whether the prohibition against a multiplicity of proceedings would be offended, it is not necessary that the multiple proceedings be identical or mirror each other in every respect; rather, the court will look at the essence of the proceedings and their similarities: *Setterington v. Merck Frosst Canada Ltd., supra,* at para. 11.

22 Where there is a competition for carriage of a class proceeding, the circumstance that one competitor joins more defendants is not determinative; rather, what is important is the rationale for the joinder and whether or not it is advantageous for the class to join the additional defendants: *Joel v Menu Foods Gen-Par Limited,* [2007] B.C.J. No. 2159 (B.C.S.C.); *Genier v. CCI Capital Canada Ltd.*, [2005] O.J. No. 1135 (S.C.J.); *Setterington v. Merck Frosst Canada Ltd., supra.*

23 In determining which firm should be granted carriage of a class action, the court may consider whether there is any potential conflict of interest if carriage is given to one counsel as opposed to others: *Joel v. Menu Foods Gen-Par Limited, supra* at para. 16; *Vitapharm Canada Ltd. v. F. Hoffman-Laroche Ltd.*, [2000] O.J. No. 4594 (S.C.J.) and [2001] O.J. No. 3673 (S.C.J.).

D. EVIDENTIARY BACKGROUND

Smith v. Sino-Forest

24 In support of its carriage motion in *Smith v. Sino-Forest*, Rochon Genova delivered affidavits from:

* Ken Froese, who is Senior Managing Director of Froese Forensic Partners Ltd., a forensic accounting firm
* Vincent Genova, who is the managing partner of Rochon Genova
* Douglas Smith, the proposed representative plaintiff

Labourers v. Sino-Forest

25 In support of their carriage motion in *Labourers v. Sino-Forest,* Koskie Minsky and Siskinds delivered affidavits from:

* Dimitri Lascaris, who is a partner at Siskinds and the leader of its class action team
* Michael Gallagher, who is the Chair of the Board of Trustees of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Operating Engineers Fund"), a proposed representative plaintiff
* David Grant, a proposed representative plaintiff

* Richard Grottheim, who is the Chief Executive Officer of Sjunde AP-Fonden, a proposed representative plaintiff
* Joseph Mancinelli, who is the Chair of the Board of Trustees of The Trustees of the Labourers' Pension Fund of Central and Eastern Canada ("Labourers' Fund"), a proposed representative plaintiff. He also holds senior positions with the Labourers International Union of North America, which has more than 80,000 members in Canada
* Ronald Queck, who is Director of Investments of the Healthcare Employee Benefits Plans of Manitoba ("Healthcare Manitoba"), which would be a prominent class member in the proposed class action
* Frank Torchio, who is a chartered financial analyst and an expert in finance and economics who was retained to opine, among other things, about the damages suffered under various proposed class periods by Sino-Forest shareholders and noteholders under s. 138.5 of the *Ontario Securities Act*
* Robert Wong, who is a proposed representative plaintiff
* Mark Zigler, who is the managing partner of Koskie Minsky

Northwest v. Sino-Forest

26 In support of its carriage motion in *Northwest v. Sino-Forest*, Kim Orr delivered affidavits from:

* Megan B. McPhee, a principal of the firm
* John Mountain, who is the Senior Vice President, Legal and Human Resources, the Chief Compliance Officer and Corporate Secretary of Northwest Ethical Investments L.P. ("Northwest"), a proposed representative plaintiff
* Zachary Nye, a financial economist who was retained to respond to Mr. Torchio's opinion
* Daniel Simard, who is General Co-Ordinator and a non-voting ex-officio member of the Board of Directors and Committees of Comité syndical national de retraite Bâtirente inc. ("Bâtirente"), a proposed representative plaintiff
* Michael C. Spencer, a lawyer qualified to practice in New York, California, and Ontario, who is counsel to Kim Orr and a partner and member of the executive committee at the American law firm of Milberg LLP
* Brian Thomson, who is Vice-President, Equity Investments for British Columbia Investment Management Corporation ("BC Investment"), a proposed representative plaintiff

E. FACTUAL BACKGROUND TO THE CLAIMS AGAINST SINO-FOREST

27 The following factual background is largely an amalgam made from the unproven allegations in the Statements of Claim in the three proposed class actions and unproven allegations in the motion material delivered by the parties.

28 The Defendant, Sino-Forest is a Canadian public company incorporated under the *Canada Business Corporations Act*, R.S.C., 1985, c. C-44 with its registered office in Mississauga, Ontario, and its head office in Hong Kong. Its shares have traded on the Toronto Stock Exchange ("TSX") since 1995. It is a forestry plantation company with operations centered in the People's Republic of China. Its trading of securities is subject to the regulation of the *Ontario Securities Act,* R.S.O. 1990, c. S.5, under which it is a "reporting issuer" subject to the continuous disclosure provisions of Part XVIII of the Act and a "responsible issuer" subject to civil liability for secondary market misrepresentation under Part XXIII.1 of the Act.

29 The Defendant, Ernst & Young LLP ("E&Y") has been Sino-Forest's auditor from 1994 to date, except for 1999, when the now-defunct Arthur Andersen LLP did the audit, and 2005 and 2006, when the predecessor of what is now the Defendant, BDO Limited ("BDO") was Sino-Forest's auditor. BDO is the Hong Kong member of BDO International Ltd., a global accounting and audit firm.

30 E&Y and BDO are "experts" within the meaning of s. 138.1 of the *Ontario Securities Act.*

31 From 1996 to 2010, in its financial statements, Sino-Forest reported only profits, and it appeared to be an enormously successful enterprise that substantially outperformed its competitors in the forestry industry. Sino-Forest's 2010 Annual Report issued in May 2011 reported that Sino-Forest had net income of $395 million and assets of $5.7 billion. Its year-end market capitalization was $5.7 billion with approximately 246 million common shares outstanding.

32 It is alleged that Sino-Forest and its auditors E&Y and BDO repeatedly misrepresented that Sino-Forest's financial statements complied with GAAP ("generally accepted accounting principles").

33 It is alleged that Sino-Forest and its officers and directors made other misrepresentations about the assets, liabilities, and performance of Sino-Forest in various filings required under the *Ontario Securities Act.* It is alleged that these misrepresentations appeared in the documents used for the offerings of shares and bonds in the primary market and again in what are known as Core Documents under securities legislation, which documents are available to provide information to purchasers of shares and bonds in the secondary market. It is also alleged that misrepresentations were made in oral statements and in Non-Core Documents.

34 The Defendant, Allen T.Y. Chan was Sino-Forest's co-founder, its CEO, and a director until August 2011. He resides in Hong Kong.

35 The Defendant, Kai Kit Poon, was Sino-Forest's co-founder, a director from 1994 until 2009, and Sino-Forest's President. He resides in Hong Kong.

36 The Defendant, David J. Horsley was a Sino-Forest director (from 2004 to 2006) and was its CFO. He resides in Ontario.

37 The Defendants, William E. Ardell (resident of Ontario, director since 2010), James P. Bowland (resident of Ontario, director since 2011), James M.E. Hyde (resident of Ontario, director since 2004), John Lawrence (resident of Ontario, deceased, director 1997 to 2006), Edmund Mak (resident of British Columbia, director since 1994), W. Judson Martin (resident of Hong Kong, director since 2006, CEO since August 2011), Simon Murray (resident of Hong Kong, director since 1999), Peter Wang (resident of Hong Kong, director since 2007) and Garry J. West (resident of Ontario, director since 2011) were members of Sino-Forest's Board of Directors.

38 The Defendants, Hua Chen (resident of Ontario), George Ho (resident of China), Alfred C.T. Hung (resident of China), Alfred Ip (resident of China), Thomas M. Maradin (resident of Ontario), Simon Yeung (resident of China) and Wei Mao Zhao (resident of Ontario) are vice presidents of Sino-Forest. The defendant Kee Y. Wong was CFO from 1999 to 2005.

39 Sino-Forest's forestry assets were valued by the Defendant, Pöyry (Beijing) Consulting Company Limited, ("Pöyry"), a consulting firm based in Shanghai, China. Associated with Pöyry are the Defendants, Pöyry Forest Industry PTE Limited ("Pöyry-Forest") and JP Management Consulting (Asia-Pacific) PTE Ltd. ("JP Management"). Each Pöyry Defendant is an expert as defined by s. 138.1 of the *Ontario Securities Act.*

40 Pöyry prepared technical reports dated March 8, 2006, March 15, 2007, March 14, 2008, April 1, 2009, and April 23, 2010 that were filed with SEDAR (the System of Electronic Document Analysis and Retrieval) and made available on Sino-Forest's website. The reports contained a disclaimer and a limited liability exculpatory provision purporting to protect Pöyry from liability.

41 In China, the state owns the forests, but the Chinese government grants forestry rights to local farmers, who may sell their lumber rights to forestry companies, like Sino-Forest. Under Chinese law, Sino-Forest was obliged to maintain a 1:1 ratio between lands for forest harvesting and lands for forest replantation.

42 Sino-Forest's business model involved numerous subsidiaries and the use of authorized intermediaries or "AIs" to assemble forestry rights from local farmers. Sino-Forest also used authorized intermediaries to purchase forestry products. There were numerous AIs, and by 2010, Sino-Forest had over 150 subsidiaries, 58 of which were formed in the British Virgin Islands and at least 40 of which were incorporated in China.

43 It is alleged that from at least March 2003, Sino-Forest used its business model and non-arm's length AIs to falsify revenues and to facilitate the misappropriation of Sino-Forest's assets.

44 It is alleged that from at least March 2004, Sino-Forest made false statements about the nature of its business, assets, revenue, profitability, future prospects, and compliance with the laws of

Canada and China. It is alleged that Sino-Forest and other Defendants misrepresented that Sino-Forest's financial statements complied with GAPP ("generally accepted accounting principles"). It is alleged that Sino-Forest misrepresented that it was an honest and reputable corporate citizen. It is alleged that Sino-Forest misrepresented and greatly exaggerated the nature and extent of its forestry rights and its compliance with Chinese forestry regulations. It is alleged that Sino-Forest inflated its revenue, had questionable accounting practices, and failed to pay a substantial VAT liability. It is alleged that Sino-Forest and other Defendants misrepresented the role of the AIs and greatly understated the risks of Sino-Forest utilizing them. It is alleged that Sino-Forest materially understated the tax-related risks from the use of AIs in China, where tax evasion penalties are severe and potentially devastating.

45 Starting in 2004, Sino-Forest began a program of debt and equity financing. It amassed over $2.1 billion from note offerings and over $906 million from share issues.

46 On May 17, 2004, Sino-Forest filed its Annual Information Form for the 2003 year. It is alleged in *Smith v. Sino-Forest* that the 2003 AIF contains the first misrepresentation in respect of the nature and role of the authorized intermediaries, which allegedly played a foundational role in the misappropriation of Sino-Forest's assets.

47 In August 2004, Sino-Forest issued an offering memorandum for the distribution of 9.125% guaranteed senior notes ($300 million (U.S.)). The Defendant, Morgan Stanley & Co. Incorporated ("Morgan") was a note distributor that managed the note offering in 2004 and purchased and resold notes.

48 Under the Sino-Forest note instruments, in the event of default, the trustee may sue to collect payment of the notes. A noteholder, however, may not pursue any remedy with respect to the notes unless, among other things, written notice is given to the trustee by holders of 25% of the outstanding principal asking the trustee to pursue the remedy and the trustee does not comply with the request. The notes provide that no noteholder shall obtain a preference or priority over another noteholder. The notes contain a waiver and release of Sino-Forest's directors, officers, and shareholders from all liability "for the payment of the principal of, or interest on, or other amounts in respect of the notes or for any claim based thereon or otherwise in respect thereof." The notes are all governed by New York law and include non-exclusive attornment clauses to the jurisdiction of New York State and United States federal courts.

49 On March 19, 2007, Sino-Forest announced its 2006 financial results. The appearance of positive results caused a substantial increase in its share price which moved from $10.10 per share to $13.42 per share ten days later, a 33% increase.

50 In May 2007, Sino-Forest filed a Management Information Circular that represented that it maintained a high standard of corporate governance. It indicated that its Board of Directors made compliance with high governance standards a top priority.

51 In June 2007, Sino-Forest made a share prospectus offering of 15.9 million common shares at $12.65 per share ($201 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were the Defendants, CIBC World Markets Inc. ("CIBC"), Credit Suisse Securities Canada (Inc.) ("Credit Suisse"), Dundee Securities Corporation ("Dundee"), Haywood Securities Inc. ("Haywood"), Merrill Lynch Canada, Inc. ("Merrill") and UBS Securities Canada Inc. ("UBS").

52 In July 2008, Sino-Forest issued a final offering memorandum for the distribution of 5% convertible notes ($345 million (U.S)) due 2013. The Defendants, Credit Suisse Securities (USA), LLC ("Credit Suisse (USA)"), and Merrill Lynch, Fenner & Smith Inc. ("Merrill-Fenner") were note distributors.

53 In June 2009, Sino-Forest made a share prospectus offering of 34.5 million common shares at $11.00 per share ($380 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were Credit Suisse, Dundee, Merrill, the Defendant, Scotia Capital Inc. ("Scotia"), and the Defendant, TD Securities Inc. ("TD").

54 In June 2009, Sino-Forest issued a final offering memorandum for the exchange of senior notes for new guaranteed senior 10.25% notes ($212 million (U.S.) offering) due 2014. Credit Suisse (USA) was the note distributor.

55 In December 2009, Sino-Forest made a share prospectus offering of 22 million common shares at $16.80 per share ($367 million offering). Chan, Horsley, Martin, and Hyde signed the prospectus. The underwriters (as defined by s. 1. (1) of the *Ontario Securities Act*) were Credit Suisse, the Defendant, Canaccord Financial Ltd. ("Canaccord"), CIBC, Dundee, the Defendant, Maison Placements Canada Inc. ("Maison"), Merrill, the Defendant, RBC Dominion Securities Inc. ("RBC"), Scotia, and TD.

56 In December 2009, Sino-Forest issued an offering memorandum for 4.25% convertible senior notes ($460 million (U.S.) offering) due 2016. The note distributors were Credit Suisse (USA), Merrill-Fenner, and TD.

57 In October 2010, Sino-Forest issued an offering memorandum for 6.25% guaranteed senior notes ($600 million (U.S.) offering) due 2017. The note distributors were Banc of America Securities LLC ("Banc of America") and Credit Suisse USA.

58 Sino-Forest's per-share market price reached a high of $25.30 on March 31, 2011.

59 It is alleged that all the financial statements, prospectuses, offering memoranda, MD&As (Management Discussion and Analysis), AIFs (Annual Information Forms) contained misrepresentations and failures to fully, fairly, and plainly disclose all material facts relating to the securities of Sino-Forest, including misrepresentations about Sino-Forest's assets, its revenues, its business activities, and its liabilities.

60 On June 2, 2011, Muddy Waters Research, a Hong Kong investment firm that researches Chinese businesses, released a research report about Sino-Forest. Muddy Waters is operated by Carson Block, its sole full-time employee. Mr. Block was a short-seller of Sino-Forest stock. His Report alleged that Sino-Forest massively exaggerates its assets and that it had engaged in extensive related-party transactions since the company's TSX listing in 1995. The Report asserted, among other allegations, that a company-reported sale of $231 million in timber in Yunnan Province was largely fabricated. It asserted that Sino-Forest had overstated its standing timber purchases in Yunnan Province by over $800 million.

61 The revelations in the Muddy Waters Report had a catastrophic effect on Sino-Forest's share price. Within two days, $3 billion of market capitalization was gone and the market value of Sino-Forest's notes plummeted.

62 Following the release of the Muddy Waters Report, Sino-Forest and certain of its officers and directors released documents and press releases and made public oral statements in an effort to refute the allegations in the Report. Sino-Forest promised to produce documentation to counter the allegations of misrepresentations. It appointed an Independent Committee of Messrs. Ardell, Bowland and Hyde to investigate the allegations contained in the Muddy Waters Report. After these assurances, Sino-Forest's share price rebounded, trading as high as 60% of its previous day's close, eventually closing on June 6, 2011 at $6.16, approximately 18% higher from its previous close.

63 On June 7, the Independent Committee announced that it had appointed PricewaterhouseCoopers ("PWC") to assist with the investigation. Several law firms were also hired to assist in the investigation.

64 However, bad news followed. Reporters from the *Globe and Mail* travelled to China, and on June 18 and 20, 2011, the newspaper published articles that reported that Yunnan Province forestry officials had stated that their records contradicted Sino-Forest's claim that it controlled almost 200,000 hectares in Yunnan Province.

65 On August 26, 2011, the Ontario Securities Commission ("OSC") issued an order suspending trading in Sino-Forest's securities and stated that: (a) Sino-Forest appears to have engaged in significant non-arm's length transactions that may have been contrary to Ontario securities laws and the public interest; (b) Sino-Forest and certain of its officers and directors appear to have misrepresented in a material respect, some of its revenue and/or exaggerated some of its timber holdings in public filings under the securities laws; and (c) Sino-Forest and certain of its officers and directors, including its CEO, appear to be engaging or participating in acts, practices or a course of conduct related to its securities which it and/or they know or reasonably ought to know perpetuate a fraud.

66 The OSC named Chan, Ho, Hung, Ip, and Yeung as respondents in the proceedings before the Commission. Sino-Forest placed Messrs. Hung, Ho and Yeung on administrative leave. Mr. Ip may only act on the instructions of the CEO.

67 Having already downgraded its credit rating for Sino-Forest's securities, Standard & Poor withdrew its rating entirely, and Moody's reduced its rating to "junk" indicating a very high credit risk.

68 On September 8, 2011, after a hearing, the OSC continued its cease-trading order until January 25, 2012, and the OSC noted the presence of evidence of conduct that may be harmful to investors and the public interest.

69 On November 10, 2011, articles in the *Globe and Mail* and the *National Post* reported that the RCMP had commenced a criminal investigation into whether executives of Sino-Forest had defrauded Canadian investors.

70 On November 13, 2011, at a cost of $35 million, Sino-Forest's Independent Committee released its Second Interim Report, which included the work of the committee members, PWC, and three law firms. The Report refuted some of the allegations made in the Muddy Waters Report but indicated that evidence could not be obtained to refute other allegations. The Committee reported that it did not detect widespread fraud, and noted that due to challenges it faced, including resistance from some company insiders, it was not able to reach firm conclusions on many issues.

71 On December 12, 2011, Sino-Forest announced that it would not file its third-quarter earnings' figures and would default on an upcoming interest payment on outstanding notes. This default may lead to the bankruptcy of Sino-Forest.

72 The chart attached as Schedule "A" to this judgment shows Sino-Forest's stock price on the TSX from January 1, 2004, to the date that its shares were cease-traded on August 26, 2011.

F. ANALYSIS OF THE COMPETING CLASS ACTIONS

1. The Attributes of Class Counsel

Smith v. Sino-Forest

73 Rochon Genova is a boutique litigation firm in Toronto focusing primarily on class action litigation, including securities class actions. It is currently class counsel in the CIBC subprime litigation, which seeks billions in damages on behalf of CIBC shareholders for the bank's alleged non-disclosure of its exposure to the U.S. subprime residential mortgage market. It is currently the lawyer of record in *Fischer v. IG Investment Management Ltd* and *Frank v. Farlie Turner,* [2011] O.J. No. 5567, both securities cases, and it is acting for aggrieved investors in litigation involving two multi-million dollar Ponzi schemes. It acted on behalf of Canadian shareholders in relation to the Nortel securities litigation, as well as, large scale products liability class actions involving Baycol, Prepulsid, and Maple Leaf Foods, among many other cases.

74 Rochon Genova has a working arrangement with Lieff Cabrasser Heimann & Bernstein, one

of the United States' leading class action firms.

75 Lead lawyers for *Smith v. Sino-Forest* are Joel Rochon and Peter Jervis, both senior lawyers with considerable experience and proficiency in class actions and securities litigation.

Labourers v. Sino-Forest

76 Koskie Minsky is a Toronto law firm of 43 lawyers with a diverse practice including bankruptcy and insolvency, commercial litigation, corporate and securities, taxation, employment, labour, pension and benefits, professional negligence and insurance litigation.

77 Koskie Minsky has a well-established and prominent class actions practice, having been counsel in every sort of class proceeding, several of them being landmark cases, including *Hollick v Toronto (City), Cloud v The Attorney General of Canada,* [2004] O.J. No. 4924, and *Caputo v Imperial Tobacco*. It is currently representative counsel on behalf of all former Canadian employees in the multi-billion dollar Nortel insolvency.

78 Siskinds is a London and Toronto law firm of 70 lawyers with a diverse practice including bankruptcy and insolvency, business law, and commercial litigation. It has an association with the Québec law firm Siskinds, Desmeules, avocats.

79 At its London office, Siskinds has a team of 14 lawyers that focus their practice on class actions, in some instances exclusively. The firm has a long and distinguished history at the class actions bar, being class counsel in the first action certified as a class action, *Bendall v. McGhan Medical Corp.* (1993), 14 O.R. (3d) 734, and it has almost a monopoly on securities class actions, having filed approximately 40 of this species of class actions, including 24 that advance claims under Part XXX.1 of the *Ontario Securities Act*.

80 As mentioned again later, for the purposes of *Labourers' Fund v. Sino-Forest*, Koskie Minsky and Siskinds have a co-operative arrangement with the U.S. law firm, Kessler Topaz Meltzer & Check LLP ("Kessler Topaz"), which is a 113-lawyer law firm specializing in complex litigation with a very high profile and excellent reputation as counsel in securities class action lawsuits in the United States.

81 Lead lawyers for *Labourers' v. Sino-Forest* are Kirk M. Baert, Jonathan Ptak, Mark Ziegler, and Michael Mazzuca of Koskie Minsky and A. Dimitri Lascaris of Siskinds, all senior lawyers with considerable experience and proficiency in class actions and securities litigation.

Northwest v. Sino-Forest

82 Kim Orr is a boutique litigation firm in Toronto focusing primarily on class action litigation, including securities class actions. It also has considerable experience on the defence side of defending securities cases.

83 As I described in *Sharma v. Timminco Ltd., supra,* where I choose Kim Orr in a carriage competition with Siskinds in a securities class action, Kim Orr has a fine pedigree as a class action firm and its senior lawyers have considerable experience and proficiency in all types of class actions. It was comparatively modest in its self-promotional material for the carriage motion, but I am aware that it is currently class counsel in substantial class actions involving claims of a similar nature to those in the case at bar.

84 Kim Orr has an association with Milberg, LLP, a prominent class action law firm in the United States. It has 75 attorneys, most of whom devote their practice to representing plaintiffs in complex litigations, including class and derivative actions. It has a large support staff, including investigators, a forensic accountant, financial analysts, legal assistants, litigation support analysts, shareholder services personnel, and information technology specialists.

85 Michael Spencer, who is a partner at Milberg and called to the bar in Ontario, offers counsel to Kim Orr.

86 Lead lawyers for *Northwest v. Sino-Forest* are James Orr, Won Kim, and Mr. Spencer.

2. Retainer, Legal and Forensic Resources, and Investigations

Smith v. Sino-Forest

87 Following the release of the Muddy Waters Report, on June 6, 2011, Mr. Smith contacted Rochon Genova. Mr. Smith, who lost much of his investment fortune, was one of the victims of the wrongs allegedly committed by Sino-Forest. Rochon Genova accepted the retainer, and two days later, a notice of action was issued. The Statement of Claim in *Smith v. Sino-Forest* followed on July 8, 2011.

88 Following their retainer by Mr. Smith, Rochon Genova hired Mr. X (his name was not disclosed), as a consultant. Mr. X, who has an accounting background, can fluently read, write, and speak English, Cantonese, and Mandarin. He travelled to China from June 19 to July 3, 2011and again from October 31 to November 18, 2011. The purpose of the trips was to gather information about Sino-Forest's subsidiaries, its customers, and its suppliers. While in China, Mr. X secured approximately 20,000 pages of filings by Sino-Forest with the provincial branches of China's State Administration for Industry and Commerce (the "SAIC Files").

89 In August 2011, Rochon Genova retained Froese Forensic Partners Ltd., a Toronto-based forensic accounting firm, to analyze the SAIC files.

90 Rochon Genova also retained HAIBU Attorneys at Law, a full service law firm based in Shenzhen, Guangdong Province, China, to provide a preliminary opinion about Sino-Forest's alleged violations of Chinese accounting and taxation laws.

91 Exclusive of the carriage motion, Rochon Genova has already incurred approximately $350,000 in time and disbursements for the proposed class action.

<u>*Labourers v. Sino-Forest*</u>

92 On June 3, 2011, the day after the release of the Muddy Waters Report, Siskinds retained the Dacheng Law Firm in China to begin an investigation of the allegations contained in the report. Dacheng is the largest law firm in China with offices throughout China and Hong Kong and also offices in Los Angeles, New York, Paris, Singapore, and Taiwan.

93 On June 9, 2011, Guining Liu, a Sino-Forest shareholder, commenced an action in the Québec Superior Court on behalf of persons or entities domiciled in Québec who purchased shares and notes. Siskinds' Québec affiliate office, Siskinds, Desmeules, avocats, is acting as class counsel in that action.

94 On June 20, 2011, Koskie Minsky, which had a long standing lawyer-client relationship with the Labourers' Fund, was retained by it to recover its losses associated with the plummet in value of its holdings in Sino-Forest shares. Koskie Minsky issued a notice of action in a proposed class action with Labourers' Fund as the proposed representative plaintiffs.

95 The June action, however, is not being pursued, and in July 2011, Labourers' Fund was advised that Operating Engineers Fund, another pension fund, also had very significant losses, and the two funds decided to retain Koskie Minsky and Siskinds to commence a new action, which followed on July 20, 2011, by notice of action. The Statement of Claim in *Labourers v. Sino-Forest* was served in August, 2011.

96 Before commencing the new action, Koskie Minsky and Siskinds retained private investigators in Southeast Asia and received reports from them, along with information received from the Dacheng Law Firm. Koskie Minsky and Siskinds also received information from an unnamed expert in Suriname about the operations of Sino-Forest in Suriname and the role of Greenheart Group Ltd., which is a significant aspect of its Statement of Claim in *Labourers v. Sino-Forest.*

97 On November 4, 2011, Koskie Minsky and Siskinds served the Defendants in *Labourers v. Sino-Forest* with the notice of motion for an order granting leave to assert the causes of action under Part XXIII.1 of the *Ontario Securities Act.*

98 On October 26, 2011, Robert Wong, who had lost a very large personal investment in Sino-Forest shares, retained Koskie Minsky and Siskinds to sue Sino-Forest for his losses, and the firms decided that he would become another representative plaintiff.

99 On November 14, 2011, Koskie Minsky and Siskinds commenced *Grant v. Sino-Forest Corp.*, which, as already noted above, they intend to consolidate with *Labourers v. Sino-Forest.*

100 *Grant v. Sino-Forest* names the same defendants as in *Labourers v. Sino-Forest,* except for the additional joinder of Messrs. Bowland, Poon, and West, and it also joins as defendants, BDO, and two additional underwriters, Banc of America and Credit Suisse Securities (USA).

101 Koskie Minsky and Siskinds state that *Grant v. Sino-Forest* was commenced out of an abundance of caution to ensure that certain prospectus and offering memorandum claims under the *Ontario Securities Act,* and under the equivalent legislation of the other Provinces, will not expire as being statute-barred.

102 Exclusive of the carriage motion, Koskie Minsky has already incurred approximately $350,000 in time and disbursements for the proposed class action, and exclusive of the carriage motion, Siskinds has already incurred approximately $440,000 in time and disbursements for the proposed class action.

<u>*Northwest v. Sino-Forest*</u>

103 Immediately following the release of the Muddy Waters Report, Kim Orr and Milberg together began an investigation to determine whether an investor class action would be warranted. A joint press release on June 7, 2011, announced the investigation.

104 For the purposes of the carriage motion, apart from saying that their investigation included reviewing all the documents on SEDAR and the System for Electronic Disclosure for Insiders (SEDI), communicating with contacts in the financial industry, and looking into Sino-Forest's officers, directors, auditors, underwriters and valuation experts, Kim Orr did not disclose the details of its investigation. It did indicate that it had hired a Chinese forensic investigator and financial analyst, a market and damage consulting firm, Canadian forensic accountants, and an investment and market analyst and that its investigations discovered valuable information.

105 Meanwhile, lawyers at Milberg contacted Bâtirente, which was one of its clients and also a Sino-Forest shareholder, and Won Kim of Kim Orr contacted Northwest, another Sino-Forest shareholder. Bâtirente already had a retainer with Milberg to monitor its investment portfolio on an ongoing basis to detect losses due to possible securities violations.

106 Northwest and Bâtirente agreed to retain Kim Orr to commence a class action, and on September 26, 2011, Kim Orr commenced *Northwest v. Sino-Forest.*

107 In October 2011, BC Investments contacted Kim Orr about the possibility of it becoming a plaintiff in the class proceeding commenced by Northwest and Bâtirente, and BC Investments decided to retain the firm and the plan is that BC Investments is to become another representative plaintiff.

108 Exclusive of the carriage motion, Kim Orr and Milberg have already incurred approximately $1,070,000 in time and disbursement for the proposed class action.

3. Proposed Representative Plaintiffs

Smith v. Sino-Forest

109 In *Smith v. Sino-Forest*, the proposed representative plaintiffs are Douglas Smith and Frederick Collins.

110 Douglas Smith is a resident of Ontario, who acquired approximately 9,000 shares of Sino-Forest during the proposed class period. He is married, 48 years of age, and employed as a director of sales. He describes himself as a moderately sophisticated investor that invested in Sino-Forest based on his review of the publicly available information, including public reports and filings, press releases, and statements released by or on behalf of Sino-Forest. He lost $75,345, which was half of his investment fortune.

111 Frederick Collins is a resident of Nanaimo, British Columbia. He purchased shares in the primary market. His willingness to act as a representative plaintiff was announced during the reply argument of the second day of the carriage motion, and nothing was discussed about his background other than he is similar to Mr. Smith in being an individual investor. He was introduced to address a possible *Ragoonanan* problem in *Smith v. Sino-Forest;* namely, the absence of a plaintiff who purchased in the primary market, of which alleged problem I will have more to say about below.

Labourers v. Sino-Forest

112 In *Labourers v. Sino-Forest*, the proposed representative plaintiffs are: David Grant, Robert Wong, The Trustees of the Labourers' Pension Fund of Central and Eastern Canada ("Labourers' Fund"), the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Operating Engineers Fund"), and Sjunde AP-Fonden.

113 David Grant is a resident of Alberta. On October 21, 2010, he purchased 100 Guaranteed Senior Notes of Sino-Forest at a price of $101.50 ($U.S.), which he continues to hold.

114 Robert Wong, a resident of Ontario, is an electrical engineer. He was born in China, and in addition to speaking English, he speaks fluent Cantonese. He was a substantial shareholder of Sino-Forest from July 2002 to June 2011. Before making his investment, he reviewed Sino-Forest's Core Documents, and he also made his own investigations, including visiting Sino-Forest's plantations in China in 2005, where he met a Sino-Forest vice-president.

115 Mr. Wong's investment in Sino-Forest comprised much of his net worth. In September 2008, he owned 1.4 million Sino-Forest shares with a value of approximately $26.1 million. He purchased more shares in the December 2009 prospectus offering. Around the end of May 2011, he owned 518,700 shares, which, after the publication of the Muddy Waters Report, he sold on June 3, 2011 and June 10, 2011, for $2.8 million.

116 The Labourers' Fund is a multi-employer pension fund for employees in the construction industry. It is registered with the Financial Services Commission in Ontario and has 52,100 members in Ontario, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador. It is a long-time client of Koskie Minsky.

117 Labourers' Fund manages more than $2.5 billion in assets. It has a fiduciary and statutory responsibility to invest pension monies on behalf of thousands of employees and pensioners in Ontario and in other provinces.

118 Labourer's Fund acted as representative plaintiff in a U.S. class actions against Fortis, Pitney Bowes Inc., Synovus Financial Corp., and Medea Health Solutions, Inc. Those actions involved allegations of misrepresentation in the statements and filings of public issuers.

119 The Labourers' Fund purchased Sino-Forest shares on the TSX during the class period, including 32,300 shares in a trade placed by Credit Suisse under a prospectus. Most of its purchases of Sino-Forest shares were made in the secondary market.

120 On June 1, 2011, the Labourers' Fund held a total of 128,700 Sino-Forest shares with a market value of $2.3 million, and it also had an interest in pooled funds that had $1.4 million invested in Sino-Forest shares. On June 2 and 3, 2011, the Labourers' Fund sold its holdings in Sino-Forest for a net recovery of $695,993.96. By June 30, 2011, the value of the Sino-Forest shares in the pooled funds was $291,811.

121 The Operating Engineers Fund is a multi-employer pension fund for employed operating engineers and apprentices in the construction industry. It is registered with the Financial Services Commission in Ontario, and it has 20,867 members. It is a long-time client of Koskie Minsky.

122 The Operating Engineers Fund manages $1.5 billion in assets. It has a fiduciary and statutory responsibility to invest pension monies on behalf of thousands of employees and pensions in Ontario and in other provinces.

123 The Operating Engineers Fund acquired shares of Sino-Forest on the TSX during the class period. The Operating Engineers Fund invested in Sino-Forest shares through four asset managers of a segregated fund. One of the managers purchased 42,000 Sino-Forest shares between February 1, 2011, and May 24, 2011, which had a market value of $764,820 at the close of trading on June 1, 2011. These shares were sold on June 21, 2011 for net $77,170.80. Another manager purchased 181,700 Sino-Forest shares between January 20, 2011 and June 1, 2011, which had a market value of $3.3 million at the close of trading on June 1, 2011. These shares were sold and the Operating Engineers Fund recovered $1.5 million. Another asset manager purchased 100,400 Sino-Forest shares between July 5, 2007 and May 26, 2011, which had a market value of $1.8 million at the close of trading on June 1, 2011. Many of these shares were sold in July and August, 2011, but the Operating Engineers Fund continues to hold approximately 37,350 shares. Between June 15, 2007 and June 9, 2011, the Operating Engineers Fund also purchased units of a pooled fund managed by

TD that held Sino-Forest shares, and it continues to hold these units. The Operating Engineers Fund has incurred losses in excess of $5 million with respect to its investment in Sino-Forest shares.

124 Sjunde AP-Fonden is the Swedish Nation Pension Fund, and part of Sweden's national pension system. It manages $15.3 billion in assets. It has acted as lead plaintiff in a large securities class action and a large stockholder class action in the United States.

125 In addition to retaining Koskie Minsky and Siskinds, Sjunde AP-Fonden also retained the American law firm Kessler Topaz to provide assistance, if necessary, to Koskie Minsky and Siskinds.

126 Sjunde AP-Fonden purchased Sino-Forest shares on the TSX from outside Canada between April 2010 and January 2011. It was holding 139,398 shares with a value of $2.5 million at the close of trading on June 1, 2011. It sold 43,095 shares for $188,829.36 in August 2011 and holds 93,303 shares.

127 Sjunde AP-Fonden is prepared to be representative plaintiff for a sub-class of non-Canadian purchasers of Sino-Forest shares who purchased shares in Canada from outside of Canada.

128 Messrs. Mancinelli, Gallagher, and Grottheim each deposed that Labourers' Fund, the Operating Engineers Fund, and Sjunde AP-Fonden respectively sued because of their losses and because of their concerns that public markets remain healthy and transparent.

129 Although it does not seek to be a representative plaintiff, the Healthcare Employee Benefits Plans of Manitoba ("Healthcare Manitoba") is a major class member that supports carriage being granted to Koskie Minsky and Siskinds, and its presence should also be mentioned here because it actively supports the appointment of the proposed representative plaintiffs in *Labourers v. Sino-Forest*.

130 Healthcare Manitoba provides pensions and other benefits to eligible healthcare employees and their families throughout Manitoba. It has 65,000 members. It is a long-time client of Koskie Minsky. It manages more than $3.9 billion in assets.

131 Healthcare Manitoba, invested in Sino-Forest shares that were purchased by one of its asset managers in the TSX secondary market. Between February and May, 2011, it purchased 305,200 shares with a book value of $6.7 million. On June 24, 2011, the shares were sold for net proceeds of $560,775.48.

Northwest v. Sino-Forest

132 In *Northwest v. Sino-Forest*, the proposed representative plaintiffs are: British Columbia Investment Management Corporation ("BC Investment"); Comité syndical national de retraite Bâtirente inc. ("Bâtirente") and Northwest & Ethical Investments L.P. ("Northwest").

133 BC Investment, which is incorporated under the British Columbia *Public Sector Pension Plans Act*, is owned by and is an agent of the Government of British Columbia. It manages $86.9 billion in assets. Its investment activities help to finance the retirement benefits of more than 475,000 residents of British Columbia, including public service employees, healthcare workers, university teachers, and staff. Its investment activities also help to finance the WorkSafeBC insurance fund that covers approximately 2.3 million workers and over 200,000 employers in B.C., as well as, insurance funds for public service long term disability and credit union deposits.

134 BC Investment, through the funds it managed, owned 334,900 shares of Sino-Forest at the start of the Class Period, purchased 6.6 million shares during the Class Period, including 50,200 shares in the June 2009 offering and 54,800 shares in the December 2009 offering; sold 5 million shares during the Class Period; disposed of 371,628 shares after the end of the Class Period; and presently holds 1.5 million shares.

135 Bâtirente is a non-profit financial services firm initiated by the Confederation of National Trade Unions to establish and promote a workplace retirement system for affiliated unions and other organizations. It is registered as a financial services firm regulated in Quebec by the Autorité des marchés financiers under *the Act Respecting the Distribution of Financial Products and Services*, R.S.Q., chapter D-9.2. It has assets of about $850 million.

136 Bâtirente, through the funds it managed, did not own any shares of Sino-Forest before the class period, purchased 69,500 shares during the class period, sold 57,625 shares during the class period, and disposed of the rest of its shares after the end of the class period.

137 Northwest is an Ontario limited partnership, owned 50% by the Provincial Credit Unions Central and 50% by Federation des caisses Desjardin du Québec. It is registered with the British Columbia Securities Commission as a portfolio manager, and it is registered with the OSC as a portfolio manager and as an investment funds manager. It manages about $5 billion in assets.

138 Northwest, through the funds it managed, did not own any shares of Sino-Forest before the class period, purchased 714,075 shares during the class period, including 245,400 shares in the December 2009 offering, sold 207,600 shares during the class period, and disposed of the rest of its shares after the end of the class period.

139 Kim Orr touts BC Investment, Bâtirente, and Northwest as candidates for representative plaintiff because they are sophisticated "activist shareholders" that are committed to ethical investing. There is evidence that they have all raised governance issues with Sino-Forest as well as other companies. Mr. Mountain of Northwest and Mr. Simard of Bâtirente are eager to be actively involved in the litigation against Sino-Forest.

4. Funding

140 Koskie Minsky and Siskinds have approached Claims Funding International, and subject to court approval, Claims Funding International has agreed to indemnify the plaintiffs for an adverse costs award in return for a percentage of any recovery from the class action.

141 Koskie Minsky and Siskinds state that if the funding arrangement with Claims Funding International is refused, they will, in any event, proceed with the litigation and will indemnify the plaintiffs for any adverse costs award.

142 Similarly, Kim Orr has approached Bridgepoint Financial Services, which subject to court approval, has agreed to indemnify the plaintiffs for an adverse costs award in return for a percentage of any recovery in the class action. If this arrangement is not approved, Kim Orr intends to apply to the Class Proceedings Fund, which would be a more expensive approach to financing the class action.

143 Kim Orr states that if these funding arrangements are refused, it will, in any event, proceed with the litigation and it will indemnify the plaintiffs for any adverse costs award.

144 Rochon Genova did not mention in its factum whether it intends to apply to the Class Proceedings Fund on behalf of Messrs. Smith and Collins, but for the purposes of the discussion later about the carriage order, I will assume that this may be the case. I will also assume that Rochon Genova has agreed to indemnify Messrs. Smith and Collins for any adverse costs award should funding not be granted by the Fund.

5. Conflicts of Interest

145 One of the qualifications for being a representative plaintiff is that the candidate does not have a conflict of interest in representing the class members and in bringing an action on their behalf. All of the candidates for representative plaintiff in the competing class actions depose that they have no conflicts of interest. Their opponents disagree.

146 Rochon Genova submits that there are inherent conflicts of interests in both *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* because the representative plaintiffs bring actions on behalf of both shareholders and noteholders. Rochon Genova submits that these conflicts are exacerbated by the prospect of a Sino-Forest bankruptcy.

147 Relying on *Casurina Ltd. Partnership v. Rio Algom Ltd.* [2004] O.J. No. 177 (C.A.) at paras. 35-36, aff'g [2002] O.J. No. 3229 (S.C.J.), leave to appeal to the S.C.C. denied, [2004] S.C.C.A. No. 105 and *Amaranth LLC. v. Counsel Corp.*, [2003] O.J. No. 4674 (S.C.J.), Rochon Genova submits that a class action by the bondholders is precluded by the pre-conditions in the bond instruments, but if it were to proceed, it might not be in the best interests of the bondholders, who might prefer to have Sino-Forest capable of carrying on business. Further still, Rochon Genova submits that, in any event, an action by the bondholders' trustee may be the preferable way for the noteholders to sue on their notes. Further, Rochon Genova submits that if there is a bankruptcy, the bondholders may prefer to settle their claims in the context of the bankruptcy rather than being connected in a class action to the shareholder's claims over which they would have priority in a bankruptcy.

148 Further still, Rochon Genova submits that a bankruptcy would bring another conflict of interest between bondholders and shareholders because under s. 50(14) of the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, and 5.1(2) of the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 the claims of creditors against directors that are based on misrepresentation or oppression may not be compromised through a plan or proposal. In contrast, *Allen-Vanguard Corp., Re*, 2011 ONSC 5017 (S.C.J.) at paras. 48-52 is authority that shareholders are not similarly protected, and, therefore, Rochon Genova submits that the noteholders would have a great deal more leverage in resolving claims against directors than would the shareholder members of the class in a class action.

149 Kim Orr denies that there is a conflict in the representative plaintiffs acting on behalf of both shareholders and bondholders. It submits that while boldholders may have an additional claim in contract against Sino-Forest for repayment of the debt outside of the class action, both shareholders and bondholders share a misrepresentation claim against Sino-Forest and there is no conflict in advancing the misrepresentation claim independent of the debt repayment claim.

150 Koskie Minsky and Siskinds also deny that there is any conflict in advancing claims by both bondholders and shareholders. They say that the class members are on common ground in advancing misrepresentation, tort, and the various statutory causes of action. Koskie Minsky and Siskinds add that if there was a conflict, then it is manageable because they have a representative plaintiff who was a bondholder, which is not the case for the representative plaintiffs in *Northwest v. Sino-Forest*. It submits that, if necessary, subclasses can be established to manage any conflicts of interest among class members.

151 Leaving the submitted shareholder and bondholder conflicts of interest, Rochon Genova submits that Labourers' Fund has a conflict of interest because BDO Canada is its auditor. Rochon Genova submits that Koskie Minsky also has a conflict of interest because it and BDO Canada have worked together on a committee providing liaison between multi-employer pension plans and the Financial Services Commission of Ontario and have respectively provided services as auditor and legal counsel to the Union Benefits Alliance of Construction Trade Unions. Rochon Genova submits that it is telling that these conflicts were not disclosed and that BDO, which is an entity that is an international associate with BDO Canada was a late arrival as a defendant in *Labourers v. Sino-Forest*, although this can be explained by changes in the duration of the class period.

152 For their part, Koskie Minsky and Siskinds raise a different set of conflicts of interest. They submit that Northwest, Bâtirente, and BC Investments have a conflict of interest with the other class members who purchased Sino-Forest securities because of their role as investment managers.

153 Koskie Minsky and Siskinds' argument is that as third party financial service providers, BC Investment, Bâtirente, and Northwest did not suffer losses themselves but rather passed the losses on to their clients. Further, Koskie Minsky and Siskinds submit that, in contrast to BC Investment, Bâtirente, and Northwest, their clients, Labourers' Fund and Operating Engineers Fund, are acting as fiduciaries to recover losses that will affect their members' retirements. This arguably makes Koskie Minsky and Siskinds better representative plaintiffs.

154 Further still, Koskie Minsky and Siskinds submit that the class members in *Northwest v. Sino-Forest* may question whether Northwest, Bâtirente, and BC Investments failed to properly evaluate the risks of investing in Sino-Forest. Koskie Minsky and Siskinds point out that the Superior Court of Québec in *Comité syndical national de retraite Bâtirente inc. c. Société financière Manuvie*, 2011 QCCS 3446 at paras. 111-119 disqualified Bâtirente as a representative plaintiff because there might be an issue about Bâtirente's investment decisions. Thus, Koskie, Minsky and Siskinds attempt to change Northwest, Bâtirente, and BC Investments' involvement in encouraging good corporate governance at Sino-Forest from a positive attribute into the failure to be aware of ongoing wrongdoing at Sino-Forest and a negative attribute for a proposed representative plaintiff.

6. Definition of Class Membership

Smith v. Sino-Forest

155 In *Smith v. Sino-Forest,* the proposed class action is: (a) on behalf of all persons who purchased shares of Sino-Forest from May 17, 2004 to August 26, 2011 on the TSX or other secondary market; and (b) on behalf of all persons who acquired shares of Sino-Forest during the offering distribution period relating to Sino-Forest's share prospectus offerings on June 1, 2009 and December 10, 2009 excluding the Defendants, members of the immediate families of the Individual Defendants, or the directors, officers, subsidiaries and affiliates of the corporate Defendants.

156 Both Koskie Minsky and Siskinds and Kim Orr challenge this class membership as inadequate for failing to include the bondholders who were allegedly harmed by the same misconduct that harmed the shareholders.

Labourers v. Sino-Forest

157 In *Labourers v. Sino-Forest,* the proposed class action is on behalf of all persons and entities wherever they may reside who acquired securities of Sino-Forest during the period from and including March 19, 2007 to and including June 2, 2011 either by primary distribution in Canada or an acquisition on the TSX or other secondary markets in Canada, other than the defendants, their past and present subsidiaries, affiliates, officers, directors, senior employees, partners, legal representatives, heirs, predecessors, successors and assigns, and any individual who is an immediate member of the family of an individual defendant.

158 The class membership definition in *Labourers v. Sino-Forest* includes non-Canadians who purchased shares or notes in Canada but excludes non-Canadians who purchased in a foreign marketplace.

159 Challenging this definition, Kim Orr submits that it is wrong in principle to exclude persons whose claims will involve the same facts as other class members and for whom it is arguable that Canadian courts may exercise jurisdiction and provide access to justice.

Northwest v. Sino-Forest.

160 In *Northwest v. Sino-Forest,* the proposed class action is on behalf of purchasers of shares or notes of Sino-Forest during the period from August 17, 2004 through June 2, 2011, except: Sino-Forest's past and present subsidiaries and affiliates; the past and present officers and directors of Sino-Forest and its subsidiaries and affiliates; members of the immediate family of any excluded person; the legal representatives, heirs, successors, and assigns of any excluded person or entity; and any entity in which any excluded person or entity has or had a controlling interest.

161 Challenging this definition, Koskie Minsky and Siskinds submit that the proposed class in *Northwest* has no geographical limits and, therefore, will face jurisdictional and choice of law challenges that do not withstand a cost benefit analysis. It submits that Sino-Forest predominantly raised capital in Canadian capital markets and the vast majority of its securities were either acquired in Canada or on a Canadian market, and, in this context, including in the class non-residents who purchased securities outside of Canada risks undermining and delaying the claims of the great majority of proposed class members whose claims do not face such jurisdictional obstacles.

7. Definition of Class Period

Smith v. Sino-Forest

162 In *Smith v. Sino-Forest,* the class period is May 17, 2004 to August 26, 2011. This class period starts with the release of Sino-Forest's release of its 2003 Annual Information Form, which indicated the use of authorized intermediaries, and it ends on the day of the OSC's cease-trade order.

163 For comparison purposes, it should be noted that this class period has the earliest start date and the latest finish date. *Labourers v. Sino-Smith* and *Northwest v. Sino-Forest* both use the end date of the release of the Muddy Waters Report.

164 In making comparisons, it is helpful to look at the chart found at Schedule A of this judgment.

165 Rochon Genova justifies its extended end date based on the argument that the Muddy Waters Report was a revelation of Sino-Forest's misrepresentation but not a corrective statement that would end the causation of injuries because Sino-Forest and its officers denied the truth of the Muddy Waters Report.

166 Kim Orr's criticizes the class definition in *Smith v. Sino-Forest* and submits that purchasers of shares or notes after the Muddy Waters Report was published do not have viable claims and ought not be included as class members.

167 Koskie Minsky and Siskinds' submission is similar, and they regard the extended end date as problematic in raising the issues of whether there were corrective disclosures and of how Part XXIII.1 of the *Ontario Securities Act* should be interpreted.

Labourers v. Sino-Forest

168 In *Labourers v. Sino-Forest,* the class period is March 19, 2007 to June 2, 2011.

169 This class period starts with the date Sino-Forest's 2006 financial results were announced, and it ends on the date of the publication of the Muddy Waters Report.

170 The March 19, 2007, commencement date was determined using a complex mathematical formula known as the "multi-trader trading model." Using this model, Mr. Torchio estimates that 99.5% of Sino-Forest's shares retained after June 2, 2011, had been purchased after the March 19, 2007 commencement date. Thus, practically speaking, there is almost nothing to be gained by an earlier start date for the class period.

171 The proposed class period covers two share offerings (June 2009 and December 2009). This class period does not include time before the coming into force of Part XXIII.1 of the *Ontario Securities Act* (December 31, 2005), and, thus, Koskie Minsky and Siskinds submit that this aspect of their definition avoids problems about the retroactive application, if any, of Part XXIII.1 of the Act.

172 For comparison purposes, the *Labourers* class period has the latest start date and shares the finish date used in the *Northwest v. Sino-Forest* action, which is sooner than the later date used in *Smith v. Sino-Forest*. It is the most compressed of the three definitions of a class period.

173 Based on Mr. Torchio's opinion, Koskie Minsky and Siskinds submit that there are likely no damages arising from purchases made during a substantial portion of the class periods in *Smith v. Sino-Forest* and in *Northwest v. Sino-Forest.* Koskie Minsky and Siskinds submit that given that the average price of Sino's shares was approximately $4.49 in the ten trading days after the Muddy Waters report, it is likely that any shareholder that acquired Sino-Forest shares for less than $4.49 suffered no damages, particularly under Part XXIII.1 of the *Ontario Securities Act*.

174 In part as a matter of principle, Kim Orr submits that Koskie Minsky and Siskinds' approach to defining the class period is unsound because it excludes class members who, despite the mathematical modelling, may have genuine claims and are being denied any opportunity for access to justice. Kim Orr submits it is wrong in principle to abandon these potential class members.

175 Rochon Genova also submits that Koskie Minsky and Siskinds' approach to defining the

class period is wrong. It argues that Koskie Minsky and Siskinds' reliance on a complex mathematical model to define class membership is arbitrary and unfair to share purchasers with similar claims to those claimants to be included as class members. Rochon Genova criticizes Koskie Minsky and Siskinds' approach as being the condemned merits based approach to class definitions and for being the sin of excluding class members because they may ultimately not succeed after a successful common issues trial.

176 Relying on what I wrote in *Fischer v. IG Investment Management Ltd.*, 2010 ONSC 296 at para. 157, Rochon Genova submits that the possible failure of an individual class member to establish an individual element of his or her claim such as causation or damages is not a reason to initially exclude him or her as a class member. Rochon Genova submits that the end date employed in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* is wrong.

Northwest v. Sino-Forest

177 In *Northwest v. Sino-Forest,* the class period is August 17, 2004 to June 2, 2011.

178 This class period starts from the day Sino-Forest closed its public offering of long-term notes that were still outstanding at the end of the class period and ends on the date of the Muddy Waters Research Report. This period covers three share offerings (June 2007, June 2009, and December 2009) and six note offerings (August 2004, July 2008, July 2009, December 2009, February 2010, and October 2010).

179 For comparison purposes, the *Northwest v. Sino-Forest* class period begins 3 months later and ends three months sooner than the class period in *Smith v. Sino-Forest.* The *Northwest v. Sino-Forest* class period begins approximately two-and-a-half years earlier and ends at the same time as the class period in *Labourers v. Sino-Forest.*

180 Kim Orr submits that its start date of August 17, 2004 is satisfactory, because on that date, Sino-Forest shares were trading at $2.85, which is below the closing price of Sino-Forest shares on the TSX for the ten days after June 3, 2011 ($4.49), which indicates that share purchasers before August 2004 would not likely be able to claim loss or damages based on the public disclosures on June 2, 2011.

181 However, Koskie Minsky and Siskinds point out that Kim Orr's submission actually provides partial support for the theory for a later start date (March 19, 2007) because, there is no logical reason to include in the class persons who purchased Sino-Forest shares between May 17, 2004, the start date of the *Smith Action* and December 1, 2005, because with the exception of one trading day (January 24, 2005), Sino-Forest's shares never traded above $4.49 during that period.

8. Theory of the Case against the Defendants

Smith v. Sino-Forest

182 In *Smith v. Sino-Forest,* the theory of the case rests on the alleged non-arms' length transfers between Sino-Forest and its subsidiaries and authorized intermediaries, that purported to be suppliers and customers. Rochon Genova's investigations and analysis suggest that there are numerous non-arms length inter-company transfers by which Sino-Forest misappropriated investors' funds, exaggerated Sino-Forest's assets and revenues, and engaged in improper tax and accounting practices.

183 Mr. Smith alleges that Sino-Forest's quarterly interim financial statements, audited annual financial statements, and management's discussion and analysis reports, which are Core Documents as defined under the *Ontario Securities Act,* misrepresented its revenues, the nature and scope of its business and operations, and the value and composition of its forestry holdings. He alleges that the Core Documents failed to disclose an unlawful scheme of fabricated sales transactions and the avoidance of tax and an unlawful scheme through which hundreds of millions of dollars in investors' funds were misappropriated or vanished.

184 Mr. Smith submits that these misrepresentations and failures to disclose were also made in press releases and in public oral statements. He submits that Chan, Hyde, Horsley, Mak, Martin, Murray, and Wang authorized, permitted or acquiesced in the release of Core Documents and that Chan, Horsley, Martin, and Murray made the misrepresentations in public oral statements.

185 In *Smith v. Sino-Forest*, Mr. Smith (and Mr. Collins) brings different claims against different combinations of Defendants; visualize:

* misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*, against all the Defendants
* subject to leave being granted, misrepresentation in secondary market disclosure under Part XXIII.1 of the Ontario *Securities Act* as against the defendants: Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, BDO and E&Y
* negligent, reckless, or fraudulent misrepresentation against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, and Wang. This claim would appear to cover sales of shares in both the primary and secondary markets.

186 It is to be noted that *Smith v. Sino-Forest* does not make a claim on behalf of noteholders, and, as described and explained below, it joins the fewest number of defendants.

187 *Smith* also does not advance a claim on behalf of purchasers of shares through Sino-Forest's prospectus offering of June 5, 2007, because of limitation period concerns associated with the absolute limitation period found in 138.14 of the *Ontario Securities Act*. See: *Coulson v. Citigroup Global Markets Canada Inc.*, 2010 ONSC 1596 at paras. 98-100.

<u>*Labourers v. Sino-Forest*</u>

188 The theory of *Labourers v. Sino-Forest* is that Sino-Forest, along with its officers, directors, and certain of its professional advisors, falsely represented that its financial statements complied with GAAP, materially overstated the size and value of its forestry assets, and made false and incomplete representations regarding its tax liabilities, revenue recognition, and related party transactions.

189 The claims in *Labourers v. Sino-Forest* are largely limited to alleged misrepresentations in Core Documents as defined in the *Ontario Securities Act* and other Canadian securities legislation. Core Documents include prospectuses, annual information forms, information circulars, financial statements, management discussion & analysis, and material change reports.

190 The representative plaintiffs advance statutory claims and also common law claims that certain defendants breached a duty of care and committed the torts of negligent misrepresentation and negligence. There are unjust enrichment, conspiracy, and oppression remedy claims advanced against certain defendants.

191 In *Labourers v. Sino-Forest,* different combinations of representative plaintiffs advance different claims against different combinations of defendants; visualize:

* Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a statutory claim under Part XXIII of the *Ontario Securities Act* against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD and Pöyry
* Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a common law negligent misrepresentation claim against Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD based on the common misrepresentation that Sino-Forest's financial statements complied with GAPP
* Labourers' Fund and Mr. Wong, purchasers of shares in a primary market distribution, advance a common law negligence claim against Sino-Forest, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD and Pöyry
* Grant, who purchased bonds in a primary market distribution, advances a statutory claim under Part XXIII of the *Ontario Securities Act* against Sino-Forest
* Grant, who purchased bonds in a primary market distribution, advances a common law negligent misrepresentation claim against Sino-Forest, E&Y and BDO based on the common misrepresentation that Sino-Forest's financial statements complied with GAPP

* Grant, who purchased bonds in a primary market distribution, advances a common law negligence claim against Sino-Forest, E&Y, BDO, Banc of America, Credit Suisse USA, and TD
* All the representative plaintiffs, subject to leave being granted, advance claims of misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation. This claim is against Sino-Forest, Ardell, Bowland, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, West, E &Y, BDO, and Pöyry
* All of the representative plaintiffs, who purchased Sino-Forest securities in the secondary market, advance a common law negligent misrepresentation claim against all of the Defendants except the underwriters based on the common misrepresentation contained in the Core Documents that Sino-Forest's financial statements complied with GAAP
* All the representative plaintiffs sue Sino-Forest, Chan, Horsley, and Poon for conspiracy. It is alleged that Sino-Forest, Chan, Horsley, and Poon conspired to inflate the price of Sino-Forest's shares and bonds and to profit by their wrongful acts to enrich themselves by, among other things, issuing stock options in which the price was impermissibly low
* While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Chan, Horsley, Mak, Martin, Murray, and Poon for unjust enrichment in selling shares to class members at artificially inflated prices
* While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Sino-Forest for unjust enrichment for selling shares at artificially inflated prices
* While it is not entirely clear from the Statement of Claim, it seems that all the representative plaintiffs sue Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia, and TD for unjustly enriching themselves from their underwriters fees
* All the representative plaintiffs sue Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, and Wang for an oppression remedy under the *Canada Business Corporations Act*

192 Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* is more focused than *Smith* and *Northwest* because: (a) its class definition covers a shorter time period and is limited to securities acquired by Canadian residents or in Canadian markets; (b) the material documents are limited to Core Documents under securities legislation; (c) the named individual defendants are limited to directors and officers with statutory obligations to certify the accuracy of Sino-Forest's public filings; and (d) the causes of action are tailored to distinguish between the claims of primary market purchasers and secondary market purchasers and so are less susceptible to motions to strike.

193 Koskie Minsky and Siskinds submit that save for background and context, little is gained in the rival actions by including claims based on non-Core Documents, which confront a higher threshold to establish liability under Part XXIII.1 of the *Ontario Securities Act*.

Northwest v. Sino-Forest

194 The *Northwest v. Sino-Forest* Statement of Claim focuses on an "Integrity Representation," which is defined as: "the representation in substance that Sino-Forest's overall reporting of its business operations and financial statements was fair, complete, accurate, and in conformity with international standards and the requirements of the *Ontario Securities Act* and National Instrument 51-102, and that its accounts of its growth and success could be trusted."

195 The *Northwest v. Sino-Forest* Statement of Claim alleges that all Defendants made the Integrity Representation and that it was a false, misleading, or deceptive statement or omission. It is alleged that the false Integrity Representation caused the market decline following the June 2, 2011, disclosures, regardless of the truth or falsity of the particular allegations contained in the Muddy Waters Report.

196 In *Northwest v. Sino-Forest*, the representative plaintiffs advance statutory claims under Parts XXIII and XXIII.1 of the *Ontario Securities Act* and a collection of common law tort claims. Kim Orr submits that to the extent, if any, that the statutory claims do not provide complete remedies to class members, whether due to limitation periods, liability caps, or other limitations, the common law claims may provide coverage.

197 In *Northwest v. Sino-Forest*, the plaintiffs advance different claims against different combinations of defendants; visualize:

* With respect to the June 2009 and December 2009 prospectus, a cause of action for violation of Part XXIII of the *Ontario Securities Act* against Sino-Forest, the underwriter Defendants, the director Defendants, the Defendants who consented to disclosure in the prospectus and the Defendants who signed the prospectus
* Negligent misrepresentation against all of the Defendants for disseminating material misrepresentations about Sino-Forest in breach of a duty to exercise appropriate care and diligence to ensure that the documents and statements disseminated to the public about Sino-Forest were complete, truthful, and accurate.
* Fraudulent misrepresentation against all of the Defendants for acting knowingly and deliberately or with reckless disregard for the truth making misrepresentations in documents, statements, financial statements, prospectus, offering memoranda, and filings issued and disseminated to the investing public including Class Members.
* Negligence against all the Defendants for a breach of a duty of care to

ensure that Sino-Forest implemented and maintained adequate internal controls, procedures and policies to ensure that the company's assets were protected and its activities conformed to all legal developments.

* Negligence against the underwriter Defendants, the note distributor Defendants, the auditor Defendants, and the Pöyry Defendants for breach of a duty to the purchasers of Sino-Forest securities to perform their professional responsibilities in connection with Sino-Forest with appropriate care and diligence.
* Subject to leave being granted, a cause of action for violation of Part XXIII.1 of the *Ontario Securities Act* against Sino-Forest, the auditor Defendants, the individual Defendants who were directors and officers of Sino-Forest at the time one or more of the pleaded material misrepresentations was made, and the Pöyry Defendants.

198 Kim Orr submits that *Northwest v. Sino-Forest* is more comprehensive than its rivals and does not avoid asserting claims on the grounds that they may take time to litigate, may not be assured of success, or may involve a small portion of the total potential class. It submits that its conception of Sino-Forest's wrongdoing better accords with the factual reality and makes for a more viable claim than does Koskie Minsky and Siskinds' focus on GAAP violations and Rochon Genova's focus on the misrepresentations associated with the use of authorized intermediaries. It denies Koskie Minsky and Siskinds' argument that it has pleaded overbroad tort claims.

199 Koskie Minsky and Siskinds submit that its conspiracy claim against a few defendants is focused and narrow, and it criticizes the broad fraud claim advanced in *Northwest v. Sino-Forest* against all the defendants as speculative, provocative, and unproductive.

200 Relying on *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591 at para. 49; *Corfax Benefits Systems Ltd. v. Fiducie Desjardins Inc.*, [1997] O.J. No. 5005 (Gen. Div.) at paras. 28-36; *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.) at paras. 25 and 38; and *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637 (Gen. Div.) at para. 477, Koskie Minsky and Siskinds submit that the speculative fraud action in *Northwest v. Sino-Forest* is improper and would not advance the interests of class members. Further, the task of proving that each of some twenty defendants had a fraudulent intent, which will be vehemently denied by the defendants, and the costs sanction imposed for pleading and not providing fraud make the fraud claim a negative and not a positive feature of *Northwest v. Sino-Forest.*

9. Joinder of Defendants

Smith v. Sino-Forest

201 In *Smith v. Sino-Forest,* the Defendants are: Sino-Forest; seven of its directors and officers; namely: Chan, Horsley, Hyde, Mak, Martin, Murray, and Wang; nine underwriters; namely, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD; and Sino-Forest's two auditors during the Class Period, E &Y and BDO.

202 The *Smith v. Sino-Forest* Statement of Claim does not join Pöyry because Rochon Genova is of the view that the disclaimer clause in Pöyry's reports likely insulates it from liability, and Rochon Genova believes that its joinder would be of marginal utility and an unnecessary complication. It submits that joining Pöyry would add unnecessary expense and delay to the litigation with little corresponding benefit because of its jurisdiction and its potential defences.

Labourers v. Sino-Forest

203 In *Labourers v. Sino-Forest*, the Defendants are the same as in *Smith v. Sino-Forest* with the additional joinder of Ardell, Bowland, Poon, West, Banc of America, Credit Suisse (USA), and Pöyry.

204 The *Labourers v. Sino-Forest* action does not join Chen, Ho, Hung, Ip, Maradin, Wong, Yeung, Zhao, Credit Suisse (USA), Haywood, Merrill-Fenner, Morgan and UBS, which are parties to *Northwest v. Sino-Forest.*

205 Koskie Minsky and Siskinds' explanation for these non-joinders is that the activities of the underwriters added to *Northwest v. Sino-Forest* occurred outside of the class period in *Labourers v. Sino-Forest* and neither Lawrence nor Wong held a position with Sino-Forest during the proposed class period and the action against Lawrence's Estate is probably statute-barred. (See *Waschkowski v. Hopkinson Estate*, [2000] O.J. No. 470 (C.A.).)

206 Wong left Sino-Forest before Part XXIII.1 of the *Ontario Securities Act* came into force, and Koskie Minsky and Siskinds submit that proving causation against Wong will be difficult in light of the numerous alleged misrepresentations since his departure. Moreover, the claim against him is likely statute-barred.

207 Koskie Minsky and Siskinds submit that Chen, Maradin, and Zhao did not have statutory duties and allegations that they owed common law duties will just lead to motions to strike that hinder the progress of an action.

208 Further, Koskie Minsky and Siskinds submit that it is not advisable to assert claims of fraud against all defendants, which pleading may raise issues for insurers that potentially put available coverage and thus collection for plaintiffs at risk.

209 Kim Orr submits that it is a mistake in *Labourers v. Sino-Forest*, which is connected to the late start date for the class period, which Kim Orr also regards as a mistake, that those underwriters that may be liable and who may have insurance to indemnify them for their liability, have been left out of *Labourers v. Sino-Forest.*

Northwest v. Sino-Forest

210 In *Northwest v. Sino-Forest,* with one exception, the defendants are the same as in *Labourers v. Sino-Forest* with the additional joinder of various officers of Sino-Forest; namely: Chen, Ho, Hung, Ip, The Estate of John Lawrence, Maradin, Wong, Yeung, and Zhao; the joinder of Pöyry Forest and JP Management; and the joinder of more underwriters; namely: Haywood, Merrill-Fenner, Morgan, and UBS.

211 The one exception where *Northwest v. Sino-Forest* does not join a defendant found in *Labourers v. Sino-Forest* is Banc of America.

212 Kim Orr's submits that its joinder of all defendants who might arguably bear some responsibility for the loss is a positive feature of its proposed class action because the precarious financial situation of Sino-Forest makes it in the best interests of the class members that they be provided access to all appropriate routes to compensation. It strongly denies Koskie Minsky and Siskinds' allegation that *Northwest v. Sino-Forest* takes a "shot-gun" and injudicious approach by joining defendants that will just complicate matters and increase costs and delay.

213 Kim Orr submits that Rochon Genova has no good reason for not adding Pöyry, Pöyry Forest, and JP Management as defendants to *Smith v. Sino-Forest* and that Koskie Minsky and Siskinds have no good reason in *Labourers v. Sino-Forest* for suing Pöyry but not also suing its associated companies, all of whom are exposed to liability and may be sources of compensation for class members.

214 While not putting it in my blunt terms, Kim Orr submits, in effect, that Koskie Minsky and Siskinds' omission of the additional defendants is just laziness under the guise of feigning a concern for avoiding delay and unnecessarily complicating an already complex proceeding.

10. Causes of Action

Smith v. Sino-Forest

215 In *Smith v. Sino-Forest,* the causes of action advanced by Mr. Smith on behalf of the class members are:

* misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*
* negligent, reckless, or fraudulent misrepresentation
* subject to leave being granted, misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation

Labourers v. Sino-Forest

216 In *Labourers v. Sino-Forest*, the causes of action advanced by various combinations of plaintiffs against various combinations of defendants are:

* misrepresentation in a prospectus under Part XXIII of the *Ontario Securities Act*
* negligent misrepresentation
* negligence
* subject to leave being granted misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation
* conspiracy
* unjust enrichment
* oppression remedy.

217 Kim Orr submits that the unjust enrichment claims and oppression remedy claims seemed to be based on and add little to the misrepresentation causes of action. It concedes that the conspiracy action may be a tenable claim but submits that its connection to the disclosure issues that comprise the nucleus of the litigation is unclear.

<u>*Northwest v. Sino-Forest*</u>

218 In *Northwest v. Sino-Forest*, the causes of action are:

* misrepresentation in a prospectus in violation of Part XXIII the *Ontario Securities Act*
* misrepresentation in an offering memorandum in violation of Part XXIII the *Ontario Securities Act*
* negligent misrepresentation
* fraudulent misrepresentation
* negligence
* subject to leave being granted misrepresentation in secondary market disclosure under Part XXIII.1 of the *Ontario Securities Act* and, if necessary, equivalent provincial legislation

219 The following chart is helpful in comparing and contrasting the joinder of various causes of action and the joinder of defendants in *Smith v. Sino-Forest*, *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest.*

Cause of Action	*Smith v. Sino-Forest,*	*Labourers v. Sino-Forest,*	*Northwest v. Sino-Forest,*
Part XXIII of the *Ontario Securities Act* – primary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Canaccord, CIBC Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management [for June 2009 and Dec. 2009 prospectus]
Part XXIII of the *Ontario Securities Act* – primary market bonds		Sino-Forest [two bond issues]	Sino-Forest [six bond issues]
Negligent misrepresentation – primary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest. JP Management,
Negligent misrepresentation – primary market bonds		Sino-Forest, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligence – primary market shares		Sino-Forest, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, E &Y, BDO, CIBC, Canaccord, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, Pöyry,	[see negligence, professional negligence]
Negligence – primary market bonds		Sino-Forest, E&Y, BDO, Banc of America, Credit Suisse USA, TD	[See negligence, professional negligence]
Negligence			Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao,

			Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Professional Negligence			Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Part XXIII.1 of the *Ontario Securities Act* – secondary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, West, E &Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Part XXIII.1 of the *Ontario Securities Act* – secondary market bonds		Sino-Forest, Ardell, Bowland, Chan, Hyde, Horsley, Mak, Martin, Murray, Poon, Wang, West, E &Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligent misrepresentation – secondary market shares	Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Wang, E&Y, BDO	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, Pöyry	Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligent misrepresentation – secondary market bonds		Sino-Forest, Ardell, Bowland, Chan, Horsley,	Sino-Forest, Ardell, Bowland, Chan, Horsley,

		Hyde, Mak, Martin, Murray, Poon, Wang, E&Y, BDO, Pöyry	Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Negligence - secondary market shares		Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, Canaccord, CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, TD, E&Y, BDO, Pöyry	[see negligence, professional negligence]
Conspiracy		Sino-Forest, Chan, Horsley, Poon,	
Fraudulent Misrepresentation - Bonds, shares			Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management
Unjust Enrichment		Chan, Horsley, Mak, Martin, Murray, Poon,	
Unjust Enrichment		Sino-Forest,	
Unjust Enrichment		Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia, TD	
Oppression Remedy		Sino-Forest, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang	

11. The Plaintiff and Defendant Correlation

220 In class actions in Ontario, for every named defendant there must be a named plaintiff with a cause of action against that defendant: *Ragoonanan v. Imperial Tobacco Canada Ltd.*, [2000] O.J. No. 4597 (S.C.J.) at para. 55 (S.C.J.); *Hughes v. Sunbeam Corp. (Canada)* (2002), 61 O.R. (3d) 433 (C.A.) at para. 18.

221 As an application of the *Ragoonanan* rule, a purchaser in the secondary market cannot be the representative plaintiff for a class member who purchased in the primary market: *Menegon v. Philip Services Corp.*, [2001] O.J. No. 5547 (S.C.J.) at paras. 28-30 aff'd [2003] O.J. No. 8 (C.A.).

222 Where the class includes non-resident class members, they must be represented by a representative plaintiff that is a non-resident: *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591 at paras. 109, 117 and 184; *Currie v. McDonald's Restaurants of Canada Ltd.* (2005), 74 O.R. (3d) 321 at para. 30 (C.A.).

223 Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* has no *Ragoonanan* problems. However, they submit that the other actions have problems. For example, until Mr. Collins volunteered, there was no representative plaintiff in *Smith v. Sino-Forest* who had purchased shares in the primary market, and at this juncture, it is not clear that Mr. Collins purchased in all of the primary market distributions. Mr. Smith and Mr. Collins may have timing-of-purchase issues. Mr. Smith made purchases during periods when some of the Defendants were not involved; viz. BDO, Canaccord CIBC, Credit Suisse, Dundee, Maison, Merrill, RBC, Scotia, and TD.

224 Koskie Minsky and Siskinds submit that none of the representative plaintiffs in *Northwest v. Sino-Forest* purchased notes in the primary market for the 2007 prospectus offering and that the plaintiffs in *Northwest* may have timing issues with respect to their claims against Wong, Lawrence, JP Management, UBS, Haywood and Morgan.

225 Rochon Genova's and Kim Orr's response is that there are no *Ragoonanan* problems or no irremediable *Ragoonanan* problems.

12. Prospects of Certification

226 Koskie Minsky and Siskinds framed part of their argument in favour of their being selected for carriage in terms of the comparative prospects of certification of the rival actions. They submitted that *Labourers v. Sino-Forest* was carefully designed to avoid the typical road blocks placed by defendants on the route to certification and to avoid inefficiencies and unproductive claims or claims that on a cost-benefit analysis would not be in the interests of the class to pursue. One of the typical roadblocks that they referred to was challenges to the jurisdiction of the Ontario Court over foreign class members and foreign defendants who have not attorned to the Ontario Superior Court of Justice's territorial jurisdiction.

227 Koskie Minsky and Siskinds submitted that their representative plaintiffs focus their claims on a single misrepresentation to avoid the pitfalls of seeking to certify a negligent misrepresentation claim with multiple misrepresentations over a long period of time. Such a claim apparently falls into a pit because it is often not certified. Koskie Minsky and Siskinds say it is better to craft a claim that has higher prospects of certification and leave some claims behind. They submit that the Supreme Court of Canada accepted that a representative plaintiff is entitled to restrict their causes of action to make their claims more amenable to class proceedings: *Rumley v. British Columbia*, [2001] 3 S.C.R. 184 at para. 30.

228 Although *Smith v. Sino-Forest* is even more focused that *Labourers v. Sino-Forest,* Koskie Minsky and Siskinds still submit that their approach is better because *Smith v. Sino-Forest* goes too far in cutting out the bondholders' claims and then loses focus by extending its claims beyond the release of the Muddy Waters Report.

229 In any event, Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* is better because the named plaintiffs are able to advance statutory and common law claims against all of the named defendants, which arguably is not the case for the plaintiffs in the other actions, who may have *Ragoonanan* problems or no tenable claims against some of the named defendants. Further, *Labourers* arguably is better because of a more focussed approach to maximize class recovery while avoiding the costs and delays inevitably linked with motions to strike.

230 Kim Orr submits that its more comprehensive approach, where there are more defendant parties and expansive tort claims, is preferable to *Labourers v. Sino-Forest* and *Smith v. Sino-Forest.* Kim Orr submits that it does not shirk asserting claims because they may be difficult to litigate and it does not abandon class members who may not be assured of success or who comprise a small portion of the class.

231 Kim Orr submits that *Northwest v. Sino-Forest* is comprehensive and also cohesive and corresponds to the factual reality. It submits that the theories of the competing actions do not capture the wrongdoing at Sino-Forest for which many are culpable and who should be held responsible. It submits that its approach will meet the challenges of certification and yield an optimum recovery for the class.

232 Rochon Genova submits that *Smith v. Sino-Forest* is much more cohesive that the other actions. It submits that the more expansive class definitions and causes of action in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* will present serious difficulties relating to manageability, preferability, and potential conflicts of interest amongst class members that are not present in *Smith v. Sino-Forest*. Rochon Genova submits that it has developed a solid, straightforward theory of the case and made a great deal of progress in unearthing proof of Sino-Forest's wrongdoing.

G. CARRIAGE ORDER

1. Introduction

233 With the explanation that follows, I stay *Smith v. Sino-Forest* and *Northwest v. Sino-Forest*, and I award carriage to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest.* In the race for carriage of an action against *Sino-Forest*, I would have ranked Rochon Genova second and Kim Orr third.

234 This is not an easy decision to make because class members would probably be well served by any of the rival law firms. Success in a carriage motion does not determine which is the best law firm, it determines that having regard to the interests of the plaintiffs and class members, to what is fair to the defendants, and to the policies that underlie the class actions regime, there is a constellation of factors that favours selecting one firm or group of firms as the best choice for a particular class action.

235 Having regard to the constellation of factors, in the circumstances of this case, several factors are neutral or non-determinative of the choice for carriage. In this group are: (a) attributes of class counsel; (b) retainer, legal, and forensic resources; (c) funding; (d) conflicts of interest; and (e) the plaintiff and defendant correlation.

236 In the case at bar, the determinative factors are: definition of class membership, definition of class period, theory of the case, causes of action, joinder of defendants, and prospects of certification.

237 Of the determinative factors, the attributes of the representative plaintiffs is a standalone factor. The other determinative factors are interrelated and concern the rival conceptualizations of what kind of class action would best serve the class members' need for access to justice and the policies of fairness to defendants, behaviour modification, and judicial economy.

238 Below, I will first discuss the neutral or non-determinative factors. Then, I will discuss the determinative factors. After discussing the attributes of the representative plaintiffs, I will discuss the related factors in two groups. One group of related factors is about class membership, and the second group of factors is about the claims against the defendants.

2. <u>Neutral or Non-Determinative Factors</u>

(a) <u>Attributes of Class Counsel</u>

239 In the circumstances of the cases at bar, the attributes of the competing law firms along with their associations with prestigious and prominent American class action firms is not determinative of carriage, since there is little difference among the rivals about their suitability for bringing a proposed class action against Sino-Forest.

240 With respect to the attributes of the law firms, although one might have thought that Mr. Spencer's call to the bar would diminish the risk, Koskie and Minsky and Siskinds, particularly Siskinds, raised a question about whether Milberg might cross the line of what legal services a foreign law firm may provide to the Ontario lawyers who are the lawyers of record, and Siskinds alluded to the spectre of violations of the rules of professional conduct and perhaps the evil of champerty and maintenance. It suggested that it was unfair to class members to have to bear this risk associated with the involvement of Milberg.

241 However, at this juncture, I have no reason to believe that any of the competing law firms, all of which have associations with notable American class action firms, will shirk their responsibilities to control the litigation and not to condone breaches of the rules of professional conduct or tortious conduct.

(b) Retainer, Legal, and Forensic Resources

242 The circumstances of the retainers and the initiative shown by the law firms and their efforts and resources expended by them are also not determinative factors in deciding the carriage motions in the case at bar, although it is an enormous shame that it may not be possible to share the fruits of these efforts once carriage is granted to one action and not the others.

243 As I have already noted above, the aggregate expenditure to develop the tactical and strategic plans for litigation not including the costs of preparing for the carriage motion are approximately $2 million. It seems that this effort by the respective law firms has been fruitful and productive. All of the law firms claim that their respective efforts have yielded valuable information to advance a claim against Sino-Forest and others.

244 All of the law firms were quickly out of the starting blocks to initiate investigations about the prospects and merits of a class action against Sino-Forest. For different reasonable reasons, the statements of claim were filed at different times.

245 In the case at bar, I do not regard the priority of the commencement of the actions as a meaningful factor, given that from the publication of the Muddy Waters Report, all the firms responded immediately to explore the merits of a class action and given that all the firms plan to amend their original pleadings that commenced the actions. In any event, I do not think that a carriage motion should be regarded as some sort of take home exam where the competing law firms have a deadline for delivering a statement of claim, else marks be deducted.

(c) Funding

246 In my opinion, another non-determinative factor is the circumstances that: (a) the representative plaintiffs in *Labourers v. Sino-Forest* may apply for court approval for third-party funding; (b) the plaintiffs in *Northwest v. Sino-Forest* may apply for court approval for third-party funding or they may apply to the Class Proceedings Fund to be protected from an adverse costs award; (c) Messrs. Smith and Collins in *Smith v. Sino-Forest* may apply to the Class Proceedings Fund to be protected from an adverse costs award; and (d) each of the law firms have respectively undertaken with their respective clients to indemnify them from an adverse costs award.

247 In the future, the court or the Ontario Law Foundation may have to deal with the funding requests, but for present purposes, I do not see how these prospects should make a difference to deciding carriage, although I will have something more to say below about the significance of the state of affairs that clients with the resources of Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, BC Investment, Bâtirente, and Northwest would seek an indemnity from their respective class counsel.

248 In any event, in my opinion, standing alone, the funding situation is not a determinative factor to carriage, although it may be relevant to other factors that are discussed below.

(d) Conflicts of Interest

249 In the circumstances of the case at bar, I also do not regard conflicts of interest as a determinative factor.

250 I do not see how the fact that Northwest, Bâtirente, and BC Investments made their investments on behalf of others and allegedly suffered no losses themselves creates a conflict of interest. It appears to me that they have the same fiduciary responsibilities to their members as do Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, and Healthcare Manitoba.

251 Northwest, Bâtirente, and BC Investments were the investors in the securities of Sino-Forest and although there may be equitable or beneficial owners, under the common law, they suffered the losses, just like the other investors in Sino-Forest securities suffered losses. The fact that Northwest, Bâtirente, and BC Investments held the investments in trust for their members does not change the reality that they suffered the losses.

252 It is alleged that Northwest, Bâtirente, and BC Investments, who were involved in corporate governance matters associated with Sino-Forest, failed to properly evaluate the risks of investing in Sino-Forest. Based on these allegations, it is submitted that they have a conflict of interest. I disagree.

253 Having regard to the main allegation being that Sino-Forest was engaged in a corporate shell game that deceived everyone, it strikes me that it is almost a spuriously speculative allegation to blame another victim as being at fault. However, even if the allegation is true, the other class members have no claim against Northwest, Bâtirente, and BC Investments. If there were a claim, it would be by the members of Northwest, Bâtirente, and BC Investments, who are not members of the class suing Sino-Forest. The actual class members have no claim against Northwest, Bâtirente, and BC Investments but have a common interest in pursuing Sino-Forest and the other defendants.

254 Further, it is arguable that Koskie Minsky and Siskinds are incorrect in suggesting that in *Comité syndical national de retraite Bâtirente inc. c. Société financière Manuvie*, 2011 QCCS 3446, the Superior Court of Québec disqualified Bâtirente as a representative plaintiff because there might be an issue about Bâtirente's investment decisions.

255 It appears to me that Justice Soldevida did not appoint Bâtirente as a representative plaintiff for a different reason. The action in Québec was a class action. There were some similarities to the case at bar, insofar as it was an action against a corporation, Manulife, and its officers and directors for misrepresentations and failure to fulfill disclosure obligations under securities law. In that action, the personal knowledge of the investors was a factor in their claims against Manulife, and Justice Soldevida felt that sophisticated investors, like Bâtirente, could not be treated on the same footing as the average investor. It was in that context that she concluded that there was an appearance of a conflict of interest between Bâtirente and the class members.

256 In the case at bar, however, particularly for the statutory claims where reliance is presumed, there is no reason to differentiate the average investors from the sophisticated ones. I also do not see how the difference between sophisticated and average investors would matter except perhaps at individual issues trials, where reasonable reliance might be an issue, if the matter ever gets that far.

257 Another alleged conflict concerns the facts that BDO Canada, which is not a defendant, is the auditor of Labourers' Fund, and Koskie Minsky and BDO Canada have worked together on several matters. These circumstances are not conflicts of interest. There is no reason to think that Labourers' Fund and Koskie Minsky are going to pull their punches against BDO or would have any reason to do so.

258 Finally, turning to the major alleged conflict between the bondholders and the shareholders, speaking generally, the alleged conflicts of interest between the bondholders that invested in Sino-Forest and the shareholders that invested in Sino-Forest arise because the bondholders have a cause of action in debt in addition to their causes of action based in tort or statutory misrepresentation claims, while, in contrast, the shareholders have only statutory and common law claims based in misrepresentation.

259 There is, however, within the context of the class action, no conflict of interest. In the class action, only the misrepresentation claims are being advanced, and there is no conflict between the bondholders and the shareholders in advancing these claims. Both the bondholders and the shareholders seek to prove that they were deceived in purchasing or holding on to their Sino-Forest securities. That the Defendants may have defences associated with the terms of the bonds is a problem for the bondholders but it does not place them in a conflict with shareholders not confronted with those special defences.

260 Assuming that the bondholders and shareholders succeed or are offered a settlement, there might be a disagreement between them about how the judgment or settlement proceeds should be distributed, but that conflict, which at this juncture is speculative, can be addressed now or later by constituting the bondholders as a subclass and by the court's supervisory role in approving settlements under the *Class Proceedings Act, 1992.*

261 If there are bondholders that wish only to pursue their debt claims or who wish not to pursue any claim against Sino-Force or who wish to have the bond trustee pursue only the debt claims,

these bondholders may opt out of the class proceeding assuming it is certified.

262 If there is a bankruptcy of Sino-Forest, then in the bankruptcy, the position of the shareholders as owners of equity is different than the position of the bondholders as secured creditors, but that is a natural course of a bankruptcy. That there are creditors' priorities, outside of the class action, does not mean that, within the class action, where the bondholders and the shareholders both claim damages, i.e., unsecured claims, there is a conflict of interest.

263 The alleged conflict in the case at bar is different from the genuine conflict of interest that was identified in *Settington v. Merck Frost Canada Ltd.*, [2006] O.J. No. 376 (S.C.J.), where, for several reasons, the Merchant Law Firm was not granted carriage or permitted to be part of the consortium granted carriage in a pharmaceutical products liability class action against Merck.

264 In *Settington,* one ground for disqualification was that the Merchant Law firm was counsel in a securities class action for different plaintiffs suing Merck for an unsecured claim. If the securities class action claim was successful, then the prospects of an unsecured recovery in the products liability class action might be imperiled. In the case at bar, however, within the class action, the bondholders are not pursuing a different cause of action from the shareholders; both are unsecured creditors for the purposes of their damages' claims arising from misrepresentation. If, in other proceedings, the bondholders or their trustee successfully pursue recovery in debt, then the threat to the prospects of recovery by the shareholders arises in the normal way that debt instruments have priority over equity instruments, which is a normal risk for shareholders.

265 Put shortly, although the analysis may not be easy, there are no conflicts of interest between the bondholders and the shareholders within the class action that cannot be handled by establishing a subclass for bondholders at the time of certification or at the time a settlement is contemplated.

(e) The Plaintiff and Defendant Correlation

266 In *Ragoonanan v. Imperial Tobacco Canada Ltd.,* (2000), 51 O.R. (3d) 603 (S.C.J.), in a proposed products liability class action, Mr. Ragoonanan sued Imperial Tobacco, Rothmans, and JTI-MacDonald, all cigarette manufacturers. He alleged that the manufacturers had negligently designed their cigarettes by failing to make them "fire safe." Mr. Ragoonanan's particular claim was against Imperial Tobacco, which was the manufacturer of the cigarette that allegedly caused harm to him when it was the cause of a fire at Mr. Ragoonanan's home. Mr. Ragoonanan did not have a claim against Rothmans or JTI-MacDonald.

267 In *Ragoonanan,* Justice Cumming established the principle in Ontario class action law that there cannot be a cause of action against a defendant without a plaintiff who has that cause of action. Rather, there must be for every named defendant, a named plaintiff with a cause of action against that defendant. The *Ragoonanan* principle was expressly endorsed by the Court of Appeal in *Hughes v. Sunbeam Corp. (Canada) Ltd.* (2002), 61 O.R. (3d) 433 (C.A.) at paras. 13-18, leave to appeal to S.C.C. ref'd (2003), [2002] S.C.C.A. No. 446, 224 D.L.R. (4th) vii.

268 It should be noted, however, that in *Ragoonanan*, Justice Cumming did not say that there must be for every separate cause of action against a named defendant, a named plaintiff. In other words, he did not say that if some class members had cause of action A against defendant X and other class members had cause of action B against defendant X that it was necessary that there be a named representative plaintiff for both the cause of action A v. X and for the cause of action B v. X. It was arguable that if the representative plaintiff had a claim against X, then he or she could represent others with the same or different claims against X.

269 Thus, there is room for a debate about the scope of the *Ragoonanan* principle, and, indeed, it has been applied in the narrow way, just suggested. Provided that the representative plaintiff has his or her own cause of action, the representative plaintiff can assert a cause of action against a defendant on behalf of other class members that he or she does not assert personally, provided that the causes of action all share a common issue of law or of fact: *Boulanger v. Johnson & Johnson Corp.*, [2002] O.J. No. 1075 (S.C.J.) at para. 22, leave to appeal granted, [2002] O.J. No. 2135 (S.C.J.), varied (2003), 64 O.R. (3d) 208 (Div. Ct.) at paras. 41, 48, varied [2003] O.J. No. 2218 (C.A.); *Healey v. Lakeridge Health Corp.*, [2006] O.J. No. 4277 (S.C.J.); *Matoni v. C.B.S. Interactive Multimedia Inc.*, [2008] O.J. No. 197 (S.C.J.) at paras. 71-77; *Voutour v. Pfizer Canada Inc.*, [2008] O.J. No. 3070 (S.C.J.); *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25 at para. 37. Thus, a representative plaintiff with damages for personal injury can claim in respect of dependents with derivative claims provided that the statutes that create the derivative causes of action are properly pleaded: *Voutour v. Pfizer Canada Inc., supra*; *Boulanger v. Johnson & Johnson Corp., supra*.

270 As noted above, in the case at bar, Koskie Minsky and Siskinds submit that *Labourers v. Sino-Forest* has no problem with the *Ragoonanan* principle and that *Smith v. Sino-Forest* and especially the more elaborate *Northwest v. Sino-Forest* confront *Ragoonanan* problems.

271 For the purposes of this carriage motion, I do not feel it is necessary to do an analysis about the extent to which any of the rival actions are compliant with *Ragoonanan.*

272 The *Ragoonanan* problem is often easy to fix. The emergence of Mr. Collins in *Smith v. Sino-Forest* to sue for the primary market shareholders is an example, assuming that Mr. Smith's own claims against the defendants do not satisfy the *Ragoonanan* principle. Therefore, I do not regard the plaintiff and defendant correlation as a determinative factor in determining carriage.

273 It is also convenient here to add that I do not see the spectre of challenges to the Superior Court's jurisdiction over foreign class members or over the foreign defendants are a determinative factor to picking one action over another. It may be that *Northwest v. Sino-Forest* has the potential to attract more jurisdictional challenges but standing alone that potential is not a reason for disqualifying *Northwest v. Sino-Forest.*

3. <u>Determinative Factors</u>

(a) <u>Attributes of the Proposed Representative Plaintiffs</u>

274 I turn now to the determinative factors that lead me to the conclusion that carriage should be granted to Koskie Minsky and Siskinds in *Labourers v. Sino-Forest.*

275 The one determinative factor that stands alone is the characteristics of the candidates for representative plaintiff. In the case at bar, this is a troublesome and maybe a profound determinative factor.

276 Kim Orr extolled the virtues of having its clients, Northwest, Bâtirente and BC Investments, which collectively manage $92 billion in assets, as candidates to be representative plaintiffs.

277 Similarly, Koskie Minsky and Siskinds extolled the virtues of having Labourers' Fund, Operating Engineers Fund, and Sjunde AP-Fonden as candidates for representative plaintiff, along with the support of major class member Healthcare Manitoba. Together, these parties to *Labourers v. Sino-Forest* collectively manage $23.2 billion in assets. As noted above, Koskie Minsky and Siskinds submitted that their clients were not tainted by involving themselves in the governance oversight of Sino-Forest, which had been lauded as a positive factor by Kim Orr.

278 As I have already discussed above in the context of the discussion about conflicts of interest, I do not regard Bâtirente's, and Northwest's interest in corporate governance generally or its particular efforts to oversee Sino-Forest as a negative factor.

279 However, what may be a negative factor and what is the signature attribute of all of these candidates for representative plaintiff is that it is hard to believe that given their financial heft, they need the *Class Proceedings Act, 1992* for access to justice or to level the litigation playing field or that they need an indemnity to protect them from exposure to an adverse costs award.

280 Although these candidates for representative plaintiff would seem to have adequate resources to litigate, they seem to be seeking to use a class action as a means to secure an indemnity from class counsel or a third-party funder for any exposure to costs. If they are genuinely serious about pursuing the defendants to obtain compensation for their respective members, they would also seem to be prime candidates to opt out of the class proceeding if they are not selected as a representative plaintiff.

281 Mr. Rochon neatly argued that the class proceedings regime was designed for litigants like Mr. Smith not litigants like Labourers Trust or Northwest. He referred to the *Private Securities Litigation Reform Act of 1995*, legislation in the United States that was designed to encourage large institutions to participate in securities class actions by awarding them leadership of securities actions under what is known as a "leadership order". He told me that the policy behind this legislation was to discourage what are known as "strike suits;" namely, meritless securities class actions brought by opportunistic entrepreneurial attorneys to obtain very remunerative nuisance value payments from the defendants to settle non-meritorious claims.

282 I was told that the American legislators thought that appointing a lead plaintiff on the basis of financial interest would ensure that institutional plaintiffs with expertise in the securities market and real financial interests in the integrity of the market would control the litigation, not lawyers. See: *LaSala v. Bordier et CIE*, 519 F.3d 121 (U.S. Ct App (3rd Cir)) (2008) at p. 128; *Taft v. Ackermans*, (2003), F.Supp.2d, 2003 WL 402789 at 1,2, D.H. Webber, "The Plight of the Individual Investor in Securities Class Actions" (2010) NYU Law and Economics Working Papers, para. 216 at p. 7.

283 Mr. Rochon pointed out that the litigation environment is different in Canada and Ontario and that the provinces have taken a different approach to controlling strike suits. Control is established generally by requiring that a proposed class action go through a certification process and by requiring a fairness hearing for any settlements, and in the securities field, control is established by requiring leave for claims under Part XXIII.1 of the *Ontario Securities Act.* See *Ainslie v. CV Technologies Inc.* (2008) 93 O.R. (3d) 200 (S.C.J.) at paras. 7, 10-13.

284 In his factum, Mr. Rochon eloquently argued that individual investors victimized by securities fraud should have a voice in directing class actions. Mr. Smith lost approximately half of his investment fortune; and according to Mr. Rochon, Mr. Smith is an individual investor who is highly motivated, wants an active role, and wants to have a voice in the proceeding.

285 While I was impressed by Mr. Rochon's argument, it did not take me to the conclusions that the attributes of the institutional candidates for representative plaintiff in *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* when compared to the attributes of Mr. Smith should disqualify the institutional candidates from being representative plaintiffs or be a determinative factor to grant carriage to a more typical representative plaintiff like Mr. Smith or Mr. Collins.

286 I think that it would be a mistake to have a categorical rule that an institutional plaintiff with the resources to bring individual proceedings or the means to opt-out of class proceedings and go it alone should be disqualified or discouraged from being a representative plaintiff. In the case at bar, the expertise and participation of the institutional investors in the securities marketplace could contribute to the successful prosecution of the lawsuit on behalf of the class members.

287 Although Mr. Smith and Mr. Collins might lose their voice, they might in the circumstances of this case not be best voice for their fellow class members, who at the end of the day want results not empathy from their representative plaintiff and class counsel.

288 Access to justice is one of the policy goals of the *Class Proceedings Act, 1992* and although it may be the case that the institutional representative plaintiffs want but do not need the access to justice provided by the Act, they are pursuing access to justice in a way that ultimately benefits Mr. Smith and other class members should their actions be certified as a class proceeding.

289 On these matters, I agree with what Justice Rady said in *McCann v. CP Ships Ltd.*, [2009] O.J. No. 5182 (S.C.J.) at paras. 104-105:

> 104. I recognize that access to justice concerns may not be engaged when a class is comprised of large institutions with large claims. Authority for this proposition is found in *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.). Moldaver J. made the following observation at p. 473:
>
> > As a rule, certification should have as its root a number of individual claims which would otherwise be economically unfeasible to pursue. While not necessarily fatal to an order for certification, the absence of this important underpinning will certainly weigh in the balance against certification.
>
> 105. Nevertheless, I am satisfied on the basis of the record before me that the individual claims and those of small corporations would likely be economically unfeasible to pursue. Further, there is no good principled reason that a large corporation should not be able to avail itself of the class proceeding mechanism where the other objectives are met.

290 Another goal of the *Class Proceedings Act, 1992* is judicial economy, and the avoidance of a multiplicity of actions. However, the Act envisions a multiplicity of actions by permitting class members to opt-out and bring their own action against the defendants. However, there is an exception. The only class member that cannot opt out is the representative plaintiff, and in the circumstances of the case at bar, one advantage of granting carriage to one of the institutional plaintiffs is that they cannot opt out, and this, in and of itself, advances judicial economy.

291 Another advantage of keeping the institutional plaintiffs in the case at bar in a class action is that the institutional plaintiffs are already to a large extent representative plaintiffs. They are already, practically speaking, suing on behalf of their own members, who number in the hundreds of thousands. Their members suffered losses by the investments made on their behalf by BC Investments, Bâtirente, Northwest, Labourers' Fund, Operating Engineers Fund, Sjunde AP-Fonden, and Healthcare Manitoba. These pseudo-class members are probably better served by the court case managing the class action, assuming it is certified and by the judicial oversight of the approval process for any settlements.

292 These thoughts lead me to the conclusion that in the circumstances of the case at bar, a determinative factor that favours *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* is the attributes of their candidates for representative plaintiff. In this regard, *Labourers v. Sino-Forest* has the further advantage that it also has Mr. Grant and Mr. Wong, who are individual investors and who can give voice to the interests of similarly situated class members.

(b) <u>Definition of Class Membership and Definition of Class Period</u>

293 The first group of interrelated determinative factors is: definition of class membership and definition of class period. These factors concern who, among the investors in Sino-Forest shares and bonds, is to be given a ticket to a class action litigation train that is designed to take them to the court of justice.

294 *Smith v. Sino-Forest* offers no tickets to bondholders because it is submitted that (a) the bondholders will fight with the shareholders about sharing the spoils of the litigation, especially because the bondholders have priority over the shareholders and secured and protected claims in a bankruptcy; (b) the bondholders will fight among themselves about a variety of matters including whether it would be preferable to leave it to their bond trustee to sue on their collective behalf to collect the debt rather than prosecute a class action for an unsecured claim for damages for misrepresentation; and (c) a misrepresentation action by the bondholders against some or all of the defendants may be precluded by the terms of the bonds.

295 In my opinion, the bondholders should be included as class members, if necessary, with their own subclass, and, thus, *Smith v. Sino-Forest* does not fare well under this group of interrelated factors. As I explained above, I do not regard the membership of both shareholders and bondholders in the class as raising insurmountable conflicts of interest. The bondholders have essentially the same misrepresentation claims as do the shareholders, and it makes sense, particularly as a matter of judicial economy, to have their claims litigated in the same proceeding as the shareholders' claims.

296 Pragmatically, if the bondholders are denied a ticket to one of the class actions now at the Osgoode Hall station because of a conflict of interest, then they could bring another class action in which they would be the only class members. That class action by the bondholders would raise the same issues of fact and law about the affairs of Sino-Forest. Thus, denying the bondholders a ticket on one of the two class actions that has made room for them would just encourage a multiplicity of litigation. It is preferable to keep the bondholders on board sharing the train with any conflicts being managed by the appointment of separate class counsel for the bondholders, who can form a subclass at certification or later assuming that certification is granted.

297 As already noted above, for those bondholders who do not want to get on the litigation train, they can opt-out of the class action assuming it is certified. That the defendants may have defences to the misrepresentation claims of the bondholders is just a problem that the bondholders will have to confront, and it is not a reason to deny them a ticket to try to obtain access to justice.

298 In *Caputo v. Imperial Tobacco Ltd.*, [2004] O.J. No. 299 (S.C.J.), Justice Winkler, as he then was, noted at para. 39 that there is a difference between restricting the joinder of causes of action in order to make an action more amenable to certification and restricting the number of class members in an action for which certification is being sought. He stated:

> Although *Rumley v. British Columbia*, [2001] 3 S.C.R. 184 holds that the plaintiffs can arbitrarily restrict the causes of action asserted in order to make a proceeding more amenable to certification (at 201), the same does not hold true with respect to the proposed class. Here the plaintiffs have not chosen to restrict

> the causes of action asserted but rather attempt to make the action more amenable to certification by suggesting arbitrary exclusions from the proposed class. This is diametrically opposite to the approach taken by the plaintiffs in *Rumley*, and one which has been expressly disapproved by the Supreme Court in *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158. There, McLachlin C.J. made it clear that the onus falls on the putative representative to show that the "class is defined sufficiently narrowly" but without resort to arbitrary exclusion to achieve that result....

299 For shareholders, *Smith v. Sino-Forest* is more accommodating; indeed, it is the most accommodating, in offering tickets to shareholders to board the class action train. Without prejudice to the arguments of the defendants, who may impugn any of the class period or class membership definitions, and assuming that the bondholders are also included, the best of the class periods for shareholders is that found in *Smith v. Sino-Forest.*

300 To be blunt, I found the rationales for shorter class periods in *Labourers v. Sino-Forest* and *Northwest v. Sino-Forest* somewhat paranoid, as if the plaintiffs were afraid that the defendants will attack their definitions for over-inclusiveness or for making the class proceeding unmanageable. Those attacks may come, but I see no reason for the plaintiffs in *Labourers* and *Sino-Forest* to leave at the station without tickets some shareholders who may have arguable claims.

301 If Mr. Torchio is correct that almost all of the shareholders would be covered by the shortest class period that is found in *Labourers v. Sino-Forest*, then the defendants may think the fight to shorten the class period may not be worth it. If they are inclined to challenge the class definition on grounds of unmanageability or the class action as not being the preferable procedure, the longer class period definition will likely be peripheral to the main contest.

302 I do not see the extension of the class period beyond June 2, 2011, when the Muddy Waters Report became public, as a problem. Put shortly, at this juncture, and subject to what the defendants may later have to say, I agree with Rochon Genova's arguments about the appropriate class period end date for the shareholders.

303 If I am correct in this analysis so far, where it takes me is only to the conclusion that the best class period definition for shareholders is found in *Smith v. Sino-Forest.* It, however, does not take me to the conclusion that carriage should be granted to *Smith v. Sino-Forest*. Subject to what the defendants may have to say, the class definitions and class period in *Labourers v. Sino-Forest* and in *Northwest v. Sino-Forest* appear to be adequate, reasonable, certifiable, and likely consistent with the common issues that will be forthcoming.

304 Since for other reasons, I would grant carriage to *Labourers v. Sino-Forest*, the question I ask myself is whether the class definition in *Labourers*, which favourably includes bondholders, but which is not as good a definition as found in *Smith v. Sino-Forest* or in *Northwest v. Sino-Forest* should be a reason not to grant carriage to *Labourers*. My answer to my own question is no, especially since it is still possible to amend the class definition so that it is not under-inclusive.

(c) Theory of the Case, Causes of Action, Joinder of Defendants, and Prospects of Certification

305 The second group of interrelated determinative factors is: theory of the case, causes of action, joinder of defendants, and prospects of certification. Taken together, it is my opinion, that these factors, which are about what is in the best interests of the putative class members, favour staying *Smith v. Sino-Forest* and *Northwest v. Sino-Forest* and granting carriage to *Labourers v. Sino-Forest.*

306 In applying the above factors, I begin here with the obvious point that it would not be in the interests of the putative class members, let alone not in their best interests to grant carriage to an action that is unlikely to be certified or that, if certified, is unlikely to succeed. It also seems obvious that it would be in the best interests of class members to grant carriage to the action that is most likely to be certified and ultimately successful at obtaining access to justice for the injured or, in this case, financially harmed class members. And it also seems obvious that all other things being equal, it would be in the best interests of class members and fair to the defendants and most consistent with the policies of the *Class Proceedings Act, 1992* to grant carriage to the action that, to borrow from rule 1.04 or the *Rules of Civil Procedure* secures the just, most expeditious and least expensive determination of the dispute on its merits.

307 While these points seem obvious, there is, however, a major problem in applying them, because the court should not and cannot go very far in determining the matters that would be most determinative of carriage. A carriage motion is not the time to determine whether an action will satisfy the criteria for certification or whether it will ultimately provide redress to the class members or whether it would be the preferable procedure or the most expeditious and least expensive procedure to resolve the dispute.

308 Keeping this caution in mind, in my opinion, certain aspects of *Northwest v. Sino-Forest* make the other actions preferable. In this regard, I find the joinder of some defendants to *Northwest v. Sino-Forest* mildly troublesome.

309 More serious, in *Northwest v. Sino-Forest,* I find the employment and reliance on the tort action of fraudulent misrepresentation less desirable than the causes of action utilized to provide procedural and substantive justice to the class members in *Smith v. Sino-Forest* and *Labourers v. Sino-Forest.* In my opinion, the fraudulent misrepresentation action adds needless complexity and costs.

310 While the finger-pointing of the OSC at Ho, Hung, Ip, and Yeung supports their joinder, the joinder of Chen, Lawrence Estate, Maradin, Wong, and Zhao is mildly troublesome. The joinder of defendants should be based on something more substantive than their opportunity to be a wrongdoer, and at this juncture it is not clear why Chen, Lawrence Estate, Maradin, Wong, and

Zhao have been joined to *Northwest v. Sino-Forest* and not to the other proposed class actions. Their joinder, however, is only mildly troublesome, because the plaintiffs in *Northwest v. Sino-Forest* may have particulars of wrongdoing and have simply failed to plead them.

311 Turning to the pleading of fraudulent misrepresentation, when it is far easier to prove a claim in negligent misrepresentation or negligence, the claim for fraudulent misrepresentation seems a needless provocation that will just fuel the defendants' fervour to defend and to not settle the class action. Fraud is a very serious allegation because of the moral and not just legal turpitude of it, and the allegation of fraud also imperils insurance coverage that might be the source of a recovery for class members.

312 Kim Orr has understated the difficulties the plaintiffs in *Northwest v. Sino-Forest* will confront in impugning the integrity of Sino-Forest, Ardell, Bowland, Chan, Horsley, Hyde, Mak, Martin, Murray, Poon, Wang, West, Chen, Ho, Hung, Ip, Lawrence Estate, Maradin, Wong, Yeung, Zhao, Canaccord, CIBC, Credit Suisse, Credit Suisse (USA), Dundee, Haywood, Maison, Merrill, Merrill-Fenner, Morgan, RBC, Scotia, TD, UBS, E&Y, BDO, Pöyry, Pöyry Forest, JP Management.

313 Fraud must be proved individually. In order to establish that a corporate defendant committed fraud, it must be proven that a natural person for whose conduct the corporation is responsible acted with a fraudulent intent. See: *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.) at para. 26; *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637 (Gen. Div.) at paras. 477-479.

314 A claim for deceit or fraudulent misrepresentation typically breaks down into five elements: (1) a false statement; (2) the defendant knowing that the statement is false or being indifferent to its truth or falsity; (3) the defendant having an intent to deceive the plaintiff; (4) the false statement being material and the plaintiff being induced to act; and (5) the defendant suffering damages: *Derry* v. *Peek* (1889), 14 App. Cas. 337 (H.L.); *Graham* v. *Saville*, [1945] O.R. 301 (C.A.); *Francis* v. *Dingman* (1983), 2 D.L.R. (4th) 244 (Ont. C.A.). The fraud elements are the second and third in this list.

315 In the famous case of *Derry* v. *Peek*, the general issue was what counts as a fraudulent misrepresentation. More particularly, the issue was whether a careless or negligent misrepresentation without more could count as a fraudulent misrepresentation. In the case, the defendants were responsible for a false statement in a prospectus. The prospectus, which was for the sale of shares in a tramway company, stated that the company was permitted to use steam power to work a tram line. The statement was false because the directors had omitted the qualification that the use of steam power required the consent of the Board of Trade. As it happened, the consent was not given, the tram line would have to be driven by horses, and the company was wound-up. The Law Lords reviewed the evidence of the defendants individually and concluded that although the defendants had all been careless in their use of language, they had honestly believed what they had said in the prospectus.

316 In the lead judgment, Lord Herschell reviewed the case law, and at p. 374, he stated in the most famous passage from the case:

> I think the authorities establish the following propositions. First, in order to sustain an action for deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless, whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false has obviously no such honest belief. Thirdly, if fraud is proved, the motive of the person guilty is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

317 Lord Herschell's third situation is the one that was at the heart of *Derry* v. *Peek*, and the Law Lords struggled to articulate that relationship between belief and carelessness in speaking. Before the above passage, Lord Herschell stated at p. 361:

> To make a statement careless whether it be true or false, and therefore without any real belief in its truth, appears to me to be an essentially different thing from making, through want of care, a false statement, which is nevertheless honestly believed to be true. And it is surely conceivable that a man may believe that what he states is the fact, though he has been so wanting in care that the Court may think that there were no sufficient grounds to warrant his belief.

318 Lord Herschell is saying that carelessness in making a statement does not necessarily entail that a person does not believe what he or she is saying. However, later in his judgment, he emphasizes that carelessness is relevant and could be sufficient to show that a person did not believe what he or she was saying. Thus, carelessness may prove fraud, but it is not itself fraud. Lord Herschell's famous quotation, where he states that fraud is proven when it is shown that a false statement was made recklessly, careless whether it be true or false, states only awkwardly the role of carelessness and must be read in the context of the whole judgment.

319 In *Angus* v. *Clifford,* [1891] 2 Ch. 449 (C.A.) at p. 471, Bowen, L.J. discussed the role of carelessness or recklessness in establishing fraud; he stated:

> Not caring, in that context [i.e., in the context of an allegation of fraud], did not mean taking care, it meant indifference to the truth, the moral obliquity which

> consists of wilful disregard of the importance of truth, and unless you keep it clear that that is the true meaning of the term, you are constantly in danger of confusing the evidence from which the inference of dishonesty in the mind may be drawn - evidence which consists in a great many cases of gross want of caution - with the inference of fraud, or of dishonesty itself, which has to be drawn after you have weighed all the evidence.

320 Bowen, L.J.'s statement alludes to the second element of what makes a statement fraudulent. Deceit or fraudulent misrepresentation requires that the defendant have "a wicked mind:" *Le Lievre* v. *Gould*, [1893] 1 Q.B. 491 at p. 498. Fraud involves intentional dishonesty, the intent being to deceive. If the plaintiff fails to prove this mental element, then, as was the case in *Derry* v. *Peek*, the claim is dismissed. To succeed in an action for deceit or for fraudulent misrepresentation, the plaintiff must show not only that the defendant spoke falsely and contrary to belief but that the defendant had the intent to deceive, which is to say he or she had the aim of inducing the plaintiff to act mistakenly: *BG Checo International Ltd. v. British Columbia Hydro and Power Authority* (1993), 99 D.L.R. (4th) 577 (S.C.C.).

321 The defendant's reason for deceiving the plaintiff, however, need not be evil. In the passage above from *Derry* v. *Peek*, Lord Herschell notes that the person's motive for saying something that he or she does not believe is irrelevant. A person may have a benign reason for defrauding another person, but the fraud remains because of the discordance between words and belief combined with the intent to mislead the plaintiff: *Smith* v. *Chadwick* (1854), 9 App. Cas. 187 at p. 201; *Bradford Building Society* v. *Borders*, [1941] 2 All E.R. 205 at p. 211; *Beckman* v. *Wallace* (1913), 29 O.L.R. 96 (C.A.) at p. 101.

322 In promoting its fraudulent misrepresentation claim, Kim Orr relied on *Gregory v. Jolley* (2001), 54 O.R. (3d) 481 (C.A.), which was a case where a trial judge erred by not applying the third branch of the test articulated in *Derry v. Peek*. Justice Sharpe discussed the trial judge's failure to consider whether the appellant had made out a case of fraud based on recklessness and stated at para. 20:

> With respect to the law, the trial judge's reasons show that he failed to consider whether the appellant had made out a case of fraud on the basis of recklessness. While he referred to a case that in turn referred to the test from *Derry v. Peek*, the reasons for judgment demonstrate to my satisfaction that the trial judge simply did not take into account the possibility that fraud could be made out if the respondent made misrepresentations of material fact without regard to their truth. The trial judge's reasons speak only of an intention to defraud or of statements calculated to mislead or misrepresent. He makes no reference to recklessness or to statements made without an honest belief in their truth. As *Derry v. Peek* holds, that state of mind is sufficient proof of the mental element required for civil fraud, whatever the motive of the party making the representation. In

> another leading case on civil fraud, *Edgington v. Fitzmaurice*, (1885), 29 Ch. D.459 at 481-82 (C.A.), Bowen L.J. stated: "[I]t is immaterial whether they made the statement knowing it to be untrue, or recklessly, without caring whether it was true or not, because to make a statement recklessly for the purpose of influencing another person is dishonest." The failure to give adequate consideration to the contention that the respondent had been reckless with the truth in regard to the income figures he gave in order to obtain disability insurance constitutes an error of law justifying the intervention of this court.

323 From this passage, Kim Orr extracts the notion that there is a viable fraudulent misrepresentation against forty defendants all of whom individually can be shown to be reckless as opposed to careless. That seems unlikely, but more to the point, recklessness is only half the battle. The overall motive may not matter, but the defendant still must have had the intent to deceive, which in *Gregory v. Jolley* was the intent to obtain disability insurance to which he was not qualified to receive.

324 Recklessness alone is not enough to constitute fraudulent misrepresentation, as Justice Cumming notes at para. 25 of his judgment in *Hughes v. Sunbeam Corp. (Canada)*, [2000] O.J. No. 4595 (S.C.J.), where he states:

> The representation must have been made with knowledge of its falsehood or recklessness without belief in its truth. The representation must have been made by the representor with the intention that it should be acted upon by the representee and the representee must in fact have acted upon it.

325 I conclude that the fraudulent misrepresentation action is a substantial weakness in *Northwest v. Sino-Forest.* In fairness, I should add that I think that the unjust enrichment causes of action and oppression remedy claims in *Labourers v. Sino-Forest* add little.

326 The unjust enrichment claims in *Labourers* seem superfluous. If Sino-Forest, Chan, Horsley, Mak, Martin, Murray, Poon, Banc of America, Canaccord, CIBC, Credit Suisse, Credit Suisse USA, Dundee, Maison, Merrill, RBC, Scotia and TD, are found to be liable for misrepresentation or negligence, then the damages they will have to pay will far exceed the disgorgement of any unjust enrichment. If they are found not to have committed any wrong, then there will be no basis for an unjust enrichment claim for recapture of the gains they made on share transactions or from their remuneration for services rendered. In other words, the claims for unjust enrichment are unnecessary for victory and they will not snatch victory if the other claims are defeated. Much the same can be said about the oppression remedy claim. That said, these claims in *Labourers v. Sino-Forest* will not strain the forensic resources of the plaintiffs in the same way as taking on a massive fraudulent misrepresentation cause of action would do in *Northwest v. Sino-Forest.*

327 For the purposes of this carriage motion, I have little to say about the "Integrity Representation" approach to the misrepresentation claims that are at the heart of the claims against the defendants in *Northwest v. Sino-Forest* or of the "GAAP" misrepresentation employed in *Labourers v. Sino-Forest,* or the focus on the authorized intermediaries in *Smith v. Sino-Forest.* Short of deciding the motion for certification, there is no way of deciding which approach is more likely to lead to certification or which approach the defendants will attack as deficient. For present purposes, I am simply satisfied that the class members are best served by the approach in *Labourers v. Sino-Forest.*

328 The cohesive, yet adequately comprehensive, approach used in *Smith v. Sino-Forest* appears to me close to *Labourers v. Sino-Forest,* but in my opinion, *Smith v. Sino-Forest* wants for the inclusion of the bondholders, and, as noted above, there are other factors which favour *Labourers v. Sino-Forest* over *Smith v. Sino-Forest.* That said, it was a close call for me to choose *Labourers v. Sino-Forest* and not *Smith v. Sino-Forest.*

H. CONCLUSION

329 For the above Reasons, I grant carriage to Koskie Minsky and Siskinds with leave to the plaintiffs in *Labourers v. Sino-Forest* to deliver a Fresh as Amended Statement of Claim.

330 In granting leave, I grant leave generally and the plaintiffs are not limited to the amendments sought as a part of this carriage motion. It will be for the plaintiffs to decide whether some amendments are in order to respond to the lessons learned from this carriage motion, and it is not too late to have more representative plaintiffs.

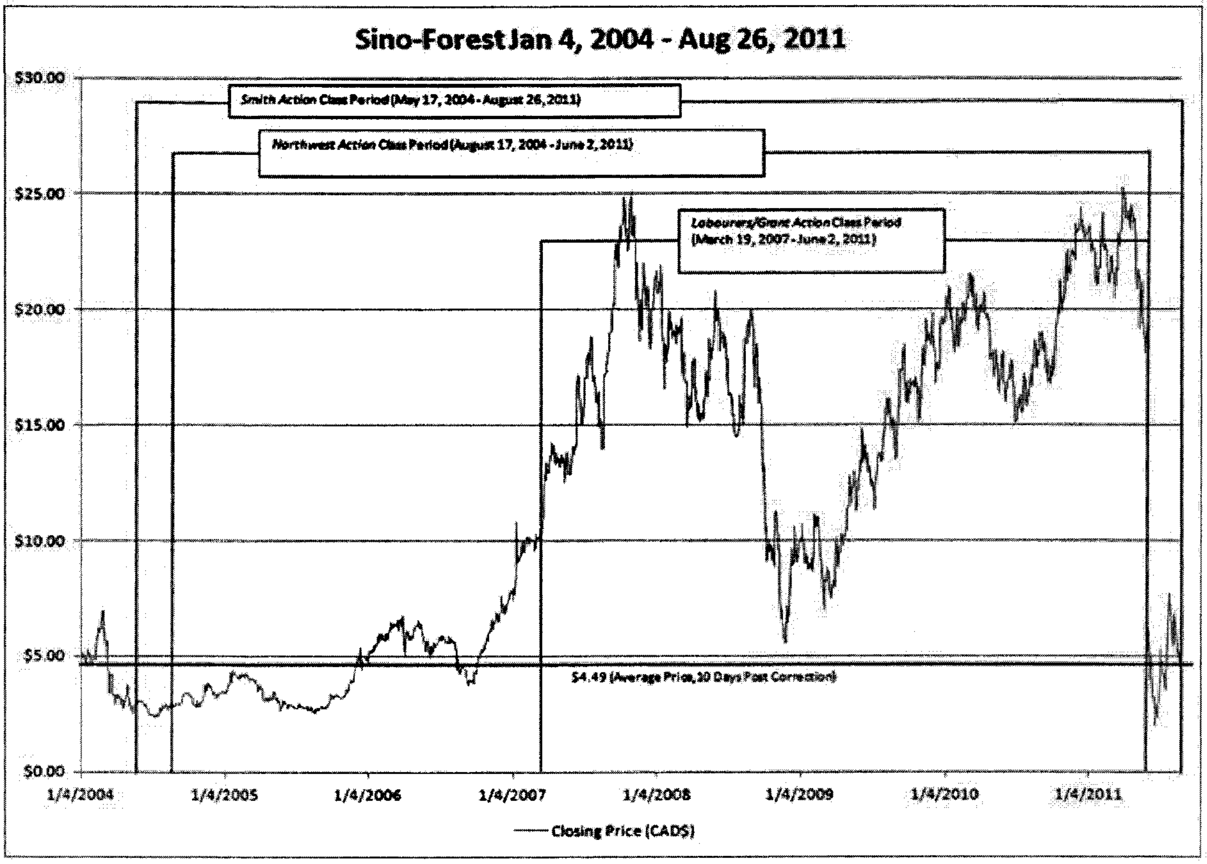
331 I repeat that a carriage motion is without prejudice to the defendants' rights to challenge the pleadings and whether any particular cause of action is legally tenable.

332 I make no order as to costs, which is in the usual course in carriage motions.

P.M. PERELL J.

* * * * *

SCHEDULE "A"



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Corrigendum
Released: January 27, 2012

Paragraph 28 (page 8) - the second to last line should read "**a responsible issuer**" and not "a responsible issue"

Paragraph 73 (page 13) - the third line should read "**CIBC**" and not "CIDC"

Paragraph 228 (page 38) - on the third line, the word "losses" should be "**loses**"

Paragraph 252 (page 42) - on the third line, the word should be "**submitted**" and not "summited"

Paragraph 252 (page 42) - the last line should have a period at the end of the paragraph

Paragraph 282 (page 46) - on the last line, the word "paper" should be "**para.**"

cp/ci/e/qlafr/qlvxw/qlced/qljxh/qljac

Case Name:
Gould v. BMO Nesbitt Burns Inc.

Between
Tim Gould and Archie Leach, Plaintiffs, and BMO Nesbitt Burns Inc., Blackmont Capital Inc., Canaccord Capital Corporation, National Bank Financial Inc., Sprott Securities Inc., TD Securities Inc., BDO Seidman, LLP, FMF Capital Group Ltd., FMF Capital LLC, FMF Holdings, LLC, Michigan Fidelity Acceptance Corporation, PKF, LLC, Thomas Little, Atul Shah, Michael Hoffman, Edan King, Howard Morof, Robert Pilcowitz, Eric Slavens, and Lorie Weisberg, Defendants

[2007] O.J. No. 1095

45 C.P.C. (6th) 360

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Court File No. 49348 CP

Ontario Superior Court of Justice

M.C. Cullity J.

Heard: March 14, 2007
Judgment: March 23, 2007.

(56 paras.)

Civil procedure -- Settlements -- Approval -- Motion by the representative plaintiffs for approval of a settlement and counsel fees allowed -- The plaintiffs incurred losses on securities issued, marketed and sold by the defendants -- They claimed aggregate general and punitive damages of $135 million for negligence, negligent misrepresentation and breaches of the Competition Act -- The settlement provided for a fund of $28.6 million to be divided among class members -- The court certified the proceeding for the purpose of implementing the settlement, which was reasonable in its amount and *terms -- Fees were capped at $4.5 million given the speed settlement was reached.*

Statutes, Regulations and Rules Cited:

Class Proceedings Act, s. 5(1), s. 5(1)(a), s. 5(1)(b), s. 5(1) (d), s. 5(1)(e), s. 32, s. 32(2), s. 32(4)(a), s. 33

Competition Act, s. 36, s. 52

Ontario Business Corporations Act, R.S.O. 1990, c. B.16,

Counsel:

Charles M. Wright, A. Dimitri Lascaris and H. Juroviesky - for the plaintiffs.

Ronald G. Slaght Q.C. and Jordan Goldblatt - for BMO Nesbitt Burns Inc., Thomas Little and Atul Shah.

Margaret Waddell - for FMF Capital Group Ltd., FMF Capital LLC, FMF Holdings, LLC, Michigan Fidelity Acceptance Corporation, PKF, LLC, Michael Hoffman, Eric Slavens, Lorie Weisberg, Edan King, Howard Morof, and Robert Pilcowitz

F. McLaughlin and Jeffrey Feiner - for TD Securities Inc.

Reena Goyal - for National Bank Financial Inc.

Gavin Smyth - for Sprott Securities Inc.

Timothy Banks - for BDO Seidman.

David Mitchell - for Canaccord Capital Corporation and Blackmont Capital Inc..

REASONS FOR DECISION

1 **M.C. CULLITY J.**:-- The plaintiffs' motions to approve the settlement of this class proceeding, and the fees of class counsel, were initially set down to be heard on January 25, 2007. On that date, after hearing the submissions of counsel, and of one of the putative class members who addressed the question of class counsel's fees, the hearing was adjourned to permit another member - Mr. Richard Byers - who had provided a written objection to the settlement to expand on his concerns. After further communications were received from him, the hearing resumed on February 23, 2007 and class counsel responded to his objections. In an endorsement released on

March 7, 2007, I declined to approve the settlement but provided counsel with an opportunity to file material, and make further submissions, on what I considered to be inadequacies in the record.

2 Additional affidavit material was then filed and addressed by counsel on March 14, 2007. At the conclusion of the hearing I indicated that I was satisfied that, in principle, the settlement should be approved. Subject to the comments I will make on particular provisions of the settlement agreement, there will be an order to this effect and an order certifying the proceeding for the purpose of implementing the settlement.

Background

3 The litigation concerns losses made by purchasers of income-participating securities ("Securities") issued by FMF Capital Group Ltd ("FMF Group"). FMF Group was incorporated under the *Ontario Business Corporations Act,* R.S.O. 1990, c. B.16 on October 20, 2004 for the purpose of an initial public offering ("IPO") of the Securities. Each of the Securities has two components: a common share, or equity component; and a subordinated note, or debt component. The prospectus stated that monthly distributions of dividends or interest were intended to be made. The value of the Securities, and the ability to declare dividends, and pay interest, on them was derived from subprime mortgage loans made by FMF Capital LLC ("FMF Capital") in the United States residential real estate market. As such loans are made to borrowers with a low credit rating, and may be made with relatively low margins, they are accompanied with a degree of risk that would not normally attach to residential mortgages. These risks were disclosed in the prospectus.

4 FMF Group has a 60 per cent indirect interest in FMF Capital. The remaining 40 per cent indirect interest is owned by Michigan Fidelity Acceptance Corporation (" MFAC") and PKF, LLC ("PKF"). PKF is allegedly controlled by the defendants, Edan King and Robert Pilcowitz, and 90 per cent of the equity of MFAC is owned by trusts for their families. Each of the above corporations - other than FMF Group - is incorporated in the United States.

5 The IPO of the Securities was made in Canada pursuant to a prospectus dated March 16, 2005. It closed on March 24, 2005 and the Securities were then listed, and traded, on the Toronto Stock Exchange ("TSX"). Dividends were declared, and interest paid, monthly, through October, 2005. On November 14, 2005, FMF Group announced that the declaration of dividends was suspended, and payments of interest deferred. The following day the listed price of the Securities on the TSX fell by 76.7 per cent. The price has continued to fall. At the close of trading on January 9, 2007, the Securities were trading at $ 0.17 compared with the offering price under the IPO of $10.00.

6 Since the initial hearing of these motions, the TSX has suspended trading of the Securities, and has informed FMF Group that they will be delisted on April 5, 2007. On March 9, 2007, FMF Group announced its decision to wind up the business and operations of FMF Capital as a result of the "continuing rapid and severe deterioration of the US nonprime mortgage industry and other factors affecting its overall nonprime mortgage business".

The litigation

7 The statement of claim in this action was issued in London, Ontario on January 25, 2006. A similar class proceeding (the "Michigan action") had been commenced in Michigan State Court on December 5, 2005. On March 21, 2006, a class proceeding was commenced in Quebec on behalf of residents of the Province who purchased Securities either in the IPO or, subsequently, over the TSX. Since that time the plaintiffs and their counsel in the three actions have attempted to co-ordinate their resources and efforts in the litigation, and the proposed settlement is intended to resolve and dispose of the issues in each of the proceedings.

8 Following amendments to the complaint filed in Michigan, the defendants in that action now include each of the defendants to this proceeding. In addition, the family trusts that own 90 per cent of MFAC are named as defendants in the Michigan proceedings. Subject to the general exclusion of residents of Quebec from the class in this proceeding, and their inclusion in the class in the Quebec action, the proposed class is defined in substantially the same manner in each of the three actions.

9 Although, strictly, I am concerned only with whether the action in Ontario should be certified, and the settlement of it approved, it was necessary to consider whether a proposed dismissal of the Michigan action would be in the interests of the putative class in this proceeding.

The parties

10 The plaintiffs purchased Securities under the IPO and, also, subsequently over the TSX before November 16, 2005. They seek to represent purchasers who would not be included in the class for which certification is sought in Quebec and who fall within each of the two categories ("Class I" and "Class II"). Of the 20 defendants, eleven consist of the corporations I have mentioned, a related holding company and certain directors and senior officers of them. These have been referred to by counsel as the "FMF Defendants". The remaining defendants consist of six underwriters, and an accounting firm, who were involved in the IPO, and a director and analyst of the lead underwriter, BMO Nesbitt Burns Inc.

The claims

11 The plaintiffs claim compensatory damages for negligence, negligent misrepresentation and breaches of sections 36 and 52 of the *Competition Act*. Punitive damages are also claimed. Expert evidence filed on behalf of the plaintiffs estimates the maximum aggregate, compensatory damages at approximately $135 million.

12 The misrepresentations consist of allegedly untrue statements in the prospectus for the IPO and, in particular, the omission of facts required to prevent other statements in the prospectus from being misleading. In addition to the prospectus misrepresentations, it is pleaded that certain of the defendants negligently made statements to, or withheld information from, the public that should be considered material to their decisions as prospective investors in the Securities. These allegations

are particularised in the pleading.

13 Underlying the claims with respect to material misrepresentations and non-disclosure is the general allegation that an extraordinary growth in FMF Capital's loan volume in the period preceding the IPO was accompanied by a degradation of its underwriting standards that led to repurchase demands by institutional purchases of the loans for which the corporation's loan loss reserves were, to the knowledge of defendants, inadequate.

The course of the proceedings

14 From the outset, the defendants indicated their intention to deny liability and to contest the claims made against them if the actions proceeded to trial. Motions to dismiss the proceedings in Michigan and to limit rights of discovery and the examination of witnesses there have been made. Apart from a successful motion by the defendants to change the venue of this action from London to Toronto, there have been no orders on motions in this proceeding to date. There is, however, a pending motion by the plaintiffs to stay this action until certification is denied, or the issues have been determined, in Michigan. The defendants have indicated their intention to oppose that motion on the ground that Ontario is the more convenient forum - the mirror image of part of their motion in the Michigan court to dismiss the action there.

15 Although Mr. Byers has characterised the motions in Michigan, and the pending motion here, as "legal manoeuvring", I am satisfied that they were much more than preliminary skirmishes. They highlight the existence of jurisdictional, procedural, practical and substantive legal issues that could impact significantly on the outcome of the litigation. Even if the likelihood of appeals from whatever disposition of the pending motions is made could be disregarded, I do not think there is any doubt that, if the litigation is to continue to a final judicial resolution, its complexity is such that it will very likely be protracted over a period of several years. It will be inordinately expensive to the parties and in terms of judicial resources. Moreover, at this stage - for the reasons I will give - there can be no guarantee of any satisfactory recovery for the members of the class. In short, this is pre-eminently a case in which the parties should be encouraged to reach a settlement that falls within a zone of reasonableness. The question is whether the proposed settlement is such.

The settlement

16 The settlement agreement was made between the plaintiffs and the defendants in each of the three actions with the exception of certain defendants in the Michigan proceedings. The latter are the spouses of Edan King and Robert Pilcowitz and the trustees of the trusts that own MFAC. The trusts are alleged to have received the greater part of the proceeds of the IPO and claims against them in respect of fraudulent conveyances and unjust enrichment are made in the Michigan proceedings. Although not parties to the settlement agreement, they are intended to be "third party beneficiaries" of it and to be entitled to all the rights it purports to confer on them - including releases of all claims that the class may have against them.

17 The agreement provides for a settlement fund consisting of (a) (US) $21 million to be provided by insurers of certain of the FMF Defendants; (b) (Can) $3,750,000 to be provided by the underwriters; and (c) (Can) $800,000 to be provided by the accounting firm involved in the IPO. The fund is to be distributed among the class in accordance with a Distribution Protocol after payment of class counsel's fees and certain expenses, including the expenses of giving notice to, and locating, class members, assisting them to make claims, and administering and distributing the balance of the fund to them. The fund ($28,625,504) has been deposited with class counsel and is earning interest of approximately $100,000 a month.

18 In consideration of those payments, all claims against the defendants - including the trusts - in the three actions are to be released without an admission of liability.

19 The Distribution Protocol is intended to permit the net settlement fund to be divided among the class members in a manner proportionate to the loss suffered by each of them with a discount factor applied to the amounts otherwise distributable to Class II members to reflect increased certification and substantive litigation risks affecting their claims.

20 Expert evidence was filed that estimated the loss per Security suffered by Class I members as falling within a range of 77 cent(s) to $7.74, and by Class II members from 46 cent(s) to $4.60. The mid-point within each range has been accepted for the purposes of the protocol.

21 Independent counsel were retained to negotiate the appropriate discount factor on behalf of the members of each of the classes. Their joint recommendation of a discount of 26 per cent is reflected in the protocol.

22 As well as the above considerations, which will require an individual determination in respect of each claimant, further adjustments are proposed to deal with a number of variables that will include: (a) whether members sold Securities prior to November 15, 2005; (b) whether they continued to own securities after that time; (c) whether they acquired Securities over the TSX as well as under the IPO; and (d) the total number of Securities purchased by class members whose valid claims are filed in a timely manner.

23 In view of the above, the Distribution Protocol is necessarily elaborate and complex and this created difficulties in summarising its contents and effect in the notices of the settlement approval hearing that were provided to purchasers of the Securities. The notices informed them of their ability to obtain further information from class counsel, or from counsel's website which contained the settlement documents including the protocol.

Analysis

24 The requirement that settlements of class proceedings must be approved by the court was enacted to ensure that the interests of the class members who will be bound by the settlement would be protected. In a case like this, where certification has not preceded the motion for settlement

approval, the concern is lessened by the right to opt out that will be provided to members who do not agree with the settlement after it has been approved. The concern, however, continues to exist because the right to opt out provides less than perfect protection for the interests of persons who are not before the court. The necessity for court approval is particularly important in cases where the factual and legal issues are complex and the task of assessing the litigation risks is difficult.

1. The governing principles

25 The principles that the court applies when considering approval of the settlement have been stated and discussed in numerous cases, including *Dabbs v. Sun Life Assurance Co of Canada* (1998), 40 O.R. (3d) 429 (G. D.), at page 444, affirmed (1998), 41 O.R. (3d) 97 (C.A.); *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.), at paras 77 - 80; *Fraser v. Falconbridge Ltd*, [2002] O.J. No. 2383 (S.C.J.), at paras 13 - 14; *Ford v. F. Hoffmann-La Roche Ltd*, [2005] O.J. No. 1118 (S.C. J.), at paras 110 - 118; and *Nunes v. Air Transat A.T. Inc.*, [2005] O.J. No. 2527 (S.C.J.)

26 As a settlement is necessarily a compromise of the competing rights asserted on behalf of the parties, it is necessary to consider the likelihood that the plaintiffs would be successful if the litigation continued and the future expense and likely duration of the proceeding, and to weigh these factors against the benefits that the settlement would provide. In deciding whether to grant, or withhold, approval, the court must consider whether the settlement is fair, reasonable and in the best interests of the class. It does not hold the parties to a standard of perfection. It is sufficient if the terms and effect of the settlement on the interests of the class fall within a zone of reasonableness.

27 Although the requirement of court approval is not a formality, and an exercise of judgment is required, the court will rarely, if ever, be in a position to weigh the benefits of the settlement against the litigation risks and likely outcome of the proceeding with the thoroughness and acuteness of experienced class counsel involved in the litigation. For that reason, a degree of deference is given to counsel's recommendation of the settlement if the court is satisfied that it was the result of arm's-length negotiations without collusion.

2. Conflicts of interest

28 As the Ontario Law Reform Commission recognised in chapter 20 of its *Report on Class Actions* (Ministry of the Attorney-General, 1982), an important threshold aspect of the court's consideration must be the adequacy of representation provided by the plaintiffs and their counsel and the potential conflicts between their respective interests and those of other class members. I have no concerns of this kind here. The proposed representative plaintiffs are by no means unsophisticated investors. Each of them purchased securities under the IPO and also on the secondary market and there is nothing in the record to suggest that they have interests that conflict with those of other putative class members under the settlement agreement, or otherwise.

29 Where, as here, counsel will also be seeking approval of an agreement for a contingency fee expressed in terms of a percentage of the gross recovery in the action, there will be a concern to see that counsel have not succumbed to a temptation to prefer their own interests by recommending a speedy settlement that would provide them with rewards disproportionate to the work they have performed and the benefits for the class. At the same time, it must be noted that an early settlement of the proceedings can be very much in the interests of the class members.

30 The motion to approve the settlement in this case is not conditioned on the court's approval of the fee counsel are requesting. Although the time records they have filed indicate that the possibility of settlement was considered, and discussed, from virtually the inception of the proceedings, I do not find this to be in any way unusual, or inconsistent with an exercise of professional judgment in the light of the respective interests of the parties faced with potentially protracted litigation of this nature.

31 Having considered the settlement at some length, I see no basis for any concern that in recommending the settlement to their clients, counsel were acting inconsistently with their professional obligations to the representative plaintiffs and the class, or that they were improperly influenced by the existence of the contingency fee agreement. They are experienced in class proceedings and, from my examination of the material filed and having heard the submissions of class counsel, I am satisfied that the settlement was arrived at in arm's-length negotiations with the numerous defendants and their similarly experienced counsel. In these circumstances, I am satisfied that I should give considerable weight to their professional judgment when assessing the litigation risks and the other factors that have a significant bearing on the merits of the settlement.

3. Litigation risks

32 Although the decline in the value of the Securities was dramatic - even spectacular - and the claims asserted on behalf of the plaintiffs were by no means frivolous, I am, as I have indicated, satisfied that the proceedings would have been protracted and, from the viewpoint of the plaintiffs and the class, that the litigation risks were considerable. Apart from the issues affecting the appropriate forum, and differences between the substantive laws of Ontario and Michigan, there are also questions relating to the enforcement of foreign judgments and the prospects of recovery against certain defendants. Although important, and to varying degrees, difficult, these issues were, in counsel's judgment, increasingly overshadowed by fundamental factual considerations of causation underlined by a general and continuing decline in the subprime mortgage market in the United States - a matter that would bear on both the defences of the defendants on the facts, and the extent of damages if liability was ultimately established.

4. The settlement fund

33 In the retainer agreements executed by the plaintiffs in December, 2005, they acknowledged that counsel had advised that the amount of a reasonable settlement could be in a range of $10,000,000 to $50,000,000. By the time notice of the settlement approval has been given and class members' individual claims have been received and processed, it is estimated that the gross settlement fund will amount to more than $29 million. When the benefits of having this amount - less fees, disbursements and expenses - available within a relatively short period are weighed against the litigation risks, I am not prepared to find that it, and the other provisions of the settlement agreement, fall outside the required zone of reasonableness. This includes the provisions of the Distribution Protocol which are based, in part, on the report of a qualified firm of consultants in economic damage quantification for complex litigation, on the recommendations of experienced counsel with respect to the Class II discount and, otherwise, on assumptions that I consider to be reasonable.

34 To the limited extent that guidance can be obtained from analyses of amounts recovered in securities cases in the United States, the settlement amount is not out of line.

5. Objections

35 Mr. Byers was the only prospective class member to file, or voice, objections to the settlement. He criticised it as a settlement of convenience that does not properly or fairly represent the best interests of the class members. I have referred above to his description of the motions in Michigan and the pending motions in Ontario as mere legal manoeuvring, and not meaningful progressive steps to advance the claims against the defendants. I am satisfied that this criticism reflects a misapprehension of the importance of those motions if, as he evidently wishes, the litigation were to continue. Among other things, success for the defendants would have created obstacles for any attempt to follow the proceeds of the IPO into the trusts that are defendants in the Michigan action. On this issue - and generally - I differ from Mr. Byers in my assessment of the benefits that are likely to be achieved for the class if the proceedings are to continue. I am satisfied that he has not appreciated fully the risks involved in prosecuting these proceedings to an eventual trial, or the length of time that would inevitably elapse - and the expense that would be incurred - before their final resolution.

36 Mr. Byers stated that he finds it incomprehensible that litigation of this magnitude could be settled so quickly. To the extent that this is intended to imply that plaintiff's counsel had not expended the time and effort required to investigate and assess the relative strengths and weaknesses of their case, I am satisfied from my review of the record - including the time sheets they provided - that the suggestion is unwarranted. This is not intended as a criticism of Mr. Byers' comments. His objections were helpful in focusing attention on a number of issues as well as the extent to which information about the settlement had been communicated to class members and the adequacy of the notice of the settlement approval hearing. As a consequence, further material was filed, further submissions were made by counsel, and the adjournment of the hearing provided members with a further opportunity to have access to materials filed on the motion. Any of the class members who share Mr. Byers' conviction that a claim could be advanced successfully against the underwriters, or other defendants, will have an opportunity to opt out of the proceedings and to pursue their separate claims in court, or otherwise. To that extent, they should not be prejudiced by this court's approval of the settlement.

37 The matters on which I considered the original material filed to be inadequate included the proposed dismissal of the Michigan action and the question whether this would be in the interests of the class in this proceeding. One of the concerns raised by Mr. Byers - and on which further material was filed and submissions made on March 14, 2007 - related to the effect of the dismissal of the Michigan action on the ability of class members to have recourse against the family trusts that are alleged to have received the greater part of the proceeds of the IPO. There was evidence, which I see no reason to reject, that a judgment of this court against the trusts might not be recognised and enforced in Michigan. While I was not entirely persuaded by the other evidence, or by counsel's submissions, on the substantive law of that jurisdiction that supposedly might withhold a restitutionary remedy against the trustees in the Michigan action, I am satisfied that any such remedy would necessarily be predicated on findings of liability there against the defendants to this proceeding. On that basis, and although the litigation risks in the Michigan action were not identical to those of this proceeding, I am satisfied that no material distinction should be drawn between the two actions for the purpose of this motion.

6. Appeals from decisions of the Claims Administrator

38 My only remaining concern about the proposed settlement is the absence of any provision for arbitration, in the event that claims are denied in full, or in part, by the Claims Administrator. This requires attention. The settlement is otherwise approved.

Certification

39 There will also be an order certifying the proceeding for the purposes of implementing the settlement. The requirements for certification in section 5(1) of the CPA are, in my judgment, satisfied. Causes of action for negligent misrepresentation and negligence have been pleaded against the defendants: section 5(1)(a); there are two classes, or subclasses, of purchasers of the Securities: section 5(1)(b); subject to my comments below, the claims of the members of the classes raise common issues: section 5(1)(c); a class proceeding is the preferable procedure for disposing of the claims: section 5(1)(d); and the representative plaintiffs will fairly and adequately represent the interests of the class and, for the purposes of certification, the settlement agreement may be considered to contain an acceptable litigation plan: section 5(1)(e).

40 The sole common issue proposed by class counsel was as follows:

> What claims to the Class 1 Members and the Class II members have against the Defendants arising from the Defendants' alleged acts, omissions, disclosures or non-disclosures relating either to the IPO, or subsequent alleged acts, omissions, disclosures or non-disclosures relating to the [Securities].

41 Given the purpose for which certification was requested, it is unnecessary to consider the extent to which the common issue would otherwise advance the proceeding but, in my judgment, it is too broadly stated. Insofar as it is to be understood as referring to valid claims, it would include issues that could only be decided individually. Although, but for the settlement, it might be necessary to define the issues more elaborately, and to separate those arising from the claims of the two classes, or subclasses, I believe the following would be satisfactory for the present purposes:

> Did the Defendants, or any of them, breach duties of care owed to the Class 1 Members, or the Class II Members, by reason of the alleged acts, omissions, disclosures or non-disclosures relating to the IPO, or subsequent alleged acts, omissions, disclosures or non-disclosures relating to the Securities.

42 In the notice of settlement approval and certification, the opting out deadline referred to in the settlement agreement is to be extended from 30 days to 60 days after the short form approval notice is published. Any other matters concerning the terms and dissemination of notice can be discussed at a case conference.

Fees of class counsel

43 The representative plaintiffs moved for the court's approval of class counsel's fees in the amount of $6,000,000, plus disbursements in the amount of $289,416.49 and GST in the amount of $123,900.38 for a total of $6,413,316.87. These amounts would be payable out of the gross settlement fund in respect of the past, and future, professional services and disbursements of the six law firms retained on behalf of the plaintiffs in the proceedings in Ontario and Michigan. The firms were Siskinds LLP ("Siskinds") counsel for the plaintiffs in this action; Bernstein, Litowitz, Berger and Grossman, New York counsel retained to assist Siskinds in its initial investigation and analysis of the relevant law and facts; Juroviesky Ricci LLP, counsel for the plaintiffs in the Michigan action; Frank, Haron, Weiner and Navarro, Michigan counsel retained for the purpose of the Michigan action; and Strosberg Sutts LLP and Rochon Genova LLP, counsel retained by Siskinds for the purpose of the Class II discount.

44 The fee represents 24.66 per cent of the amount of the settlement fund notionally allocated to the Ontario action after 15 per cent of the fund has been attributed to the proposed settlement of the proceedings in Quebec. It is in line with the Siskinds retainer agreements with the representative plaintiffs that provided for a contingency fee of 25 per cent of any recovery by way of settlement, or judgment, in the action. Although the plaintiffs in the Michigan action had agreed to a fee of 33 per cent of the total value of the settlement, their counsel - the Juroviesky firm - have supported the motion for a global fee of $6,000,000. The fee is intended to cover the work performed in respect of the settlement motion and any further services that may be required in connection with the administration of the settlement by the Claims Administrator. I see no reason why the latter should be substantial or be permitted to have any significant impact on the size of the contingent fee.

45 Putting on one side for the moment the reasonableness of the amounts, I have no problem with the request to approve fees and disbursements in respect of the Michigan, as well as the Ontario, action. The settlement and the settlement fund are applicable to each of the actions and, although strictly, I may have jurisdiction under the CPA to deal only with the fees attributable to this proceeding, I see no reason why I cannot, with the consent, and at the request, of the parties, deal with all the fees and disbursements in accordance with the practice and principles applied in this court.

46 Although there were separate proceedings in Ontario and Michigan, there was, in reality, one piece of litigation conducted on two fronts. In the circumstances, I am not prepared to find that this was unreasonable. Neither of the proceedings was frivolous and the advantages of one over the other would not have been apparent at the outset. Practical, as well as different legal, advantages and disadvantages for the parties attached to each and, as I have indicated earlier in these reasons, the pending motion to stay the proceedings here until the termination of the Michigan action might well have had an important, although at this stage necessarily unpredictable, bearing on the outcome of the litigation - if it had continued.

47 The representative plaintiffs filed substantially identical affidavits in which they referred to the fee provisions in the retainer agreements and expressed their support for applications to the court consistent with their terms. The affidavits were prepared by their counsel and there is no evidence that they obtained independent legal advice. They did not expressly state their belief that the fees requested by counsel are fair and reasonable from the viewpoint of the class but I am satisfied that this is to be inferred and that they were aware that, without court approval, the fee agreements would be unenforceable.

48 Section 32(2) of the CPA requires that fee agreements with representative plaintiffs are not enforceable without the consent of the court. The court must still be satisfied that their effect will not be unduly and unfairly detrimental to the interests of the class. Despite the agreement of the plaintiffs, the complexity of the issues involved in the litigation, and the quality of the services performed, I have had serious concerns about the size of the fee requested given, in particular, the relatively short period between the commencement of the proceedings and the negotiation of the settlement. Similar concerns were addressed at the initial hearing by one of the investors, Mr. David McDonald.

49 My concerns were enhanced when counsel attempted to persuade me that the fee of $6 million would represent a multiplier of less than three times the value of the time that will have been expended by the conclusion of the matter. As of January 17, 2007, the time sheets and dockets provided on behalf of the six law firms recorded time of more than 50 lawyers, paralegals and students for a total value of $1,776,430.20. As I have earlier indicated, the Michigan action was commenced on December 5, 2005 and this action on January 25, 2006. While I do not question that the docket entries record time actually spent, they fall far short of satisfying me that it was productive time, or time that might otherwise properly be charged to a client, or allowed for the purpose of determining a base fee pursuant to section 33 of the CPA. Many of the entries are repetitive, and inscrutably uninformative, and suggest, rather than exclude, the possibility of an amount of duplication and unnecessary work. The time sheets of the Juroviesky firm, in particular, are replete with general references to research and analysis, and time spent reviewing materials and memoranda prepared by, or emails received from, other lawyers. Almost $40,000 of time is, for example, attributed to "Research & analysis re: FMF share price decline, service of process". Counsel's reliance on the docketed time appears explicable only on an assumption that every minute with a possible connection to the litigation could properly be charged to the clients and the class. On April 4, 2006 the Juroviesky firm reported time spent " Preparing FMF documents for meeting and cleaning the office". The time was not significant but its inclusion in the materials filed in support of the motion was indicative.

50 Between November 15, 2005 and early January 2006, when discussions to co-ordinate work with Siskinds commenced, the Juroviesky firm, with little previous experience in class action litigation, recorded time valued at almost $400,000. Much of this was spent on introductory research and analysis - work that was also performed by Siskinds. Time is included on the defendants' successful challenge to the venue chosen by Siskinds for the Ontario action and, from early October until the conclusion of the second hearing on February 23, 2007, the firms recorded time valued at more than $200,000 finalising the settlement and preparing for the approval motions, including the motion in respect of their fees. Overall, although I do not denigrate the high professional quality of the work performed, or the benefits achieved for the class, the time recorded is, in my judgment, significantly in excess of that which could properly be charged to a client in the absence of a contingency fee agreement.

51 The fees awarded to plaintiffs' counsel in class actions are often astronomical compared with those in other civil proceedings. They can provide an enormous, and understandable, incentive to lawyers to be over-generous in their allocation of their time and their resources. Inflated expectations of counsel can be reflected in inflated hourly rates as, for example, in the rate of $810 per hour reported by one of the senior counsel who performed supervisory work in the preparation of an opinion on the Class II discount. The hourly rates of other lawyers increased significantly during the proceeding but, overall, I do not consider them to be unreasonable.

52 The application of a multiplier to a base fee is just one method of computing a contingency fee under the provisions of the CPA. It may also be helpful in some circumstances in testing the reasonableness of a fee that is expressed as a percentage of recovery in an agreement between counsel and representative plaintiffs. Its utility is more limited in a case like this where the proceedings were settled in a relatively short time. In these circumstances, the speed with which a resolution of the issues was effected can itself be considered to be a significant benefit for the class. To the extent, however, that class counsel have relied on the multiplier method to justify their fee request, my review of the time records they have provided, and of the course of the proceedings, has satisfied me that a reasonable base fee for past and future professional services would not exceed $1,000,000.

53 While an agreement for a contingency fee of 25 per cent has been approved in this jurisdiction in other cases, it may well be excessive if, at the time the fee agreement was executed, there was a reasonable likelihood that a quick settlement would be obtained. Most class actions settle and I have no doubt that, in accepting the retainer by the representative plaintiffs, Siskinds - the firm that took the lead in the co-ordinated litigation - hoped, and intended, to concentrate its efforts and resources in attempting to negotiate a settlement as quickly as possible. I have no doubt also that, from the outset, the firm was alive to the prospect that the defendants would not wish to be involved in lengthy cross-border proceedings in two jurisdictions and might well be interested in an early settlement. The firm's dockets suggest that the first settlement meeting occurred as early as February 16, 2006 - approximately three weeks after the statement of claim in the Ontario action was issued. The plaintiffs agreed to a settlement in principle with the FMF Defendants less than five months later.

54 I am satisfied that, when the retainer agreements with Messrs Gould and Leach were executed in December 2005, Siskinds was aware that there was a reasonable possibility that an early settlement would be reached. There is no evidence that they informed their clients of this, or of the possibility of having variable percentages in the retainer agreements to accommodate the possibility of an early settlement.

55 In determining whether the fee requested in this case is excessive, it is necessary to be careful not to rely on hindsight, or to penalize counsel for the quality of their work and the success they achieved in negotiating an early settlement. It is also necessary to recognize that, in December 2005, when they accepted the retainers from Messrs Gould and Leach that made their fees and disbursements contingent on success in the litigation, there was only a reasonable possibility, and no certainty, that the defendants would settle. The risks counsel assumed were not negligible. They are, nevertheless, very experienced in class action litigation and must be presumed to have been cognizant of the possibility of a speedy recovery, as well as the risks they were assuming.

56 I have not, in terms, been asked to approve the fee agreements in this motion. Counsel have, however, relied on sections 32 and 33 of the CPA as grounds for their motion for approval of the fees. In these circumstances, I have a discretion under section 32(4)(a) to determine the amount of an appropriate fee: see *Garland v. Enbridge Gas Distribution Inc.*, [2006] O.J. No. 4907 (S.C.J.), at para 23. I believe, also, that counsel have the burden of demonstrating that the contingency fee they request is fair and reasonable remuneration for the professional services they have rendered to their clients and the members of the class and may perform during the administration of the settlement. They have not satisfied me that global fees in excess of an amount of $4.5 million would be justified or, indeed, that the agreements that provided for a fee of 25 per cent of the gross recovery irrespective of the length of the proceedings should be approved in these circumstances. In my judgment, a global fee of $4,500,000 would represent fair and reasonable compensation for the work performed - and to be performed - the risks that were assumed, and the benefits that were obtained for the class. Accordingly, there will be an order approving fees of that amount, plus the disbursements claimed and GST as applicable.

M.C. CULLITY J.

cp/e/qlcct/qlpwb

In re IMAX Securities Litigation

Master File No. 06 Civ. 6128 (NRB)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

283 F.R.D. 178; 2012 U.S. Dist. LEXIS 86513

June 20, 2012, Decided
June 20, 2012, Filed

SUBSEQUENT HISTORY: Costs and fees proceeding at, Application granted by, in part In re Imax Secs. Litig., 2012 U.S. Dist. LEXIS 108516 (S.D.N.Y., Aug. 1, 2012)

PRIOR HISTORY: In re IMAX Secs. Litig., 2011 U.S. Dist. LEXIS 41709 (S.D.N.Y., Apr. 14, 2011)

CORE TERMS: settlement, notice, class action, discovery, class members, investor, theater, final approval, fiscal year, adequacy, attorneys' fees, certification, mediation, approve, class certification, internal quotation marks omitted, per share, accounting, stock, settlement amount, reasonableness, installation, installs, questions of law, share price, restatement, experienced, typicality, inflation, certify

COUNSEL: **[**1]** For Westchester Capital Management Inc., Lead Plaintiff: Jill Sharyn Abrams, Richard Barry Margolies, LEAD ATTORNEYS, Arthur N. Abbey, Abbey Spanier Rodd Abrams & Paradis, LLP, New York, NY.

For Snow Capital Investment Partners, L.P., Lead Plaintiff: Mark Samuel Reich, Robbins Geller Rudman & Dowd LLP(LI), Melville, NY.

For The Merger Fund, Lead Plaintiff: Jill Sharyn Abrams, Richard Barry Margolies, Abbey Spanier Rodd Abrams & Paradis, LLP, New York, NY.

For Motti Kaplan, Individually, Motti Kaplan, and on behalf of all others similarly situated, Plaintiffs: Nancy Kaboolian, Arthur N. Abbey, LEAD ATTORNEY, Abbey Spanier Rodd Abrams & Paradis, LLP, New York, NY.

For Santiago Guzman, individually and on behalf of all others similarly situated, Eric S. Bergen, individually and on behalf of all others similarly situated, Michael LaRosa, individually and on behalf of all others similarly situated, Robert Feeney, Floyd Reynolds, individually and on behalf of all others similarly situated, Anthony Caiafa, individually and on behalf of all others similarly situated, Robert B. Gray, individually and on behalf of all others similarly situated, Consolidated Plaintiffs: Arthur N. Abbey, Abbey Spanier **[**2]** Rodd Abrams & Paradis, LLP, New York, NY.

For Gary Creagh, Marlene Creagh, Movants: Catherine A. Torell, Cohen Milstein Sellers & Toll P.L.L.C., New York, NY.

For IMAX Investor Group, Movant: Evan J. Smith, LEAD ATTORNEY, Brodsky & Smith, L.L.C., Mineola, NY.

For Snow Capital Investment Partners, L.P., Movant: David Avi Rosenfeld, Mark Samuel Reich, Robbins Geller Rudman & Dowd LLP(LI), Melville, NY.

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For Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, IMAX Corporation, Kathryn A. Gamble, Defendants: Lewis J. Liman, LEAD ATTORNEY, Cleary Gottlieb Steen & Hamilton, LLP(NYC), New York, NY.

For Michael LaRosa, Jay M. Spritzler, Interested Parties; Ronen Sarraf, LEAD ATTORNEY, Sarraf Gentile, LLP, New York, NY.

For Robert Lieblang, Interested Party: Jonathan K. Levine, Girard Gibbs LLP, San Francisco, CA.

JUDGES: NAOMI REICE BUCHWALD, UNITED STATES **[**3]** DISTRICT JUDGE.

OPINION BY: NAOMI REICE BUCHWALD

OPINION

[*181] MEMORANDUM AND ORDER

NAOMI REICE BUCHWALD
UNITED STATES DISTRICT JUDGE

I. Introduction

On March 28, 2012, we preliminarily certified a class for the purpose of settlement and preliminarily approved an amended settlement of this long-running securities class action against defendants IMAX Corporation ("IMAX"), Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, Kathryn A. Gamble (the "individual defendants"), and PricewaterhouseCoopers LLP ("PwC") (collectively "defendants"). See Amended Order, In re IMAX Corp. Sec. Litig., Master File No. 06 Civ. 6128 (S.D.N.Y. Mar. 28, 2012) (hereinafter the "Preliminary Order"). Following the provision of notice to the members of the preliminarily certified class, on June 14, 2012, we held a hearing on the motion of lead plaintiff The Merger Fund ("TMF" or "lead plaintiff") for final approval of the amended settlement and the proposed plan of allocation, final certification of the class for the purpose of settlement, and the award of attorneys' fees and reimbursement of expenses. For the reasons stated below as well as those reasons that we articulated at the hearing, which are incorporated here by reference, **[**4]** we (1) find that the notice provided to members of the class was adequate; (2) certify the class for the purpose of settlement; (3) approve the settlement; (4) approve the plan of allocation; and (5) reserve decision on the requested attorneys' fees and expenses pending further briefing on these issues from lead plaintiff's counsel Abbey Spanier Rodd & Abrams, LLP ("Abbey Spanier" or "lead plaintiff's counsel").

II. Background[1]

1 The facts recited here are drawn from the following sources: (1) the Stipulation and Agreement Between Settlement Class Members and IMAX Corporation, Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, Kathryn A. Gamble, and PricewaterhouseCoopers LLP, dated January 26, 2012 ("Settlement"); (2) the Amended Stipulation and Agreement Between Settlement Class Members and IMAX Corporation, Richard L. Gelfond, Bradley J. Wechsler, Francis T. Joyce, Kathryn A. Gamble, and PricewaterhouseCoopers LLP, dated March 20, 2012 ("Am. Settlement"); (3) the Preliminary Order; (4) the Declaration of Arthur N. Abbey in Support of Lead Plaintiff's Motion for Final Approval of the Settlement with Defendants, etc. ("Abbey Decl."); and (5) the Affidavit of Paul Mulholland Concerning **[**5]** Mailing of Notice ("Mulholland Aff.").

A. The Class Action

Almost six years have passed since the eight cases that were consolidated to form this class action were originally filed with this Court. See Kaplan v. Gelfond, 240 F.R.D. 88, 90 (S.D.N.Y. 2007). It has similarly been almost six years since the parallel class action that remains pending in Canada (the "Canadian Action") was originally filed with the Ontario Superior Court. See Abbey Decl. ¶ 11.[2] During the intervening years, we have appointed three different entities as lead plaintiff, denied one motion to dismiss and two motions for class certification, and at the time that the parties entered into a memorandum of understanding ("MOU") to settle this litigation on November 2, 2011 we were preparing to decide a third motion for class certification. See id. at ¶¶ 10-57, 68. In the course of addressing these various issues, we have previously set out the facts underlying the allegations of securities fraud in this case in multiple decisions and will not rearticulate them in detail here. See, e.g., In re IMAX Sec. Litig. , 272 F.R.D. 138, 142-45 (S.D.N.Y. 2010); In re IMAX Sec. Litig. , 587 F. Supp. 2d 471, 474-78 (S.D.N.Y. 2008). **[**6]** It is enough for our present purpose to repeat the following passages:

> IMAX is an entertainment technology company specializing in digital and film-based motion picture technologies and large-format film presentations. The Company's main business is the design, **[*182]** manufacture, sale and lease of theater systems. As of December 31, 2006, the IMAX theater network included 284 theaters operating in 40 countries.
>
> The majority of IMAX's revenue [between February 27, 2003 and July 20, 2007] was derived from the sale and lease of theater systems to third-party owners of large-format theaters. Throughout [this time period], IMAX reported upward-trending financial results: 16 theater system installations ("installs") and $71 million revenue for fiscal year 2002; 21 installs and $75.8 million revenue for 2003; 22 installs and $86.6 million revenue for 2004; and 39 installs and $99.7 million revenue for 2005.
>
> On February 17, 2006, IMAX issued a press release announcing its 2005 financials and reporting that the Company had completed 14 [installs] during the fourth quarter of 2005. On March 9, 2006, IMAX filed its Form 10-K for fiscal year 2005 ("2005 10-K"), describing a "record" 14 [installs] and $35.1 **[**7]** million revenue in the fourth quarter.
>
> Five months later, on August 9, 2006, IMAX announced that it was responding to an informal inquiry from the Securities and Exchange Commission ("SEC") concerning the timing of revenue recognition and, specifically, its application of multiple element arrangement . . . accounting derived from theater system sales and leases.
>
> . . .
>
> In addition to disclosing the SEC investigation, the August 9th announcement stated that [IMAX]'s discussions with potential buyers and strategic partners had faltered. The following day, the price of IMAX shares fell from $9.63 to $5.73.
>
> On March 29, 2007, IMAX announced that, based on comments it had received from the SEC and the Ontario Securities Commission, it was expanding its [internal] review [of its accounting practices], "primarily in connection with its revenue recognition for certain theater system installations in previous periods, including the fourth quarter of 2005." Because of this "expanded review," IMAX stated that it "may determine that it is necessary to restate additional items beyond the previously identified errors."
>
> Four months later, on July 20, 2007, IMAX filed its Form 10-K for fiscal year 2006 **[**8]** . . . , which included a restatement of its financial results for fiscal years 2002 through the first three quarters of 2006.[3]
>
> . . .
>
> As a result of the restatement of theater system revenue, 16 installation transactions representing $25.4 million in revenue shifted between quarters in their originally reported years, and 14 installation transactions representing $27.1 million in revenue shifted between fiscal years. Of the 14 transactions for which revenue shifted between fiscal years, one was originally recorded as revenue in fiscal year 2002, two were recorded in fiscal year 2004, ten in fiscal year 2005, and one in fiscal year 2006.

In re IMAX, 272 F.R.D. at 142-43 (internal footnotes omitted).

2 The eight cases--06 Civ. 6128, 06 Civ. 6235, 06 Civ. 6313, 06 Civ. 6349, 06 Civ. 6449, 06 Civ. 6693, 06 Civ. 7057, and 06 Civ. 7162--were filed between August 11, 2006 and September 18, 2006. The Canadian Action commenced thereafter on September 20, 2006. Abbey Decl. ¶ 11.

3 Following this restatement, the price of IMAX shares actually closed up $0.45. See Abbey Decl. ¶ 132.

Bringing claims of securities fraud under §§ 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a), **[**9]** and Rule 10b-5, 17 C.F.R. § 240.10b-5, the Consolidated Class Action Complaint, which was filed on October 2, 2007, essentially alleges that (i) IMAX, (ii) the individual defendants, who were among IMAX's directors and officers, and (iii) PwC, which served as IMAX's accountant, were responsible for the issuance of materially false and misleading statements concerning IMAX's recognition of revenue from theater system installations during the period from February 27, 2003 through July 20, 2007. See id. at 143-44.

B. Discovery and Settlement Proceedings

In September 2008, following the denial of defendants' motions to dismiss, the parties agreed to engage in discovery on the merits as well as discovery related to the forthcoming class certification proceedings. Abbey Decl. ¶ 20. In January 2009, IMAX and the **[*183]** individual defendants produced approximately 150, 000 pages of documents. Id. at ¶ 32. In February 2009, Abbey Spanier, having reviewed this production, served interrogatories on IMAX and the individual defendants to which these defendants responded in March 2009. Id. at ¶ 33. Also in February 2009, PwC produced another approximately 12,000 pages of documents. Id. at ¶ 34. It appears **[**10]** that defendants made further productions over the ensuing months because both Abbey Spanier and Robbins Geller Rudman & Dowd LLP ("Robbins Geller"), which served as lead plaintiff's counsel between June 2009 and December 2010, make reference in their submissions to the review of hundreds of thousands of pages of documents. See id. at ¶ 78 ("[l]ead [c]ounsel have reviewed and analyzed hundreds of thousands of pages of documents produced by [d]efendants"); id. at Ex. E ("Rudman Decl.") ¶ 15 (prior to the appointment of Robbins Geller as lead plaintiff's counsel in June 2009 "[d]efendants had previously produced approximately 500,000 pages of documents to plaintiffs"). In addition to the discovery that they obtained from defendants, it appears that both Abbey Spanier and Robbins Geller subpoenaed documents from third parties during the course of the litigation, some of which had previously expressed an interest in acquiring IMAX prior to August 2006. See Abbey Decl. ¶¶ 30, 45.

We understand that neither Abbey Spanier nor Robbins Geller conducted any merits depositions during this litigation. See June 14, 2012 Hr'g Tr. 5:24-6:12. However, Abbey Spanier has reviewed transcripts from interviews **[**11]** conducted by the SEC of the individual defendants as well as eleven other persons and has also gained access to transcripts from depositions conducted by plaintiffs' counsel in the Canadian Action of eleven persons, including a member of PwC. See Abbey Decl. ¶ 11, 78; Amended Settlement ¶ EE. In addition, further confirmatory discovery was conducted in January 2012 after the parties entered into a MOU to settle on November 2, 2011. See Abbey Decl. ¶¶ 70, 78.

At a number of earlier points during the litigation, the parties explored settlement. Specifically, on December 2, 2008, Abbey Spanier participated in a mediation session with counsel for defendants presided over by the Honorable E. Leo Milonas (Ret.), formerly of the New York Supreme Court, Appellate Division. Id. at ¶ 28. As part of this mediation, the parties exchanged confidential mediation statements. Id. On July 16, 2010, Robbins Geller participated in a further mediation with counsel for defendants presided over by the Honorable Daniel Weinstein (Ret.), formerly of the California Superior Court. Id. at ¶ 44. In preparation for this mediation, Robbins Geller also prepared a mediation statement. Rudman Decl. ¶ 26. While these **[**12]** earlier efforts at mediation proved unsuccessful, once Abbey Spanier was reappointed lead plaintiff's counsel in April 2011, it restarted settlement discussions with counsel for defendants that involved numerous meetings which successfully culminated in the parties entering the MOU to settle on November 2, 2011. See Abbey Decl. ¶ 67. Following further negotiations and the production of confirmatory discovery, the parties entered into a settlement on January 26, 2012, which we preliminarily approved on February 1, 2012. See id. at ¶¶ 71-73. In response to proposed revisions from plaintiffs' counsel in the Canadian Action, the parties agreed to amend the notice proposed in connection with their settlement of the 26th and approved in this Court's Order of the 1st, changing the notice to provide inter alia fuller contact information for plaintiffs' counsel in the Canadian Action. See id. at ¶ 73. On March 20, 2012, the parties ultimately entered into an amended settlement, which reflected this alteration, among other changes, as well as a structural modification of the settlement terms, which is discussed immediately below. See id. at ¶¶ 73-74.

C. The Amended Settlement

Pursuant to the amended **[**13]** settlement, lead plaintiff and defendants have agreed to resolve this litigation through a cash settlement of $12,000,000. Id. at ¶ 1.[4] This cash settlement **[*184]** lies within the range of possible damages forecast by the parties, which extended as high as $91,000,000 pursuant to lead plaintiff's estimation and as low as $5,000,000 according to defendants' calculation, assuming arguendo defendants' liability. See id. at ¶ 127. The proposed class on whose behalf lead plaintiff seeks to enter the amended settlement (the "settlement class" or "American Class") includes all investors that acquired the common shares of IMAX on the NASDAQ Stock Market (the "NASDAQ") from February 27, 2003 through July 20, 2007 (the "settlement class period" or "American Class Period"). Id. at ¶ 1 n. 1. The settlement class and settlement class period differ from their analogues in the Canadian Action, which is being actively litigated on behalf of all investors that acquired IMAX's common stock on the NASDAQ or Toronto Stock Exchange on or after February 17, 2006 and held some or all of those securities on August 9, 2006 (the "Canadian Class" and the "Canadian Class Period"). See id. at ¶ 59. In order to address **[**14]** the overlap between the American Class and the Canadian Class, which was previously certified in the Canadian Action on December 14, 2009, the amended settlement is conditioned on the entry of an order in the Canadian Action that excludes from the Canadian Class those investors who do not opt out of the American Class (the "Canadian Order"). See id. at ¶¶ 59, 75. We understand that counsel for IMAX and the individual defendants in the Canadian Action have filed a motion seeking to redefine the Canadian Class in this manner and that oral argument on that motion is now set to begin on July 30, 2012 in the Ontario Superior Court. See IMAX and Individual Defs.' Letter of June 12, 2012 1. While the settlement contemplated entry of the Canadian Order prior to our final approval of the settlement, the amended settlement reflects a structural modification of the settlement terms insofar as it reverses this sequence of events and seeks our final approval of the settlement prior to entry of the Canadian Order. Compare Settlement ¶ 5 with Amended Settlement ¶ 5. The amended settlement, however, remains contingent on entry of the Canadian Order. See Amended Settlement ¶ 8. In light of this contingency, **[**15]** there is an unaccustomed uncertainty as to the finality of our "final" approval of the amended settlement between the parties; however, we proceed to address that settlement on the assumption that the negotiated resolution of this litigation will not be further disturbed should we approve it, as we do.

4 The $12,000,000 has already been deposited in an escrow account where it is earning interest. See Abbey Decl. ¶ 71 n. 3.

D. The Preliminary Order and the Provision of Notice

On March 28, 2012, we preliminarily certified the settlement class for the purpose of settlement, approved the amended settlement, and approved the form and content of the notice to be provided to the members of the settlement class (the "notice"). Preliminary Order 2-3. We further set out the procedures by which the notice was to be disseminated to the settlement class and the deadlines by which any members of the settlement class who wished to object to or be excluded from the amended settlement must act ahead of the hearing that we set for June 14, 2012 to finally approve the amended settlement. Id. at 3-12.

In accordance with our direction, lead plaintiff's counsel retained Strategic Claims Services ("SCS") to supervise **[**16]** and administer the dissemination of the notice pursuant to the approved notice procedure. See Preliminary Order ¶ 5. SCS arranged for the notice to be provided via mail to 426 individuals and organizations identified on a list of shareholders provided by IMAX. See Mulholland Aff. ¶¶ 4, 8, Ex. A. In addition, SCS mailed the notice to a further 1,813 banks, brokerage companies, and institutional investors, which may have traded the common shares of IMAX in their clients' or their own accounts during the settlement class period. See id. These initial mailings were completed by April 23, 2012. Id. at ¶ 4. Following receipt of the notice, the banks, brokerage companies, and institutional investors mentioned above as well other individuals requested that an additional 85,695 copies of the notice be disseminated to possible additional members of the settlement class. Id. at ¶ 8. Thus, in total, 87,934 copies of the notice have been mailed to possible members of the settlement class. See id. ¶¶ 4, 8-9. Where a mailing was returned as undeliverable, SCS has followed up where possible to **[*185]** obtain updated addresses. Id. at ¶ 9. In addition to the mailing of the notice, SCS launched a settlement **[**17]** website that contained the notice, among other relevant documents, and further published an approved form of summary notice through the national editions of newspapers in both the United States and Canada as well as via electronic newswires. See id. at ¶¶ 5-6.

The hearing to address the amended settlement was held on June 14, 2012, as scheduled. No members of the settlement class appeared. As of that date, we were informed that only seven investors had sought to be excluded from the settlement class and only one investor, Mr. Skip Ames, had filed an objection to the amended settlement (the "objection"), which we discuss below. See June 14, 2012 Hr'g Tr. 4:22-5:8.

III. Discussion

A. Adequacy of the Notice

Federal Rule of Civil Procedure 23(c)(2)(B) provides the notice that is required to be given to members of a class when it is certified pursuant to Federal Rule of Civil Procedure 23(b)(3), which is the case here.[5] Federal Rule of Civil Procedure 23(e)(1) in turn provides the notice that is required to be given to members of a certified class in which a settlement has been proposed for court approval, which is also the case here.[6] "Where, as here, the parties seek simultaneously to certify **[**18]** a settlement class and to settle a class action, the elements of Rule 23(c) notice . . . are combined with the elements of Rule 23(e) notice" and because "Rule 23(e)'s notice requirements are less specific than that of Rule 23(c)'s . . . [we] will focus on Rule 23(c)'s requirements." In re Global Crossing Sec. and ERISA Litig., 225 F.R.D. 436, 448 (S.D.N.Y. 2004) (Lynch, J.). See also Fed. R. Civ. P. 23 advisory committee's note (emphasizing "[n]otice of a settlement binding on the class is required either when the settlement follows class certification or when the decisions on certification and settlement proceed simultaneously" before stating "[r]easonable settlement notice may require individual notice in the manner required by Rule 23(c)(2)(B) for certification notice to a Rule 23(b)(3) class"). Where there is compliance with Rule 23(c)(2)(B), the requirements of due process are satisfied. See Eisen v. Carlisle and Jacquelin, 417 U.S. 156, 172-174, 94 S. Ct. 2140, 40 L. Ed. 2d 732 (1974) (discussing incorporation of due process requirements into Rule 23(c)(2)(B)'s predecessor provision). In addition, in the context of a securities class action settlement, the Private Securities Litigation Reform Act of 1995 (the **[**19]** "PSLRA") imposes additional notice that must be provided to members of the class. See 15 U.S.C. § 78u-4(a)(7).[7]

5 Rule 23(c)(2)(B) provides:

> For any class certified under Rule 23(b)(3), the court must direct to class members the best notice that is practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice must clearly and concisely state in plain, easily understood language:
>
> (i) the nature of the action;
> (ii) the definition of the class certified;
> (iii) the class claims, issues, or defenses;
> (iv) that a class member may enter an appearance through an attorney if the member so desires;
> (v) that the court will exclude from the class any member who requests exclusion;
> (vi) the time and manner for requesting exclusion; and
> (vii) the binding effect of a class judgment on members under Rule 23(c)(3).

FED. R. CIV. P. 23(c)(2)(B).

6 Rule 23(e)(1) provides that "[t]he court must direct notice in a reasonable manner to all class members who would be bound by the proposal." FED. R. CIV. P. 23(e)(1).

7 Pursuant to the PSLRA, the notice must contain the following information as well as a cover page summarizing it:

> (A) Statement **[**20]** of recovery--the amount of the settlement determined in the aggregate and on an average per share basis;
> (B) Statement of potential outcome of case--amount of damages per share recoverable if plaintiffs were to prevail on every claim. If the parties are unable to agree on damages, a statement concerning the issues on which the parties disagree;
> (C) Statement of attorneys' fees--statement of fees and costs to be applied for in the aggregate and on a per share basis;
> (D) Identification of lawyers' representatives--the name, telephone number, and address of counsel available to answer questions; and
> (E) Reasons for settlement-- a brief statement explaining the reasons why the parties are proposing the settlement.

In re Indep. Energy Holdings PLC Sec. Litig., 302 F. Supp. 2d 180, 184 (S.D.N.Y. 2003).

[*186] We have reviewed the notice in the form in which it was disseminated to members of the settlement class, see Mulholland Aff. Ex. A, and also considered the procedure that we earlier approved. We find that the notice provided here was the best practicable under the circumstances, that it included all of the content necessary as a matter of law, and that it was accordingly adequate under Rule 23, **[**21]** due process, and the PSLRA.

B. Final Certification of the Settlement Class

"Certification of a settlement class 'has been recognized throughout the country as the best, most practical way to effectuate settlements involving large numbers of claims by relatively small claimants.'" In re Giant Interactive Group, Inc. Sec. Litig., 279 F.R.D. 151, 158 (S.D.N.Y. 2011) (quoting In re Prudential Sec. Inc. Ltd. P'ships Litig., 163 F.R.D. 200, 205 (S.D.N.Y. 1995)). See also Weinberger v. Kendrick, 698 F.2d 61, 72 (2d Cir. 1982) ("[t]emporary settlement classes have proved to be quite useful in resolving major class action disputes") (internal quotation marks omitted). "Classes certified for settlement purposes, like all other classes, must meet the requirements of Rule 23(a) and at least one of three requirements set forth in Rule 23(b)." In re Marsh & McLennan Cos., Inc. Sec. Litig., No. 04 Civ. 8144 (CM), 2009 U.S. Dist. LEXIS 120953, 2009 WL 5178546, at *8 (S.D.N.Y. Dec. 23, 2009). Here, we find that the settlement class satisfies the requirements of Federal Rule of Civil Procedure 23(a) and (b)(3) and accordingly certify it for the purpose of settlement.

1. Federal Rule of Civil Procedure 23(a)

Pursuant to Rule 23(a), certification **[**22]** of a class is proper where "(1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interests of the class." FED. R. CIV. P. 23(a).

a. Numerosity

In a previous decision, we found that the settlement class as now constituted plainly met the numerosity requirement of Rule 23(a)(1). See In re IMAX, 272 F.R.D. at 146.

b. Commonality and Typicality

"'The commonality requirement [of Rule 23(a)(2)] is met if plaintiffs' grievances share a common question of law or of fact.'" Cent. States Se. & Sw. Areas Health & Welfare Fund v. Merck-Medco Managed Care, LLC, 504 F.3d 229, 245 (2d Cir. 2007) (quoting Marisol A. v. Giuliani, 126 F.3d 372, 376 (2d Cir. 1997) (per curiam)). In turn, "[t]ypicality [pursuant to Rule 23(a)(3)] 'requires that the claims of the class representatives be typical of those of the class, and is satisfied when each class member's claim arises from the same course of events, and each class member makes similar legal arguments **[**23]** to prove the defendant's liability.'" Id. (quoting Robinson v. Metro-N. Commuter R.R. Co., 267 F.3d 147, 155 (2d Cir. 2001)). As the Supreme Court has observed, the commonality requirement "tend[s] to merge" with the typicality requirement because "[b]oth serve as guideposts for determining whether . . . the named plaintiff's claim and the class claims are so interrelated that the interests of the class members will be fairly and adequately protected in their absence." Gen. Tel. Co. of Sw. v. Falcon, 457 U.S. 147, 158 n.13, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982).

Here the commonality and typicality requirements are satisfied. The settlement class, and in particular TMF as lead plaintiff, share many common questions of law and fact bearing on for example the central issues of whether defendants' public statements regarding income recognition contained material misstatements or omissions and whether defendants acted with scienter in the issuance of those statements. In a previous decision, we addressed and rejected a number of arguments against TMF's appointment as lead plaintiff on the basis of its failure to satisfy the typicality as well as adequacy requirements of Rule 23(a)(3) and (4), and we find no novel reason **[**24]** on the record before us to believe that TMF's claims are atypical in any manner or that it is **[*187]** subject to unique defenses. See In re IMAX Sec. Litig., Master File No. 06 Civ. 6128, 2011 U.S. Dist. LEXIS 41709, 2011 WL 1487090, at *3-7 (S.D.N.Y. April 14, 2011) (rejecting arguments that TMF's (i) successive reassignment of its claims and (ii) investment strategies did not give rise to unique defenses or undermine satisfaction of the typicality and adequacy requirements).

c. Adequacy

"The adequacy requirement of Rule 23(a)(4) involves an inquiry as to whether: (1) the plaintiff's interests are antagonistic to the interests of the other members of the [c]lass; and (2) plaintiff's counsel are qualified, experienced, and capable of conducting the litigation." In re Giant, 279 F.R.D. at 159 (citing Baffa v. Donaldson, Lufkin & Jenrette Sec. Corp. , 222 F.3d 52, 60 (2d Cir. 2000)). Here, there is no reason to believe that lead plaintiff's interests are in conflict with those of the other members of the settlement class whose claims share common questions of law and fact, and we find that lead plaintiff's counsel is qualified to litigate this case on behalf of the settlement class. We note that the achievement of the lead **[**25]** plaintiff and lead plaintiff's counsel in securing a well-received settlement that we approve below provides confirmation that they have met the adequacy requirement. See id. (finding satisfaction of adequacy requirement "confirmed by the lack of any opposition to this settlement (and the very small number of opt-outs), as well as the above-average recovery in this case, measured as a percentage of maximum potential recovery").

2. Federal Rule of Civil Procedure 23 (b) (3)

In addition to meeting the four requirements of Rule 23(a), a class must also satisfy one out of the three sub-paragraphs to Rule 23(b). Here, lead plaintiff seeks certification of the settlement class pursuant to Rule 23(b)(3), which requires that a court find "that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy." FED. R. CIV. P. 23(b)(3).[8]

8 In undertaking these two inquiries, the following matters are among those that Rule 23(b)(3) identifies as "pertinent":

(A) the class members' interests in individually controlling the prosecution [**26] or defense of separate actions;
(B) the extent and nature of any litigation concerning the controversy already begun by or against class members;
(C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and
(D) the likely difficulties in managing a class action.

FED. R. CIV. P. 23(b)(3).

a. Predominance of Common Questions

"Class-wide issues predominate if resolution of some of the legal or factual questions that qualify each class member's case as a genuine controversy can be achieved through generalized proof, and if these particular issues are more substantial than the issues subject only to individualized proof." Moore v. PaineWebber, Inc., 306 F.3d 1247, 1252 (2d Cir. 2002). As the Supreme Court has observed, the requirement of predominance is "readily met in certain cases alleging consumer or securities fraud or violations of the antitrust laws." Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 625, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997). Here, lead plaintiff alleges that defendants' allegedly fraudulent public statements caused damages to the settlement class, and these allegations are sufficient to establish predominance. See In re Global Crossing, 225 F.R.D. at 454.

b. [27] Superiority to Other Methods of Adjudication**

The class action here is superior to the other available methods for adjudicating the controversy between the settlement class and defendants. "The interest of the class as a whole in litigating the many common questions substantially outweighs any interest by individual members in bringing and prosecuting separate actions," which has been evidenced from the fact that only one member of the settlement class has objected to the amended settlement and only seven members **[*188]** of the settlement class have sought to exclude themselves from the amended settlement. Cromer Fin. Ltd. v. Berger, 205 F.R.D. 113, 133 (S.D.N.Y. 2001) (continuing to note that "[t]o force each investor to litigate separately would risk disparate results among those seeking redress, . . . would exponentially increase the costs of litigation for all, and would be a particularly inefficient use of judicial resources").

Given the existence of the Canadian Action, it has been periodically suggested in the course of this litigation that the parallel class action proceedings to the north offer a better forum for the resolution of this general controversy. See In re IMAX, 272 F.R.D. at 158. **[**28]** Indeed, the one objection to the amended settlement alleges the comparative attractiveness of the Canadian Action. See Objection 2-3. We again "decline to deny certification on th[is] ground[] because, amongst other reasons," PwC is not a defendant in the Canadian Action, the American Class Period is significantly longer than the Canadian Class Period, and the American Class includes only purchasers on the NASDAQ whereas the Canadian Class includes purchasers on both the NASDAQ and Toronto Stock Exchange. In re IMAX, 272 F.R.D. at 158-59. As we previously stated:

> At bottom, a class action in a foreign jurisdiction, applying that jurisdiction's securities laws, to which a named defendant in the United States action is not a party, in which the first complaint in the foreign jurisdiction was filed after the first complaint in this case, is not a "superior" way of adjudicating plaintiffs' claims against that party for alleged violations of U.S. securities laws--claims which we already have upheld against defendants' motions to dismiss.

Id. at 159. Moreover, there is now a further factor in play that we find resolves any lingering doubt as to whether this class action is superior: the American **[**29]** Class has secured a certain recovery of millions of dollars against defendants through the advocacy of lead plaintiff's counsel here whereas the Canadian Class continues to litigate in the hope of securing a settlement or judgment.[9] It is no less true in the context of securities class action litigation that a bird in hand is worth two in the bush. Finally, to the extent that members of the American Class who are also members of the Canadian Class--it is estimated that 83.9% of the shares of IMAX involved in the Canadian Action were purchased on the NASDAQ, see Preliminary Order Ex. A-1 4--share the opinion conveyed in the one objection that the Canadian Action promises a superior alternative for them to recover their investment losses they would "presumably have excluded themselves from the settlement class." In re Global Crossing, 225 F.R.D. at 454. As noted earlier, there were only seven exclusion requests despite the extensive notice.

9 The most recent development of which we are aware in the settlement negotiations in the Canadian Action is that on May 3, 2012 defendants' counsel in the Canadian Action made an offer to plaintiffs' counsel in the Canadian Action to settle on terms **[**30]** roughly analogous to those on which the parties have reached agreement here. See Abbey Decl. Ex. A Tab 2 1 29.

* * *

In light of the foregoing analysis, we find that the settlement class satisfies the requirements of Federal Rule of Civil Procedure 23(a) and (b)(3) and accordingly certify it for the purpose of settlement.

C. Final Approval of the Amended Settlement

At the outset, we emphasize that that there is a "strong judicial policy in favor of settlements, particularly in the class action context." In re Paine Webber Ltd. P'ships Litig., 147 F.3d 132, 138 (2d Cir. 1998). Pursuant to Federal Rule of Civil Procedure 23(e) any settlement of this class action requires our approval. See FED. R. CIV. P. 23(e). Because the amended stipulation will bind the settlement class to its terms, we can only approve it should we find that "it is fair, reasonable, and adequate." FED. R. CIV. P. 23(e)(2). "In undertaking this evaluation, [we] must consider 'both the [amended] settlement's terms and the negotiating process leading to settlement,' that is, [we] must review the settlement for both procedural and substantive fairness." In re Giant, 279 F.R.D. at 160 (quoting Wal-Mart Stores, Inc. **[*189]** v. Visa U.S.A. Inc., 396 F.3d 96, 116 (2d Cir. 2005)).

1. [**31] Procedural Fairness

We owe a fiduciary duty to the settlement class "to ensure that the [amended] settlement is not the product of collusion." In re PaineWebber Ltd. P'ships Litig., 171 F.R.D. 104, 125 (S.D.N.Y. 1997), aff'd, 117 F.3d 721 (2d Cir. 1997) (citing In re Warner Comm'ns Sec. Litig., 798 F.2d 35, 37 (2d Cir. 1986)). With that said, "a class action settlement enjoys a 'presumption of correctness' where it is the product of arm's-length negotiations conducted by experienced, capable counsel." In re Telik, Inc. Sec. Litig., 576 F. Supp. 2d 570, 575 (S.D.N.Y. 2008) (quoting In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig., 718 F. Supp. 1099, 1103 (S.D.N.Y. 1989)). Further, "great weight is accorded to the recommendations of counsel, who are most closely acquainted with the facts of the underlying litigation." In re PaineWebber, 171 F.R.D. at 125 (internal quotation marks omitted). Here, the presumption of correctness attaches because "[a]ll parties were represented throughout the [s]ettlement negotiations by able counsel experienced in class action and securities litigation." In re Telik, 576 F. Supp. 2d at 576. This finding is further buttressed in light of the substantial **[**32]** merits-related discovery conducted in this case as well as the prior mediation sessions that, though unfruitful, took place before retired judges. See In re Giant, 279 F.R.D. at 160 (noting extent of merits-related discovery); In re Telik, 576 F. Supp. 2d at 576 (noting involvement of retired judges). In the absence of evidence to rebut the presumption, we find that the amended settlement is procedurally fair.

2. Substantive Fairness

In the Second Circuit, district courts determine whether a proposed settlement in a class action is substantively fair through analysis of the nine factors articulated in City of Detroit v. Grinnell Corp., 495 F.2d 448 (2d Cir. 1974). These factors are:

> (1) the complexity, expense and likely duration of the litigation;

(2) the reaction of the class to the settlement;
(3) the stage of the proceedings and the amount of discovery completed;
(4) the risks of establishing liability;
(5) the risks of establishing damages;
(6) the risks of maintaining the class action through the trial;
(7) the ability of the defendants to withstand a greater judgment;
(8) the range of reasonableness of the settlement fund in light of the best possible recovery;
(9) the range of reasonableness **[**33]** of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

Wal-Mart Stores, 396 F.3d at 117 (quoting Grinnell, 495 F.2d at 463). "In finding that a settlement is fair, not every factor must weigh in favor of settlement, 'rather [a] court should consider the totality of these factors in light of the particular circumstances.'" In re Global Crossing, 225 F.R.D. at 456 (quoting Thompson v. Metro. Life Ins. Co., 216 F.R.D. 55, 61 (S.D.N.Y. 2003)). Upon consideration of these factors, we find that the amended settlement is substantively fair.

a. Complexity, Expense, and Likely Duration of Litigation

"[I]n evaluating the settlement of a securities class action, federal courts, including this [c]ourt, have long recognized that such litigation is notably difficult and notoriously uncertain." In re Sumitomo Copper Litig., 189 F.R.D. 274, 281 (S.D.N.Y. 1999) (internal quotation marks omitted). In this case, we have from the outset acknowledged the complexity of the underlying accounting principles involved. See In re IMAX, 587 F. Supp. 2d at 475-77. While this complexity does not appear extraordinary in the context of issues that are regularly implicated in **[**34]** the course of securities class action litigation, we agree with lead plaintiff's counsel that it would materially increase the challenge as well as expense of litigating this case through trial. See Mem. of Law in Support of Lead Plaintiff's Mot. for Final Approval of the Settlement, etc. ("Br.") 9-10; Abbey Decl. ¶ 110. Furthermore, we agree with lead plaintiff's counsel that following a renewed class certification motion, a motion for summary judgment **[*190]** from one or more of the defendants would possibly precede a trial. See Abbey Decl. ¶ 9. In short, we find that the amended settlement permits the settlement class to avoid complicated, expensive, and likely protracted litigation, probably lengthened in its cost and duration due to the parties' likely efforts to coordinate proceedings with those in the Canadian Action.

b. Class Members' Reaction to the Amended Settlement

"It is well-settled that the reaction of the class to the settlement is perhaps the most significant factor to be weighed in considering its adequacy." Maley v. Del Global Techs. Corp., 186 F. Supp. 2d 358, 362 (S.D.N.Y. 2002). Here, only one investor objected to the amended settlement and only seven requested to opt out **[**35]** of the settlement class. In light of the fact that over 87,000 notices were mailed to investors and possible members of the settlement class, this demonstration of discontent is but a whisper amidst an otherwise thundering roar of silence.

c. Stage of Proceedings and Amount of Discovery Completed

In considering this factor, "the question is whether the parties had adequate information about their claims," In re Global Crossing, 225 F.R.D. at 458, such that their counsel can intelligently evaluate "the merits of [p]laintiffs' claims, the strengths of the defenses asserted by [d]efendants, and the value of [p]laintiffs' causes of action for purposes of settlement." Maley, 186 F. Supp. 2d at 364. The threshold necessary to render the decisions of counsel sufficiently well informed, however, is not an overly burdensome one to achieve-- indeed, formal discovery need not have necessarily been undertaken yet by the parties. See In re Sony SXRD Rear Projection Television Class Action Litig., No. 06 Civ. 5173 (RPP), 2008 U.S. Dist. LEXIS 36093, 2008 WL 1956267, at *7 (S.D.N.Y. May 1, 2008) (stating "[a]lthough the parties did not engage in extensive formal discovery, such efforts are not required for the [s]ettlement to **[**36]** be adequate, so long as the parties conducted sufficient discovery to understand their claims and negotiate settlement terms" and citing cases). This case has been pending for almost six years. During that time period, substantial merits-related discovery of both a formal and informal variety has occurred. In addition, the parties have conducted additional confirmatory discovery pending their entrance into the amended settlement. Against this history of activity, we find that lead plaintiff's counsel and defendants' counsel are both able to assess the strengths and weaknesses of their respective positions.

d. Risks of Establishing Liability

"This factor does not require [a] [c]ourt to adjudicate the disputed issues or decide unsettled questions; rather, the [c]ourt need only assess the risks of litigation against the certainty of recovery under the proposed settlement." In re Global Crossing, 225 F.R.D. at 459. See In re Austrian & German Bank Holocaust Litig., 80 F. Supp. 2d 164, 177 (S.D.N.Y. 2000) (approving proposed settlement and emphasizing "[t]he [c]ourt is impressed by the factual difficulties and legal defenses that plaintiffs face in further litigation of their claim"). We **[**37]** agree with lead plaintiff's counsel that significant risks would lie ahead should the litigation of this case proceed. See Br. 17-18. In particular, for reasons that we have previously noted, albeit in denying defendants' motion to dismiss, whether lead plaintiff could establish scienter on the part of IMAX, the individual defendants, and PwC is far from certain in this case involving accounting irregularities that implicated the recognition not creation of income. See In re IMAX, 587 F. Supp. 2d at 481, 485 (noting the question of whether scienter was adequately pleaded as to IMAX and the individual defendants was a "close one" and observing "[i]f . . . discovery reveals that P[w]C's involvement in the development of IMAX's accounting policy was not so extensive as alleged" then the "inference of scienter will weaken substantially").

e. Risks of Establishing Damages

In the context of securities class actions, "[c]alculation of damages is a 'complicated and uncertain process, typically involving conflicting expert opinion' about the difference between the purchase price and the stock's 'true' value absent the alleged fraud." **[*191]** In re Global Crossing, 225 F.R.D. at 459 (quoting Maley, 186 F. Supp. 2d at 365). **[**38]** In this case, loss causation presents a stark challenge to lead plaintiff. On August 9, 2006, IMAX disclosed (i) that the SEC was investigating its accounting practices and also (ii) that a potential acquisition or strategic partnership had not come to fruition. The timing of these twin disclosures significantly complicates the question of what, if any, amount of the resulting drop in the share price is attributable to prior allegedly misrepresentative statements regarding theater system installations and resulting revenue.[10]

10 In addition, on July 20, 2007, when IMAX actually restated its financial results from multiple prior years, its share price closed up $0.45 in response to this correction. Abbey Spanier effectively now concedes that no loss to investors is attributable to the restatement, which conclusion guides its proposed plan of allocation, as discussed below. See Abbey Decl. ¶ 132.

f. Risks of Maintaining Class Action Through Trial

We have not yet certified a class in this case except for the purpose of settlement. Were this case to proceed in the absence of the amended settlement, even if lead plaintiff secured certification of the entire settlement class, at the next stage **[**39]** the possibility would remain that following additional factual development multiple sub-classes would emerge for different groups of investors. See In re NASDAQ Market-Makers Antitrust Litig., 187 F.R.D. 465, 476 (S.D.N.Y. 1998) (noting that "if insurmountable management problems were to develop at any point, class certification can be revisited at any time" pursuant to Federal Rule of Civil Procedure 23(c)(1)) (internal quotation marks omitted).

g. Defendants' Ability to Withstand Greater Judgment

Without question, IMAX, the individual defendants, and PwC could withstand a much greater judgment against them, and this factor weighs against the fairness of the amended settlement. "But a defendant is not required to 'empty its coffers' before a settlement can be found adequate." In re Sony, 2008 U.S. Dist. LEXIS 36093, 2008 WL 1956267, at *8 (quoting McBean v. City of New York, 233 F.R.D. 377, 388 (S.D.N.Y. 2006) (Lynch, J.)). Indeed, this factor, standing alone, is not sufficient to preclude a finding of substantive fairness where the other factors weigh heavily in favor of approving a settlement. See D'Amato v. Deutsche Bank, 236 F.3d 78, 86 (2d Cir. 2001).

h. Amended Settlement's Range of Reasonableness in Light [40] of Possible Recovery**

"The adequacy of the amount achieved in settlement may not be judged 'in comparison with the possible recovery in the best of all possible worlds, but rather in light of the strengths and weaknesses of plaintiffs' case." In re Giant, 279 F.R.D. at 162 (internal quotation marks omitted). Instead, we must examine whether the settlement amount lies within a "range of reasonableness," which range reflects "the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion." Wal-Mart, 396 F.3d at 119 (internal quotation marks omitted). We have already discussed the material weaknesses in lead plaintiff's case as well as the additional risks attendant to further litigating this class action. In light of these weaknesses and risks, we find that the settlement amount here--$12,000,000, which constitutes over 13% of the maximum damages that lead plaintiff's counsel argues are conceivably possible to prove--is within the range of reasonableness. Nor is it without precedent that settlement amounts reflecting similar (or lower) percentages of possible recoveries have been approved in other **[**41]** recent securities class action cases. See, e.g., In re Giant, 279 F.R.D. at 162 (finding $13,000,000 settlement amount that reflected percentage of recovery of 16.5% was within the range of reasonableness). See also In re China Sunergy Sec. Litig., No. 07 Civ. 7895 (DAB), 2011 U.S. Dist. LEXIS 53007, 2011 WL 1899715, at *5 (S.D.N.Y. May 13, 2011) (noting "average settlement amounts in securities fraud class actions where investors sustained losses over the past decade . . . have ranged from 3% to 7% of the class members' estimated losses") (internal quotation marks omitted); In re Union Carbide, 718 F. Supp. at 1103 **[*192]** (noting the Second Circuit "has held that a settlement can be approved even though the benefits amount to a small percentage of the recovery sought" and emphasizing "[t]he essence of settlement is compromise").

* * *

In light of the foregoing analysis, we find that the amended settlement is substantively fair under the factors of Grinnell and accordingly give it final approval.

D. Final Approval of the Plan of Allocation

"'To warrant approval, the plan of allocation must also meet the standards by which the settlement was scrutinized-- namely, it must be fair and adequate.'" In re WorldCom, Inc. Sec. Litig., 388 F. Supp. 2d 319, 344 (S.D.N.Y. 2005) **[**42]** (quoting Maley, 186 F. Supp. 2d at 367). "'When formulated by competent and experienced counsel,' a plan for allocation of net settlement proceeds 'need have only a reasonable, rational basis.'" In re Telik, 576 F. Supp. 2d at 580 (quoting In re Global Crossing, 225 F.R.D. at 462). Such "[a] reasonable plan may consider the relative strength and values of different categories of claims." Id. See In re Lloyd's Am. Trust Fund Litig., No. 96 Civ. 1262 (RWS), 2002 U.S. Dist. LEXIS 22663, 2002 WL 31663577, at *18 (S.D.N.Y. Nov. 26, 2002) ("[c]lass action settlement benefits may be allocated by counsel in any reasonable or rational manner because allocation formulas reflect the comparative strengths and values of different categories of the claim") (internal ellipsis and quotation marks omitted).

The proposed plan of allocation effectively divides the settlement class period into two parts. For common shares of IMAX purchased from February 27, 2003 through August 9, 2006, the plan of allocation assigns an inflation factor per share of $3.90, which reflects the entire drop in the share price that occurred immediately following IMAX's disclosure on August 9th of the SEC's investigation into its accounting practices. for **[**43]** shares of IMAX purchased from August 10, 2006 through July 20, 2007, the plan of allocation assigns no inflation factor. See Preliminary Order Ex. A-1 19-20. This latter assignment of value renders worthless the claims of those members of the settlement class who purchased the common stock of IMAX after the initial disclosure. The plan of allocation reflects the advice of lead plaintiff's counsel's damages expert, who in particular "recommended that there w[ere] no damages for IMAX shareholders between the period of August 10, 2006 and July 20, 2007 (the date of the [r]estatement) because on the date of the restatement, IMAX'[s] stock closed up $0.45 from the previous day's closing." Abbey Decl. ¶ 132.

We find that the proposed plan of allocation, which was devised by experienced counsel, is fair and supported by a reasonable, rational basis. The assignment of no value to the claims of investors who purchased after August 9th not unreasonably reflects what we agree would be the considerable difficulty of establishing damages during this time period. The mere fact that the lead plaintiff selects zero as the proper correction to the share price during this period of the settlement class **[**44]** does not alone undermine the fairness of the plan of allocation because the selection of zero seems rational here. See Buxbaum v. Deutsche Bank AG, 216 F.R.D. 72, 74-76, 78-79 (S.D.N.Y. 2003) (rejecting post-approval challenge to plan of allocation in securities class action premised on allegedly false denials of impending merger that assigned "$8.00 per share for those shares traded from October 26, 1998 through November 18, 1998; $3.91 per share for those shares traded on November 19, 1998; and $0.00 for [those] shares traded on November 20, 1998" and noting "[t]he deflationary effect declined to $3.91 per share on November 19[th] and to zero on November 20[th], because by those dates there was new information in the marketplace indicating that there was to be an impending merger announcement and that information drove the price . . . back to its predeflationary levels"). Furthermore, no member of the settlement class has objected to this aspect of the plan of allocation.

The one objection to the amended settlement instead criticizes the plan of allocation because it assigns a uniform inflation value to claims arising from transactions on or before **[*193]** August 9th. See Objection 1. In **[**45]** particular, the objection argues that the value of common shares prior to 2005 was less inflated, citing the opinion of an expert submitted in the Canadian Action. See id.; Abbey Decl. Ex. B Tab 2 ("Torchio Aff."). While we have no reason to doubt that the expert retained by plaintiffs' counsel in the Canadian Action is as qualified to opine on this topic as the expert retained by Abbey Spanier here and moreover that his rationale for further segmenting the share price inflation in the plan of allocation is not unreasonable, see Torchio Aff. ¶¶ 18-20, it is well established that damages calculations in securities class actions often descend into a battle of experts. See In re Marsh, 2009 U.S. Dist. LEXIS 120953, 2009 WL 5178546, at *6 ("[o]n damages, this case would have ended up as a classic 'battle of the experts'"). In the context of settlement approval, however, the rationale here for setting inflation at a constant rate throughout the entire portion of the settlement class period that preceded the initial corrective disclosure and that was covered by subsequently restated financial results need not overwhelm in our estimation all competing theories of damages. Instead, the rationale need only be reasonable **[**46]** and rational, which it is.

E. The Requested Attorneys' Fees and Expenses

In connection with its motion for final approval of the amended settlement, Abbey Spanier also seeks an award of attorneys' fees of $3,000,000, representing 25% of the settlement amount, as well as reimbursement of expenses totaling $1,677,838.02. See Br. 33-42. Adding these attorney's fees and expenses, the total of $4,677,838.02 reflects almost 39% of the settlement amount. While this figure alone gives us pause, as we explained at the hearing on June 14, 2012, we are concerned about the attorneys' hours expended and expert fees incurred by Abbey Spanier and in particular Robbins Geller given the evidentiary challenges that were obviously involved in bringing this case from the outset. In addition, we find particularly troubling the failure of Robbins Geller to address in its application the circumstances of its prior removal as lead plaintiff's counsel, which circumstances drew into question the candor and good faith of its representations to this Court. See In re IMAX, 272 F.R.D. at 155-57, 160; In re IMAX, 2011 U.S. Dist. LEXIS 41709, 2011 WL 1487090, at *9. In light of these concerns, we agreed with Abbey Spanier at ring on the 14th that **[**47]** further briefing on the issue of the requested attorneys' fees and expenses is appropriate. Accordingly, we reserve decision on the award of fees and reimbursement of expenses.

IV. Conclusion

For the reasons stated above as well as those reasons that we articulated at the hearing, which are incorporated here by reference, we (1) find that the notice provided to members of the class was adequate; (2) certify the class for the purpose of settlement; (3) approve the settlement; (4) approve the plan of allocation; and (5) reserve decision on the requested attorneys' fees and expenses pending further briefing on these issues from lead plaintiff's counsel.

Dated: New York, New York

June 20, 2012

/s/ NAOMI REICE BUCHWALD

NAOMI REICE BUCHWALD

UNITED STATES DISTRICT JUDGE

IN RE PAINEWEBBER LIMITED PARTNERSHIPS LITIGATION; THIS DOCUMENT RELATES TO: ALL ACTIONS; THIS DOCUMENT ALSO RELATES TO (BUT IS NOT FILED IN) THE COORDINATED ACTION NEIDICH ET AL. v. GEODYNE RESOURCES INC., ET AL., NO. 94-052860, PENDING IN THE DISTRICT COURT OF HARRIS COUNTY, TEXAS.

Master File 94 Civ. 8547 (SHS)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

171 F.R.D. 104; 1997 U.S. Dist. LEXIS 3254

March 20, 1997, Decided
March 20, 1997, FILED

DISPOSITION: **[**1]** All objections overruled, the present motion GRANTED, and the settlement of this class action APPROVED pursuant to Rule 23(e) of the Federal Rules of Civil Procedure.

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff investor class moved, pursuant to Fed. R. Civ. P. 23(e), for final approval of a settlement of a class action on the terms set forth in a settlement agreement executed by the investors and defendant investment company for alleged fraud and misrepresentation by the investment company in selling risky and illiquid partnerships in a scheme to maximize the investment company's own profits at the expense of the investor class.

OVERVIEW: The investor class brought an action against the investment company alleging fraud, misrepresentation and civil RICO violations in the sale of certain partnership investments. The parties reached a proposed settlement and the investors sought court approval pursuant to Fed. R. Civ. P. 23(e). On review of the settlement after hearing, the court granted final approval to the settlement. The court addressed nine factors: (1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; and (9) the range of reasonableness of the settlement fund in light of all the attendant risks of litigation. The court found that the settlement was fair, reasonable, and adequate for the investors compared with the uncertainties and risks of trying the case.

OUTCOME: The court approved the settlement agreement between the investor class and the investment company.

CORE TERMS: partnership, settlement, class members, investor, notice, partner, class action, negotiation, certification, discovery, consolidated, settlement fund, proposed settlement, aircraft, residual values, marketing, fiduciary, billion, real estate, valuation, attorneys' fees, calculation, assigned, limitations defenses, reasonableness, adequacy, subclass, weigh, broker, rata

LexisNexis(R) Headnotes

Civil Procedure > Class Actions > Certification
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN1] A settlement class is a device whereby the court postpones the formal certification procedure until the parties have successfully negotiated a settlement. Because the court indulges the assumption of the class's existence only until a settlement is reached or the parties abandon the negotiations, settlement classes are also sometimes referred to as temporary or provisional classes.

Civil Procedure > Class Actions > Prerequisites > Numerosity
Civil Procedure > Class Actions > Prerequisites > Typicality
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN2] In determining whether a federal class should be certified, the court must consider the four factors set forth in Fed. R. Civ. P. 23(a), i.e., numerosity, commonality, typicality and representativeness, and must also determine, pursuant to Fed. R. Civ. P. 23(b), whether a class action is the appropriate avenue of recovery. Fed R. Civ. P. 23.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Prerequisites > General Overview
Civil Procedure > Class Actions > Voluntary Dismissals
[HN3] Fed. R. Civ. P. 23(e) provides that notice of a proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Notices
Civil Procedure > Class Actions > Prerequisites > Numerosity
[HN4] Notice of settlement in a class action must fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with the proceedings. The notice need not be highly specific. Nor does the adequacy of notice turn on the ability of an individual class member to calculate the amount of his or her actual recovery

under the settlement.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Class Actions > Voluntary Dismissals
[HN5] Fed. R. Civ. P. 23(e) provides that a class action shall not be dismissed or compromised without the approval of the court. The decision to grant or deny such approval lies squarely within the discretion of the trial court, and this discretion should be exercised in light of the general judicial policy favoring settlement.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
Governments > Fiduciary Responsibilities
[HN6] Ultimately, the court, as protector of the interests of absent class members, must determine whether a proposed settlement is fair, reasonable and adequate. This determination involves consideration of two types of evidence. The court's primary concern is with the substantive terms of the settlement compared to the likely result of a trial, and to that end the trial judge must apprise himself of all the facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claims be litigated. The court's second concern is with the negotiating process by which the settlement was reached, which must be examined in light of the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves. The court has a fiduciary duty to ensure that the settlement is not the product of collusion.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
Governments > Fiduciary Responsibilities
[HN7] So long as the integrity of the arm's length negotiation process is preserved, a strong initial presumption of fairness attaches to a proposed settlement, and great weight is accorded to the recommendations of counsel, who are most closely acquainted with the facts of the underlying litigation.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Prerequisites > General Overview
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN8] In determining whether to approve a proposed settlement a district court should consider the following nine factors: (1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; and (9) the range of reasonableness of the settlement fund in light of all the attendant risks

of litigation. In its consideration of these factors, the court must eschew any rubber stamp approval in favor of an independent evaluation, yet, at the same time, it must stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN9] Avoiding wasteful litigation and expense are factors which lay behind the congressional infusion of a power to compromise. Accordingly, the court must consider the complexity, expense and likely duration of the litigations that the parties seek to avoid.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN10] A favorable reception by the class constitutes strong evidence of the fairness of a proposed settlement and supports judicial approval. In particular, the absence of objectants may itself be taken as evidencing the fairness of a settlement.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Discovery > Relevance
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN11] The stage of the proceedings and the amount of discovery completed at the time a settlement is reached is relevant to the parties' knowledge of the strengths and weaknesses of the various claims in the case, and consequently affects the determination of the settlement's fairness.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN12] Litigation inherently involves risks. If settlement has any purpose at all, it is to avoid a trial on the merits because of the uncertainty of the outcome.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Fraud & Misrepresentation
Criminal Law & Procedure > Criminal Offenses > Racketeering > Racketeer Influenced & Corrupt Organizations > General Overview
[HN13] A cause of action does not accrue under the Racketeer Influenced and Corrupt Organizations Act, specifically 18 U.S.C.S. § 1962, until the amount of damages becomes clear and definite.

Business & Corporate Law > Distributorships & Franchises > Causes of Action > Fraud & Misrepresentation
Business & Corporate Law > General Partnerships > Management Duties & Liabilities > Causes of Action > Negligent Acts of Partners
Torts > Negligence > Causation > Proximate Cause > Intervening Causation
[HN14] A civil Racketeer Influenced and Corrupt Organizations Act (RICO) suit requires pleading and proof of loss by reason of the defendant's violation. 18 U.S.C.S. § 1964(c). In the context of

predicate acts grounded in fraud, the plaintiff must show that the misstatements were the reason the transaction turned out to be a losing one. Thus, when factors other than the defendant's fraud are an intervening direct cause of a plaintiff's injury, that same injury cannot be said to have occurred by reason of the defendant's actions.

Business & Corporate Law > Limited Partnerships > General Overview
Civil Procedure > Pleading & Practice > Defenses, Demurrers & Objections > Affirmative Defenses > General Overview
Governments > Legislation > Statutes of Limitations > Time Limitations
[HN15] The applicable statute of limitations for Racketeer Influenced and Corrupt Organizations Act (RICO) is four years from the moment when a plaintiff discovers or should have discovered the injury. Where plaintiffs acquire an interest in a limited partnership in reliance on allegedly fraudulent offering material, the injury is the actual purchase of the partnership interest. The plaintiff's duty of inquiry with regard to that injury arises, and the RICO cause of action thereby accrues, when the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded.

Civil Procedure > Class Actions > Judicial Discretion
Torts > Damages > General Overview
Torts > Vicarious Liability > Partners > General Overview
[HN16] In class actions, the complexities of calculating damages increase geometrically.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Trials > Jury Trials > Province of Court & Jury
[HN17] Damages are a matter for the jury, whose determinations can never be predicted with certainty.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > General Overview
[HN18] The ability of the defendant to pay a judgment greater than the amount offered in a settlement can be relevant to the court's determination of a settlement's fairness. In particular, evidence that the defendant will not be able to pay a larger award at trial tends to weigh in favor of approval of a settlement, since the prospect of a bankrupt judgment debtor down at the end of the road does not satisfy anyone involved in the use of class action procedures. However, the converse is not necessarily true; i.e., the fact that a defendant is able to pay more than it offers in settlement does not, standing alone, indicate that the settlement is unreasonable or inadequate.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN19] Fundamental to analyzing a settlement's fairness is the need to compare the terms of the compromise with the likely rewards of litigation. This determination is not susceptible of a

mathematical equation yielding a particularized sum, but turns on whether the settlement falls within a range of reasonableness. The adequacy of the amount offered in settlement must be judged not in comparison with the best possible recovery in the best of all possible worlds, but rather in light of the strengths and weaknesses of the plaintiffs' case. However, it is not necessary in making this determination for the court to try the case which is before it for settlement, since such a procedure would emasculate the very purpose for which settlements are made. Rather, the court is called upon to consider and weigh the nature of the claim, the possible defenses, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN20] The dollar amount of the settlement by itself is not decisive in a fairness determination, and the fact that the settlement fund may equal only a fraction of the potential recovery at trial does not render the settlement inadequate.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
Torts > Procedure > Settlements > General Overview
[HN21] There is no rule that settlements benefit all class members equally.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN22] A fundamental indicator of a settlement's fairness is the fact that it was properly negotiated at arm's length by the parties. As long as the integrity of the negotiating process is ensured by the court, it is assumed that the forces of self-interest and vigorous advocacy will of their own accord produce the best possible result for all sides. Accordingly, the court has an obligation to satisfy itself that the settlement process has not been corrupted and that the class members have been adequately represented by qualified counsel.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Discovery > Methods > Requests for Production & Inspection
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN23] An allegation of collusion will not stand in the absence of any credible evidence.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Prerequisites > General Overview
Governments > Fiduciary Responsibilities
[HN24] The court's responsibility for ensuring that a proposed settlement is equitably allocated among class members derives from the requirement of Fed. R. Civ. P. 23(e) that the settlement of a class action have court approval, and the standard of fairness, adequacy and reasonableness applies with as much force to the review of the allocation plan as it does to the review of the overall

settlement. The review of the plan of allocation is squarely within the discretion of the district court, and in this function, as in its review of the settlement itself, the court acts as the fiduciary of all class members.

Civil Procedure > Class Actions > Compromises
Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN25] In the case of a large class action the apportionment of a settlement can never be tailored to the rights of each plaintiff with mathematical precision. To determine precisely the distribution of the settlement fund among the myriad claimants in such a class would require counsel or the district court to weigh the strengths and weaknesses of the claims of each class member and would be an almost impossible task.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN26] When real and cognizable differences exist between the likelihood of ultimate success for different plaintiffs, it is appropriate to weigh distribution of the settlement in favor of plaintiffs whose claims comprise the set that was more likely to succeed.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN27] The adequacy of an allocation plan turns on whether counsel has properly apprised itself of the merits of all claims, and whether the proposed apportionment is fair and reasonable in light of that information.

Civil Procedure > Class Actions > Judicial Discretion
Civil Procedure > Settlements > Settlement Agreements > General Overview
[HN28] Efficiency, ease of administration, and conservation of public and private resources are highly relevant to the reasonableness of a settlement, particularly where, the issues are complex, the outcome of the litigation unclear, and the class large.

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SHARRY EVANS, Trustee, claimant, Pro se, San Antonio, TX.

JUDGES: SIDNEY H. STEIN, U.S. DISTRICT JUDGE.

OPINION BY: SIDNEY H. STEIN

OPINION

[*105] *OPINION AND ORDER*

SIDNEY H. STEIN, U.S. DISTRICT JUDGE.

The plaintiff class has moved, pursuant to Fed. R. Civ. P. 23(e), for final approval of the settlement of this class action on the terms set forth in the Stipulation and Agreement of Compromise and Settlement (the "Settlement Agreement") executed by the parties on July 11, 1996. By its Order dated July 17, 1996, this Court granted preliminary approval of the Settlement Agreement as "fair, reasonable and adequate," set a date for a hearing on whether the terms of the Settlement Agreement were fair, reasonable and adequate, and directed Class Counsel to provide notice to the Class. In August of 1996, Class members were notified by mail and newspaper publication of the terms of the Settlement Agreement, including the proposed Plan of Allocation, the proposed award of attorneys' fees, and the date and purpose of the fairness hearing. Objections were subsequently filed by members of the Class **[**2]** **[*106]** and arguments were presented at a fairness hearing before this Court on October 25 and November 8, 1996, at which testimony was taken and legal arguments heard. On the basis of all the evidence and arguments submitted, and for the reasons set forth below, the proposed Settlement and Plan of Allocation are determined to be fair, reasonable and adequate, and accordingly are hereby approved pursuant to Fed. R. Civ. P. 23(e). The award of attorneys' fees and litigation expenses is not decided in this Opinion and Order and will be the subject of a separate Order.

I.

FACTS

A. *Introduction*

The Settlement Agreement submitted here for approval applies to two distinct but related consolidated lawsuits: the Consolidated Complaint now pending in this Court known as *In Re PaineWebber Limited Partnerships Litigation* (Master File No. 94 Civ. 8547) ("Federal Action"), and the Consolidated Petition currently pending in the District Court of Harris County, Texas, under the caption *Neidich, et al. v. Geodyne Resources. Inc., et al.*, No. 94-052860 ("Texas Action"). Both the Federal and Texas Actions are comprised of multiple litigations and have previously been certified as class **[**3]** actions; they have proceeded on a coordinated basis in this Court during much of the discovery process and throughout the negotiation of the Settlement Agreement.

The plaintiff class in the Federal Action is composed of investors who purchased shares in one or more of 70 limited partnerships and investment trusts ("Partnerships") which were organized, marketed and operated by PaineWebber. (*See* Class Plaintiffs' Memorandum in Support of Approval ("Class Mem.") at 1.) The plaintiff class in the Texas Action, which is entirely encompassed within the Federal Class, is composed of investors who purchased units in 23 of the 29 Geodyne limited partnerships ("Geodyne Units") marketed by PaineWebber. (*See* Notice of Proposed Class Action Settlement ("Settlement Notice") at PP 4-5.) Unless otherwise noted, the Federal and Texas Classes will be referred to collectively as "the Class," and their members as "Class Members." The defendants in the Federal and Texas Actions are PaineWebber Group, Inc., PaineWebber Incorporated, Ltd., and certain PaineWebber subsidiaries, affiliates and individual officers; they will be referred to collectively as "PaineWebber" or "the Defendants." Defendants **[**4]** and the Class will be referred to together as "the Parties." Finally, certain counsel have been designated by the Texas Court or by this Court to act as Executive Committees on behalf of their respective classes in the Texas and Federal Actions; unless otherwise noted, these counsel will be referred to collectively as "Class Counsel."

The members of the Federal Class have alleged, among other claims, that PaineWebber sold them risky and illiquid Partnerships in an effort to maximize its own fees and commissions, and engaged in a conspiracy to misrepresent those Partnerships as safe investments suitable for most investors. The Federal Class seeks relief pursuant to the Racketeer Influenced and Corrupt Organizations Act ("RICO"), federal securities law, and the common law. The members of the Texas Class have alleged, among other claims, that PaineWebber defrauded them by failing to disclose the true nature of the risks presented by the Geodyne partnerships, and by misrepresenting the likely benefits of those investments. They seek relief under the statutes and common law of Texas. The Defendants deny all allegations of wrongdoing and liability. (*See* Settlement Notice at PP 4-6.)

[5]** On July 11, 1996, PaineWebber and Class Counsel reached an agreement to settle these consolidated class actions, pending approval by this Court. The proposed Settlement would provide a cash recovery of $ 125 million, plus a variety of "Additional Benefits" -- such as guarantees and fee waivers -- which the parties assert to be worth at least $ 75 million. The stated objective of the Settlement is to allow all Class Members to recoup as much of their lost capital investments as possible, and accordingly the settlement proceeds are to be allocated to Class Members pro rata on the basis of "Recognized **[*107]** Loss," a defined term in the proposed Settlement. (*See infra* Section I.) Payments will not be weighted to reflect possible differences in the relative strength of Class members' claims on the merits. (*See* Class Mem. at 48-51.)

This Opinion and Order sets forth the material facts underlying the Settlement of these class actions, and addresses the legal issues -- including those issues that have been raised by objecting Class Members -- that are relevant to the determination of the Settlement's fairness, reasonableness and adequacy.

B. *Background of the Federal Action*

[6]** Between November 23, 1994 and January 4, 1995, 10 lawsuits were filed in this District by individual plaintiffs against PaineWebber, alleging claims arising from the marketing and sale of the Partnerships and requesting certification as class actions. [1] Shortly thereafter, Judge Charles S. Haight, Jr. of this Court consolidated those actions [2] for pretrial purposes under the caption *In re PaineWebber Limited Partnerships Litigation*, Master File No. 94 Civ. 8547; approved the formation of plaintiffs' counsel into an Executive Committee; and set schedules for the filing of a Consolidated Complaint and for discovery. (*See* Case Management Orders 1 and 2, dated March 3 and 16, 1995.)

1 *Rittmaster v. PaineWebber Group, Inc., et al.*, No. 94 Civ. 8547; *Schwartz, et al. v. PaineWebber Group, Inc.*, No. 94 Civ. 8549; *Romine v. PaineWebber Group, Inc., et al.*, No. 94 Civ. 8558; *Tiefer v. PaineWebber Group, Inc.*, No. 94 Civ. 8609; *Fine, Bryant & Wah P.T. Chartered Profit Sharing Trust v. PaineWebber Group, Inc.*, No. 94 Civ. 8637; *Clark v. PaineWebber Group, Inc.*, No. 94 Civ. 8712; *Nassirzadeh v. PaineWebber Group, Inc.*, No. 94 Civ. 8762; *Williams v. PaineWebber Group, Inc.*, No. 94 Civ. 8772; *McLeod v. PaineWebber Group, Inc., et al.*, No. 94 Civ. 8934; and *Sanfilippo v. PaineWebber Group, Inc.*, No. 95 Civ. 0056.

[7]**

2 Three additional cases -- *Danziger v. PaineWebber Group, Inc.*, No. 95 Civ. 3370; *Paulson v. PaineWebber Group, Inc.*, No. 95 Civ. 4570; and *Beckwith v. PaineWebber, Inc., et al.*, No. 95 Civ. 7755 (September 8, 1995) -- have since been added to the Consolidated Complaint.

On March 27, 1995, eighteen plaintiffs, on behalf of all those similarly situated, filed a First Consolidated Amended Class Action Complaint ("Complaint") in this Court against PaineWebber Group, Inc., PaineWebber Incorporated ("PWI"), various PaineWebber subsidiaries and affiliates, and three individual corporate officers. [3] The Complaint alleges that between 1980 and 1992, PaineWebber developed, marketed and operated numerous investment Partnerships as part of an ongoing conspiracy to defraud investors and enrich itself through excessive fees and commissions. Specifically, the Complaint asserts that the 70 Partnerships, which include limited partnerships in oil and gas, aircraft leasing and research and development, as well as real estate investment trusts (REITs) and other entities, [4] were falsely and **[*108]** indiscriminately **[**8]** promoted to the public by PaineWebber as low-risk investments, when in fact PaineWebber knew the opposite to be true. (Complaint at PP 10-20, 116-136.)

3 *See* Complaint at PP 50-112. The named individual defendants are: Joseph J. Grano, Jr. (President of Retail Sales and Marketing for PWI and a Director of PaineWebber); Paul B. Guenther (President of PWI and a Director of PaineWebber); and Donald B. Marron (Chairman and CEO of PaineWebber, Chairman and CEO of PWI, and, at various times, President of PWI and Chairman of PaineWebber Properties, Inc.). (Complaint at PP 108-110.)

4 The 70 Partnerships are the following: PaineWebber/Geodyne Energy Income Limited Partnerships I-A through I-F; PaineWebber/Geodyne Energy Income Limited Partnerships II-A through II-H; PaineWebber/Geodyne Energy Income Limited Partnerships III-A through III-G; PaineWebber/Geodyne Inst/Pension Energy Income P-1 through P-8 Limited Partnerships; Kagan Media Partners; PaineWebber CMJ Properties, L.P.; PaineWebber Development Partners IV, Ltd.; PaineWebber Equity Partners I through III Limited Partnerships; Fiduciary Capital Partners, L.P.; Fiduciary Capital Pension Partners, L.P.; PaineWebber Growth Properties I, L.P. and II, L.P.; PaineWebber Growth Partners III, L.P.; PaineWebber Guaranteed Futures Fund, L.P.; PaineWebber Income Properties Limited Partnership; PaineWebber Income Properties Two through Eight Limited Partnerships; PaineWebber Independent Living Mtge. Fund, Ltd.; PaineWebber Independent Living Mtge. Inc. II; PaineWebber Insured Mortgage Partners IA L.P. and IB L.P.; PaineWebber IRB Property Fund Limited Partnership; PaineWebber Mortgage Partners V, L.P.; Participating Income Properties III Limited Partnership; PaineWebber Preferred Yield Fund, L.P.; PW Preferred Yield II, L.P.; PaineWebber Qualified Plan Property Fund, L.P.; PaineWebber Qualified Plan Property Fund Two, L.P. through Four, L.P.; PaineWebber R&D Partners, L.P.; PaineWebber R&D Partners II, L.P. and III, L.P.; Realty Southwest Fund II, Ltd. and III, Ltd.; Retail Property Investors, Inc.; Pegasus Aircraft Partners, L.P.; Pegasus Aircraft Partners II, L.P.

[9]** Defendants are alleged to have implemented their scheme through the use of "Uniform Sales Materials" and broker "scripts" which stressed the safety of the Partnerships and emphasized PaineWebber's experience, skill and trustworthiness in investigating and selecting high quality investment opportunities. [5] (Complaint at PP 131-132.) The Partnerships allegedly were marketed as acceptable investments for retirement funding and as alternatives to tax free bonds or certificates of deposit, and PaineWebber brokers allegedly were coached to promote the Partnerships regardless of each customer's investment objectives and without concern for the suitability of such investments. (Complaint at PP 18, 130-132.) It is also alleged that the marketing of the Partnerships was centrally orchestrated through the use of a uniform series of statements and sales materials, and that the same presentations were used nationwide for virtually all of the Partnerships regardless of the risk associated with the venture or the quality of the particular investment. (*See* Complaint at PP 12, 116, 118, 128; Affidavit of Nicholas Chimicles submitted in support of the settlement ("Chimicles Aff.") at P 14.) Defendants **[**10]** are alleged to have known, and to have concealed from investors, that the Partnerships were not actually conservative investments, but were in fact highly speculative ventures, and moreover that it would be extremely unlikely, if not impossible, for these investments ever to attain their stated goals, particularly in light of PaineWebber's own substantial up-front fees and commissions. (Complaint at P 136.)

5 For example, brokers were allegedly encouraged to promote the PaineWebber Insured

Mortgage Partners Partnership as an investment that "eliminates the volatility of the stock market." (Complaint at PP 126-127.)

The Complaint further alleges that PaineWebber deliberately circumvented the disclosure requirements of federal securities law by promoting the sale of Partnerships on the sole basis of summary Uniform Sales Materials, and actively discouraging brokers and investors from reading or referring to the Prospectuses. Brokers and prospective investors were allegedly told that the Uniform Sales Materials **[**11]** explained the legal language contained in the Prospectus, when in fact such Sales Materials allegedly glossed over or failed to disclose risks noted in the Prospectus. (Complaint at PP 138-139; Chimicles Aff. at P 15.) Finally, it is alleged that in order to conceal their initial fraud, induce investors to purchase future offerings, and deceive investors about the true financial condition and performance of their investments, Defendants manipulated quarterly cash distributions and misreported data in investor reports and account statements, so as to make it appear for some time that the Partnerships were in fact meeting their projections. (Complaint at PP 141-143; Chimicles Aff. at P 16.)

Count I of the Complaint asserts RICO claims pursuant to 18 U.S.C. § 1962(c) and (d); Count II asserts RICO claims pursuant to 18 U.S.C. § 1962(a) and (d); Count III asserts violations of Section 10(b) of the Securities and Exchange Act of 1934, and of Rule 10b-5 under that Act; Count IV asserts violations of Section 11 of the Securities Act of 1933; Count V asserts violations of Section 12 of the Securities Act. The remaining Counts allege common law fraud (Count VI), negligent misrepresentation **[**12]** (Count VII), breach of fiduciary duty (Count VIII), breach of third party contract against PWI (Count IX), and breach of implied covenants against PWI (Count X). (Complaint at PP 177-248; Chimicles Aff. at P 17.)

By Order dated May 30, 1995, Judge Haight certified the Consolidated Complaint as a class action pursuant to Fed. R. Civ. P. 23(b)(3) in accordance with a prior stipulation of the parties. (*See* Stipulation and Order Regarding Class Certification dated May 30, 1995 ("Certification Order") at P E, § 10.) The Federal Class consists of all persons and entities who purchased units in one or more of the Partnerships from or through PaineWebber between January 1, 1980 and December 31, 1992, and its representatives are the eighteen named plaintiffs in the Consolidated **[*109]** Complaint. [6] In accordance with Fed. R. Civ. P. 23(a), the Certification Order specified that the Federal Class satisfies all the requirements of class certification. Specifically, it provided that: (a) due to the large number of potential plaintiffs, joinder of class members individually would be impracticable; (b) there are numerous questions of law and fact common to the Class; (c) the Class representatives **[**13]** allegedly purchased Partnership interests in reliance on false representations by PaineWebber, and their claims for relief are typical of the Claims for relief of the Class; and (d) as there is no existing conflict between the Class representatives and the other members of the Class, and as both the representatives and their counsel are willing and able to prosecute this action vigorously, the Class representatives would fairly and adequately protect the interests of the Class. (*See* Certification Order at P E, §§ 3-9.)

6 Excluded from the Class are the following: officers and directors of PaineWebber, their families and heirs; those who acquired Partnership units from a source other than PaineWebber; those who have settled their Partnership claims against PaineWebber and have signed a release; and those who have resolved their Partnership claims against PaineWebber in a separate litigation or arbitration.

C. ***Background of the Texas Action***

In late 1994, two lawsuits were filed by individual plaintiffs **[**14]** in the 127th District Court of Harris County, Texas, on behalf of a putative class of investors who had purchased units in 23 "Geodyne" oil and gas limited partnerships marketed by PaineWebber between March, 1987 and June, 1991. [7] They were consolidated by Judge Sharolyn Wood of the Texas District Court on April 26, 1995, under the caption *Neidich, et al. v. Geodyne Resources, Inc., et al.*, No. 94-052860 (Harris County, Texas), and an Executive Committee of plaintiffs' counsel was appointed. (*See* Affidavit of Karen Morris in Support of the Proposed Settlement ("Morris Aff.") at PP 2-3.)

7 The Geodyne Units at issue in the Texas Action are the following: PaineWebber/Geodyne Energy Income Limited Partnerships II-A through II-H; PaineWebber/Geodyne Energy Income Limited Partnerships III-A through III-G; and PaineWebber/Geodyne Inst/Pension Energy Income P-1 through P-8 Limited Partnerships. Six additional Geodyne Partnerships (PaineWebber/Geodyne Energy Income Limited Partnerships I-A through I-F) are part of the Federal Action but are not included in the Texas Action.

[15]** In May of 1995, the plaintiffs in those actions filed a Consolidated and Amended Petition ("Texas Petition") in the Texas Court against PaineWebber and other defendants, asserting claims under state law arising from the marketing and sale of the Geodyne Units. The Consolidated Petition charges Defendants with substantially the same course of conduct set forth in the Federal Consolidated Complaint, and alleges, among other claims, that PaineWebber deliberately misled investors by concealing the speculative nature of the Geodyne Units and by misrepresenting the safety and likely benefits of those investments. It is further alleged that PaineWebber knew that their projections for the Geodyne Units were not attainable and that those partnerships were not appropriate for investors seeking to preserve capital. The Petition seeks redress under Texas law for fraud, breach of fiduciary duty and negligent misrepresentation. (*See* Settlement Notice at P 5.)

The following month, the Consolidated Petition was certified by Judge Wood as a class action pursuant to Rule 42(b)(4) of the Texas Rules of Civil Procedure. The Class in the Texas Action consists of all persons or entities who purchased **[**16]** Geodyne Units from or through PaineWebber. [8] (*See* Notice of Pendency of Class Actions ("Notice of Pendency") at P 7.)

8 Exclusions from the Texas Class are the same as for the Federal Class. *See supra* note 6.

D. *Pretrial Coordination of the Federal and Texas Actions*

In late May and early June of 1995, Judge Haight and Judge Wood issued orders which coordinated the Federal and Texas Actions in the Federal Court for pretrial purposes, in accordance with the stipulation of the Parties. Pursuant to those Stipulations and Orders, the Texas Class agreed to be bound by the Federal Court's final determination of **[*110]** legal and factual issues concerning the 23 Geodyne Units involved in both actions, and to coordinate with the Federal Class any pleadings or pretrial motion practice relating to Geodyne. The parties also agreed to coordinate investigation and discovery regarding the Geodyne Units. (*See* Case Management Order No. 3 at PP 1-10.)

On June 7, 1995, pursuant to the Orders of Class Certification, **[**17]** and in accordance with Fed R. Civ. P. 23(c)(2), a joint Notice of Pendency of the Class Action was mailed by the Notice Administrator, Rudolph, Palitz LLP. The Administrator mailed 218,398 copies of the Notice to individuals and companies whose names were provided by PaineWebber, and also to nominees whose names the Administrator maintains on its own database. [9] (Chimicles Aff. at P 23.) Recipients of the Notice included brokers and other record owners of Partnership interests, who were instructed to forward the Notice to beneficial owners, or to provide the names of such owners to Class Counsel. (*See* Notice Of Pendency at P 20.) Within 10 days of this mailing, a summary version of the Notice was also printed in the national editions of *The Wall Street Journal, The New York Times* and *USA Today*. Among other information, the Notice of Pendency summarized the claims asserted in the Complaint and the Texas Petition, defined the Federal and Texas Classes, identified the members of the Executive Committees, apprised Class Members of their right to opt out of the Class, and informed them that any such request must be postmarked or received by July 21, 1995. Subsequently, 5,458 **[**18]** timely requests for exclusion were received by the Notice Administrator. (Chimicles Aff. at P 23.) [10]

9 The number of mailed copies exceeds the number of potential Class Members because investors with multiple accounts received multiple notices. The number of potential class members has been estimated by Class Counsel to be approximately 150,000. (*See* Class Mem. at 2, 29.)

10 Since the expiration of the exclusion deadline, this Court has received a number of

motions by Class Members seeking to opt out late. These have been decided on an individual basis pursuant to the legal standard of "excusable neglect." In addition, duplicative proceedings commenced by Class Members in other jurisdictions have been enjoined by Order of this Court or by stipulation of the Parties. (*See* Opinion and Order dated June 28, 1996; Stipulation and Order dated December 11, 1996.)

E. *Investigation, Discovery and Document Analysis*

Preliminary investigation and discovery was undertaken separately by lawyers in **[**19]** the Texas and Federal Actions prior to the certification and coordination of the two actions. (*See* Affidavit of Karen Morris in Support of Request for Attorneys' Fees ("Morris Fee Aff.") at PP 26; Chimicles Aff. at P 25.) Thereafter, discovery was coordinated in accordance with Case Management Order No. 3, and PaineWebber produced, on a rolling basis, more than 200 boxes of documents to Class Counsel during the summer of 1995. (Chimicles Aff. at P 25.) Additionally, Class Counsel subpoenaed documents from third parties, including former PaineWebber employees, general partners such as Geodyne, Pegasus and Samson Oil, and certain appraisal and accounting firms. In response to these subpoenas, Counsel obtained eight compact disks of information -- each representing approximately 10 boxes of documents. By the early fall of 1995, Class Counsel was in possession of the equivalent of approximately 300 boxes of documents produced by PaineWebber and third parties or obtained from public sources, including prospectuses, marketing materials, quarterly and annual reports, correspondence and memoranda, due diligence materials, broker training materials, reserve reports, and financial records. **[**20]** (*Id.* at PP 25, 29.)

In addition, Class Counsel conducted interviews with hundreds of Class Members and former PaineWebber brokers regarding the sales tactics used by PaineWebber in its marketing of the Partnerships and the information provided to customers regarding the subsequent performance of those investments. Class Members were also requested to provide Counsel with copies of the written sales materials they had been given by PaineWebber in connection with their purchases of Partnership units. (Chimicles Aff. at P 26.) Between October 1995 and January 1996, pursuant to a deposition protocol negotiated **[*111]** by the Parties, Class Counsel deposed approximately 30 individuals, including: PaineWebber personnel responsible for the creation and sale of the Partnerships and for due diligence and compliance with state and federal regulations; officers of selected PaineWebber subsidiaries and affiliates; and current and former PaineWebber brokers. (*Id.*) Class Counsel also deposed third parties, including officers and managers of the Pegasus Partnerships, and, in coordination with Texas Counsel, individuals involved in the sale and operations of the Geodyne Partnerships. Certain of the **[**21]** deponents located beyond the subpoena jurisdiction of this Court were deposed on videotape in order to preserve their testimony for trial. (*Id.*; Morris Fee Aff. at P 37.)

The documents obtained by Class Counsel through the discovery process and from public sources were coded in a master database for review and analysis. (Chimicles Aff. at PP 30-32.) Meanwhile, the 70 Partnerships were subdivided and classified by industry -- i.e., real estate, Geodyne, Pegasus, and research & development -- and each class was assigned to an attorney working group under the aegis of a member of the Executive Committee. Finally, individual firms, drawn from among plaintiffs' counsel in the original lawsuits, were assigned to review discovery materials with respect to specific Partnerships. (Chimicles Aff. at P 28.) The review and analysis of Geodyne-related documents was coordinated with Counsel in the Texas Action, which had already performed work with respect to those Partnerships. The Executive Committee, in its role as supervisor of the process, prepared analysis guidelines for the working groups, circulated memoranda and status reports, and organized meetings to facilitate the sharing of information. **[**22]** (*Id.*)

Beginning in June of 1995 and running through September of 1996, Class Counsel retained the services of industry and financial experts to provide assistance in analyzing the merits of the various claims and in calculating residual values for each of the 70 Partnerships. The foundation of these analyses was the "initial financial condition summary" prepared in December of 1994 by Kathleen Balon, a financial expert retained by Class Counsel. (*See* Affidavit of Kathleen Balon ("Balon Aff.") at PP 42-46.) The following experts were engaged: James Vodola of PASCORP (valuation of Real Estate Partnerships and REITs, and Remaining Value Guarantees); Gustavson Associates (valuation of Geodyne Partnerships); Professor William Jordan (assistance with Pegasus and Geodyne, and partnership structure in general); David Treitel of Simat, Helliesen & Eichner, Inc. (valuation of Pegasus Partnerships); Michael Dowd of Equity Research Collaborative and Mark Roth of Korpacz & Associates, Inc. (statistical data affecting the Real Estate Partnerships); and Candace Preston of Princeton Venture Research (valuation of certain Partnerships and of the proposed Additional Benefits). (See Balon Aff. **[**23]** at P 38; Balon Deposition Tr. at 13, 61; Chimicles Aff. at P 33.) [11]

11 In addition, Counsel for the Texas Class retained the following experts with respect to the Geodyne Partnerships: Frank Webster (valuations); Huddleston & Co. (reserve analysis); Corporate Capital Consultants, Inc. (analysis of prospectuses); Hugh Lamle (valuation and consulting); Eisner & Co. (forensic accounting analysis); and Ten Eyck Associates, Inc. (forensic accounting, analysis of public filings regarding Partnership performance).

Under Balon's supervision, these individuals analyzed the performance histories, current assets, and financial conditions of each Partnership, including cost structures, debt burdens, likely liquidation periods, and potentials for future income generation. They also reviewed particular industry and market risks for the purpose of discounting future cash flows. (Balon Aff. at PP 17-18, 39.) [12] Specifically, with regard to the 28 real estate Partnerships, they analyzed individual property financial statements, **[**24]** cash flow projections and, where appropriate, joint venture agreements, for approximately 180 properties. For each of the 29 Geodyne Partnerships, they reviewed up to four years of reserve data, comprising information relating **[*112]** to three reserve categories as well as operating costs. For the two Pegasus Partnerships, they analyzed the 17 aircraft leases in place, including expected revenue from each lease, the credit quality of the lessees, and the estimated residual market value of each aircraft. With regard to the R&D Partnerships, they evaluated individual royalty contracts and projected revenue. (*Id.* at P 24.) For the remaining Partnerships, including the Fiduciary Capital and Preferred Yield Partnerships, a less extensive analysis was prepared due to lack of available information. (*Id.* at P 25.) On the basis of these studies, Balon and the experts assigned fair market values to the assets and operations remaining in each of the 70 Partnerships, as discounted to January 1, 1996. These residual values would be crucial to Class Counsel's calculation of the "Recognized Losses" suffered by the Class, which calculations would, in turn, provide the touchstone for the negotiation **[**25]** of the Settlement, the Plan of Allocation, and certain Additional Benefits. (*See id.* at PP 18-19.)

12 Balon also prepared alternative scenario valuations using such factors as third-party appraisals, general partner repurchase offers, and secondary market activity and pricing. (*Id.* at PP 32-33.)

F. *Settlement Negotiations*

On July 27, 1995, PaineWebber announced that it would take a $ 200 million charge against earnings to cover potential liabilities arising from its marketing and sale of the Partnerships. Such liabilities included any judgments, settlements, fees and costs incurred in connection with the Federal and Texas Actions, opt outs from those actions, other individual or mass litigations and arbitrations, and an ongoing SEC investigation. [13] (Chimicles Aff. at P 100.) PaineWebber also announced that it had entered into settlement negotiations with the SEC. (*Id.*) Several weeks later, PaineWebber made a preliminary settlement offer to Class Counsel; the offer allegedly represented **[**26]** "a small fraction of the ultimate Settlement," and was rejected. (*Id.*) Settlement negotiations between the Parties began in earnest in October, 1995, after the conclusion of the bulk of discovery. (*Id.* at P 37.) In connection with those negotiations, Class Counsel established a Settlement Committee, and also convened a "Sounding Board" from among the named plaintiffs to assist in evaluating settlement proposals and to bring specific investor concerns to the attention of the Settlement Committee. [14] (*Id.* at P 42.)

13 *See infra* Section G.

14 The Sounding Board, created in September 1995, represented diverse geographical areas and Partnership interests. Its members included investors in R&D Partners I-III, Equity Partners II, Qualified Plan Property Fund III, Geodyne Institutional/Pension Energy Income

Partners P-5, and Pegasus Aircraft Partnership II. (Chimicles Aff. at 42.)

(1) *Loss Calculations and Negotiation of the Settlement Fund*

Underlying the negotiations between the Parties **[**27]** was Class Counsel's calculation of the losses suffered by investors in each of the Partnerships. Based on the data analyses performed by the various attorney working groups and experts, and in consideration of the risks that would be involved in establishing damages at trial, Class Counsel decided to proceed, for settlement purposes, on a theory of "Recognized Loss." Accordingly, investor losses in each Partnership Unit were deemed to equal the Unit's purchase price, minus all cash distributions received through December 31, 1995, minus the residual value, if any, of the Partnership Unit as of January 1, 1996. (Chimicles Aff. at P 90.) Other legal theories, such as lost investment opportunity, were not included in the evaluation, and no interest component was applied. [15] Distributions were assumed to encompass both income and return on capital; tax benefits, with one exception, were not considered. [16] Finally, with respect to residual values, the asset valuations performed for each **[*113]** Partnership by Balon with the assistance of the retained experts, as described above, were adopted by Class Counsel. (Balon Aff. at P 32.) [17]

15 Class Counsel's expert has estimated that a standard interest component would probably double the amount of damages, and that a loss theory aimed at compensating Class Members for the promised return on the Partnerships would probably result in damages of over one billion dollars. (*See* Balon Aff. at P 34.) Such an amount was deemed by Class Counsel to be "unmanageably large" in light of the funds available for settlement. (Class Mem. at 41 n.19.)

[28]**

16 Tax benefits were counted as distributions only for the CMJ Properties Partnership, which was structured specifically as a tax shelter and produced no other benefits. (*See* Class Mem. at 60.)

17 These values would continue to be refined in early 1996 for the purpose of negotiating the Additional Benefits and the Plan of Allocation. In general, the expert valuations approximated the findings of PaineWebber's own third-party appraisers, with the exception of the Geodyne Partnerships, whose residual values came out lower than secondary market prices. (Balon Aff. at P 35.)

The total capital investment by Class Members in the Partnerships, as adjusted for opt outs and independently settled claims, was determined to be approximately $ 2.3 billion, of which $ 1.2 billion (53%) was invested in the Real Estate Partnerships and REITs, $ 444 million (19%) was invested in the Geodyne oil and gas partnerships, $ 176 million (8%) was invested in the Pegasus aircraft leasing Partnerships, and $ 458 million (20%) was invested in partnerships operating in other industries, including research and **[**29]** development, equipment leasing, mezzanine capital, futures trading and media debt. (Class Mem. at 9-10.) Total distributions from the 70 Partnerships through December 31, 1995 were approximately $ 1.46 billion, with distributions exceeding the amount of investment in 14 cases. (*Id.* at 10.) For the remaining Partnerships, the amount of capital at risk (including capital lost through liquidated Partnerships) was determined to be $ 913 million, and the residual value of these investments as of January 1, 1996 was deemed to be $ 589 million. (Chimicles Aff. at P 38.) Based on these figures, Class Counsel estimated that the total Recognized Loss suffered by the Class as of January 1, 1996, again as adjusted for opt outs and other settlements, was approximately $ 410 million. (Balon Aff. at P 36.) Of this amount, $ 285.4 million was lost in the Real Estate Partnerships, $ 115.2 million in Geodyne, $ 8.99 million in Pegasus, and $ 530,000 in other Partnerships. (Morris Aff. at P 7 & n.3.) [18]

18 Until all claims are filed, these estimates remain subject to several variables, including the demographics of investors who purchased units in the secondary market or sold units prior to January 1, 1996, or who have opted out of the Class or settled their claims independently. (Balon Aff. at P 37.) Specific distribution and residual value figures for each Partnership appear in the Data Appendix to the Settlement Agreement.

[30]** The Parties engaged in arm's length negotiations during the late fall of 1995. During the negotiations, there was substantial disagreement over Class Counsel's calculation of the residual values, particularly with regard to the projected earning capacity of the Partnerships. (Chimicles Aff. at P 38.) On December 12, 1995, the Parties entered into an initial Memorandum of Understanding ("MOU"). An amended MOU, together with a Stipulation and Order Approving Appointment of Escrow Agents and Establishing an Account with the Court, was filed with, and signed by, this Court approximately one month later, on January 18, 1996. (Chimicles Aff. at P 48.) The MOU provided for the immediate payment by PaineWebber of $ 125 million into a cash Settlement Fund for the benefit of the Class, and for the prompt negotiation of Additional Benefits having a further value to the Class of at least $ 75 million. Pursuant to the MOU and Order, PaineWebber deposited $ 125 million into an interest-bearing escrow account with the Court Registry Investment System that same day, January 18, 1996. (Chimicles Aff. at P 48.)

(2) *Negotiation of the Additional Benefits*

Following the execution of the MOU, and **[**31]** in accordance with its terms, the Parties proceeded with the negotiation of the Additional Benefits, attempting to confer at least $ 75 million in economic value on the Class, without any immediate outlay of cash by PaineWebber, at the same time as tailoring the Benefits where possible to the particular needs of investors in the different Partnerships.

At issue in the negotiation was the creation of specific guarantees to protect those Class Members who -- because cash flow projections for their investments are determined to be high -- might be saddled with artificially low levels of Recognized Loss as of January 1, 1996. Such guarantees would shift a portion **[*114]** of the risk of future performance from the investor to PaineWebber, and negotiations therefore included an assessment of the amount of risk PaineWebber was willing to assume in each Partnership. In those Partnerships where PaineWebber continued to control the operations, it was willing to assume more risk; conversely, in those Partnerships where it no longer had control or economic interest, such as Geodyne, it was unwilling to provide a "Par" or "Remaining Value" guarantee. (Chimicles Aff. at P 73.)

On July 11, 1996, the Parties **[**32]** concluded the Settlement Agreement, which incorporated Additional Benefits -- Par Guarantees, the Remaining Value Guarantee, the Geodyne Guarantee, waived and assigned fees, and other benefits -- worth at least $ 75 million. The Settlement also includes an Additional Benefits Protocol which outlines procedures for any valuations that may be required, as well as for the selection of mutually acceptable appraisers and advisors. [19]

19 For a summary of the terms of the Additional Benefits, see *infra* Section H.

(3) *Development of the Plan of Allocation*

Also during the first six months of 1996, Class Counsel established an Allocation Committee to develop a fair method of distributing Settlement proceeds among Class Members. Within this Committee, separate advocacy teams were created to represent the claims of investors in the four major Partnership groups -- Real Estate, Geodyne, Pegasus, and R&D. These advocacy teams were composed of the same law firms and industry experts that had been responsible for **[**33]** each Partnership group during the discovery phase of the litigation. The purpose of the Allocation Committee's structure was to encourage an independent evaluation of each group's claims, and to promote, through an internal adversarial process, an objective comparison of the relative rights of all Class Members. In early 1996, each advocacy team, in conjunction with its assigned expert or experts, reviewed the merits of its constituent investors' claims. In addition, Class Counsel prepared assessments of the impact of various statutes of limitation on all claims. (Chimicles Aff. at P 61.) All the teams met together to assess relative strengths and weaknesses and the opinions of the investor Sounding Board were solicited. (Class Plaintiffs' Supplemental Memorandum in Further Support of Approval ("Class Supp. Mem.") at 18 n.18.)

The Allocation Committee ultimately determined that while some distinctions existed between the claims asserted by different Class Members, all claims demonstrated substantial merit. [20] Similarly, the Committee found that no reasonable basis existed to treat the Partnerships differently on the basis of possible statute of limitations defenses, at least with **[**34]** regard to RICO liability, where the most substantial such defenses had been raised. (Chimicles Aff. at P 66.) Consequently, the Committee concluded that any differences that might exist among the strengths or weaknesses of particular claims were not sufficient, given the determined basic ability of all plaintiffs to establish liability, to justify "weighting" the distribution of Settlement proceeds in favor of certain Class Members over others. (Class Mem. at 51; Class Supp. Mem. at 14; Chimicles Aff. at P 89.)

20 For example, the advocacy team responsible for the Real Estate Partnerships concluded that PaineWebber had committed marketing abuses constituting fraud and breach of fiduciary duty, had engaged in questionable financing techniques, had failed to disclose the full extent of fees and commissions, and had stockpiled property purchases indiscriminately. The Geodyne Team, led by Texas Counsel, found, *inter alia,* that PaineWebber had defrauded investors, particularly with regard to the safety and likely profitability of the Geodyne Partnerships. Similarly, the Pegasus team concluded that a fraud had been committed on Pegasus investors with regard to the safety and income potential of the aircraft leases (including the likely resale value of the leased aircraft), and that in particular PaineWebber had failed to disclose that a nearly identical aircraft leasing plan was rejected by Shearson-Hutton in 1988. (*See* Chimicles Aff. at PP 61-65.)

[35]** It was decided instead that the primary purpose of allocation should be to return to all investors the greatest possible percentage of their invested capital, and that the Plan should therefore be based simply on an investor's pro rata share of Recognized Loss, **[*115]** without regard to the relative merits of his or her particular claim. (Class Mem. at 50.) This uniform allocation theory, in conjunction with the specific tailoring provided by the Additional Benefits, was deemed by the Committee to be the fairest overall method of apportioning the Settlement proceeds. (*See* Class Supp. Mem. at 12.) [21]

21 For a summary of the terms of the Plan of Allocation, see *infra,* Section I.

G. *The SEC Investigation*

During the pendency of the Federal and Texas Actions, PaineWebber was also the subject of an investigation by the Securities and Exchange Commission ("SEC") regarding the marketing and sale of certain Partnerships. The existence and purpose of the SEC investigation were disclosed in an article published **[**36]** in the *Wall Street Journal* on November 22, 1994, just prior to the filing of the first lawsuits in the Federal Action. (Complaint at PP 14, 24.) A second article, published on February 7, 1995, revealed that PaineWebber and the SEC were involved in negotiations to settle the Commission's claims. (*Id.* at PP 15, 25.) As noted earlier, PaineWebber announced on July 27, 1995 that it would take a $ 200 million charge to cover the "costs of resolving the limited partnership issues," and that it expected to conclude settlement talks with the SEC within 90 days. [22]

22 The impact of the SEC investigation on these actions is primarily relevant to Class Counsel's request for attorneys' fees, and will be examined more fully in a separate Order addressing that request.

On January 17, 1996, the Commission issued a highly critical Order Instituting Public Administrative Proceedings, Making Findings, Imposing Remedial Sanctions, and Issuing Cease and Desist Order ("SEC Order"), to which PaineWebber consented without **[**37]** admitting or denying its findings. The Order was filed in this Court on the following day, contemporaneously with the MOU in the Federal and Texas Actions. [23] The SEC Order sets forth extensive findings of violations by PaineWebber of the federal securities laws, and addresses many of the same claims and facts at issue in the Complaint and in the Texas Petition. [24] Pursuant to its agreement with the SEC, PaineWebber agreed to pay a total of $ 292.5 million for the benefit of aggrieved Partnership investors, including $ 120 million to settle individual suits and arbitrations, and $ 40 million for a special claims fund ("SEC Fund") to be allocated among eligible claimants. [25] In addition, the Order required PaineWebber to pay a civil penalty of $ 5 million, to waive or assign all fees generated from the Partnerships, and to implement certain oversight and management policies. (Class Mem. at 8.) Finally, the Order gave PaineWebber credit for the $ 125 million it had paid into the Settlement Fund pursuant to the MOU in the Federal and Texas Actions; however, in a "flipback" clause, the Order also specifically provided that the Settlement of these actions must be judicially approved **[**38]** by a specific date -- unless that date were extended by this Court -- or the $ 125 million would then be distributed among claimants to the SEC fund.

23 The Order was filed in an action entitled *SEC v. PaineWebber Inc.*, 96 Civ 0331 (SHS), commenced -- and simultaneously resolved -- in this Court as a related case to the Consolidated Complaint.

24 In several respects, however, the findings in the SEC Order are narrower than the claims in these actions. Most notably, while the SEC Order focuses on PaineWebber's marketing of the Geodyne units, and also addresses Pegasus and four of the mortgage Partnerships, it does not make specific findings regarding the Real Estate and R&D Partnerships, which represent approximately 65% of the sales at issue in these actions. Nor does the Order address units purchased from 1980 through 1985. Finally, while the Order is primarily concerned with PaineWebber's marketing and sale of "unsuitable" investments to individual customers, these

actions additionally allege a company-wide pattern of sales fraud, including prospectus fraud. (*See* Morris Fee Aff. at P 73.)

[39]**

25 Qualified members of the Federal and Texas Classes may file claims in both settlements, but may not recover twice for the same alleged loss.

H. *The Terms of the Proposed Settlement*

The terms of the proposed Settlement are set forth in detail in the Settlement Agreement. In essence, it seeks to compensate **[*116]** Class Members for as much of their initial investments as possible, either through distributions or through direct payments by PaineWebber. (Class Mem. at 48-50.) The Settlement has a total value of approximately $ 200 million and is composed of the following two parts: (1) the $ 125 million Settlement Fund, which has been deposited by PaineWebber into an interest-bearing escrow account, and from which attorneys' fees and litigation expenses will be deducted; and (2) the Additional Benefits, discussed below, which the parties assert to be worth at least $ 75 million. The Additional Benefits are comprised of three specific performance guarantees -- the Par Guarantees, the Remaining Value Guarantee and the Geodyne Guarantee -- which collectively have been valued by the Parties at approximately **[**40]** $ 65 million, as well as a provision for the waiver or assignment of future fees and compensation worth at least $ 10 million. In addition, the Settlement provides certain groups of Class Members with various non-cash benefits, to which no specific value has been assigned.

Pursuant to the Par Guarantees, PaineWebber promises that investors in the 13 Par Guarantee Partnerships [26] will, by December 31, 2000, have recouped at least the initial purchase price ("Par Value") of their investments. Thus, if on December 31, 2000, the sum of all cash distributions paid out over the life of a covered Partnership, plus the residual value of that Partnership, equal less than the Partnership's Par Value, PaineWebber will pay the difference. [27] For the purposes of this guarantee, "distributions" include any cash payments received from the Settlement Fund or the SEC fund in connection with claims arising from the Partnership. The current economic value of this Guarantee to the Class has been calculated by plaintiff's expert to be at least $ 10.25 million. (Balon Aff. at PP 8-9.)

26 The Par Guarantee Partnerships are: Fiduciary Capital Partners, L.P.; Fiduciary Capital Pension Partners, L.P.; PaineWebber Independent Living Mtge. Fund, Ltd.; PaineWebber Independent Living Mtge. Inc. II; PaineWebber Insured Mortgage Partners IB, L.P.; Participating Income Properties III Limited Partnership; PaineWebber Preferred Yield Fund, L.P.; PW Preferred Yield II, L.P.; PaineWebber R&D Partners, L.P.; PaineWebber R&D Partners II, L.P. and III, L.P.; Pegasus Aircraft Partners, L.P.; and Pegasus Aircraft Partners

II, L.P.

[**41]

27 PaineWebber's obligation is capped with respect to two of the Par Guarantee Partnerships, PW Preferred Yield II, L.P. (maximum payment of $ 7 million) and Pegasus Aircraft Partners II, L.P. (maximum payment of $ 12 million).

Pursuant to the Remaining Value Guarantee, PaineWebber promises that the aggregate amount recouped by investors in the 12 covered Partnerships [28] as of December 31, 2000, will be $ 257 million, i.e. approximately $ 92 million more than the aggregate value of those same Partnerships as of January 1, 1996. Thus, on December 31, 2000, if the sum of all cash distributions paid out by the covered Partnerships, plus the remaining values of those Partnerships, together equal less than $ 257 million, PaineWebber will pay the difference. Because these guarantees are considered in the aggregate, PaineWebber may use a better-than-projected performance by one Partnership to partially offset payments which would otherwise be due to a poor performer; however, the extent to which extraordinary profits may be used in this way to fulfill the overall guarantee obligation is limited. The **[**42]** current economic value of this guarantee to the Class has been **[*117]** calculated to be at least $ 42.7 million. (Balon Aff. at PP 8-9.)

28 The Remaining Value Guarantee Partnerships are: PaineWebber Equity Partners I through III Limited Partnerships; PaineWebber Growth Properties I through III, L.P.; PaineWebber Income Properties Four through Eight Limited Partnerships; and PaineWebber Mortgage Partners V, L.P.

Pursuant to the Geodyne Guarantee, PaineWebber promises to provide protection to investors in the 29 Geodyne Partnerships in the event that oil and/or gas prices fall below specified levels between January 1, 1997 and May 30, 2001. Specifically, if market prices should drop below $ 18.00 per barrel of oil and $ 1.80 per MCF of gas during the relevant period, PaineWebber will pay Geodyne investors the difference, in specified quantities, between the market price and the guarantee price. The current economic value of this guarantee to the Class has been calculated to be at least $ 12.5 million. (Balon Aff. at **[**43]** PP 8, 14.)

PaineWebber further agrees to assign or waive for the benefit of Class Members all fees or other compensation which it will earn from the Partnerships -- including amounts which it might receive as general partner in any of the Partnerships -- from January 16, 1996 through the termination of each Partnership. PaineWebber guarantees that the value to the Class of such waivers and assignments will be at least $ 10 million as of December 31, 2000. Of this amount, approximately $ 7.425 million will be in the form of cash from assigned fees and approximately $ 2.575 million will be in the form of waived fees, particularly loans and costs relating to the liquidation of the Retail Property Investors Partnership ("RPI"). (Balon Aff. at PP 4, 6.)

In addition to these cash benefits, the Settlement provides various other advantages for which no economic value has been assigned. These include an independent valuation opinion and tax effect assessment of the CMJ Properties Partnership, free facilitation of the liquidation of warrants distributed to Class Members from the R&D Partnerships, and advisory opinions regarding tender offers, roll-up proposals, or other proposals which may **[**44]** be considered by Class Members with regard to the Partnerships. (Balon Aff. at P 4.)

I. ***The Terms of the Proposed Plan of Allocation***

The terms of the proposed Plan of Allocation are set out in detail in the Settlement Agreement. Basically, the proceeds of the Settlement are to be allocated pro rata among Class Members on the basis of Recognized Loss. The latter term is comprised of a Class Member's initial investment in a Partnership unit (i.e., the unit's purchase price), minus (a) all distributions paid out or payable on that unit, and (b) any value remaining in the unit as of a specified date. To participate in the Settlement, Class Members must submit a proof of claim form setting forth, among other data, the date and quantity of their purchase and or sale of Partnership units. Upon receipt of all valid claim forms, the Claims Administrator will calculate the aggregate Recognized Loss suffered by all eligible claimants, and the Settlement proceeds will then be allocated to each claimant in the same proportion that his or her own loss bears to the loss of the Class as a whole. As previously noted, the formula for computing Recognized Loss for every Class Member is identical. **[**45]** The Plan of Allocation assumes a comparable potential of all Class Members to prevail on the merits, and accordingly it does not reflect any differences in relative strength that might exist among the claims of investors in different Partnerships.

(1) *Allocation of the Net Cash Settlement Fund.*

The Net Cash Settlement Fund consists of the $ 125 million in cash deposited by PaineWebber on January 18, 1996, plus interest, less attorneys' fees and litigation expenses. For the purpose of allocating this fund, Recognized Loss per Partnership unit is determined as of January 1, 1996 in the manner described above. For Class Members who sold their units prior to January 1, 1996, distributions are calculated only through the date of sale, and the price at which the unit was sold is considered in place of the unit's residual value. For Partnerships which have been, or are deemed to be, "liquidated," Recognized Loss equals the purchase price of the Partnership, minus all cash distributions up to and including the final distribution following liquidation. Finally, for the PaineWebber CMJ Properties Partnership only, tax benefits are deemed to count as cash distributions for the purpose of **[**46]** Recognized Loss.

Based on Class Counsel's valuations of the Partnerships as of January 1, 1996, it is likely that only 44 Partnerships will show Recognized Losses for the purpose of sharing in the Settlement Fund. [29] The specific **[*118]** amounts that will be paid out on these investments cannot be calculated prior to the submission of all claims and the determination of fees and litigation expenses. In the event that the aggregate Recognized Loss of the Class is less than the amount in the Net Cash Settlement Fund, the balance will be paid into a "Look-Back Fund," and redistributed on the basis of Recognized Loss as of December 31, 2000. [30]

29 Those 44 Partnerships are the following: PaineWebber/Geodyne Energy Income Limited Partnerships I-A through I-C; PaineWebber/Geodyne Energy Income Limited Partnerships II-A through II-H; PaineWebber/Geodyne Energy Income Limited Partnerships III-A through III-G; PaineWebber/Geodyne Inst/Pension Energy Income P-1 through P-8 Limited Partnerships; PaineWebber Development Partners IV, Ltd.; PaineWebber Equity Partners I through III Limited Partnerships; PaineWebber Growth Properties I, L.P. and II, L.P.; PaineWebber Growth Partners III, L.P.; PaineWebber Income Properties Four through Eight Limited Partnerships; PaineWebber Mortgage Partners V, L.P.; PW Preferred Yield II, L.P.; Pegasus Aircraft Partners II, L.P.; PaineWebber Development Partners IV, L.P. (liquidated); Realty Southwest Fund II, Ltd. and III, Ltd. (liquidated); and Retail Property Investors, Inc. (liquidated).

[47]**

30 *See* discussion, *infra* Subsection 2.

(2) *Allocation of the Additional Benefits and Look-Back Fund*

The Additional Benefits provide that cash payments may be made by PaineWebber to eligible Class Members pursuant to the Par Guarantees, the Remaining Value Guarantee, and the Geodyne Guarantee. Such payments will be made on a pro rata basis to those Class Members who are covered by each Guarantee, and will not exceed the amount of any Class Member's Recognized Loss as of the end of the year 2000. For the purpose of allocating these payments, Recognized Loss per Partnership unit is calculated as of December 31, 2000 in the manner described earlier. Cash distributions include any value already received in relation to the Partnership unit pursuant to any of the Guarantees, the Net Cash Settlement Fund or the SEC Fund.

The Additional Benefits also provide for the waiver or assignment of PaineWebber's fees and other compensation relating to the Partnerships. All waivers will benefit the Class Members who hold units in the particular Partnerships to which the waivers apply. All assignments, **[**48]** with limited exceptions [31], will be paid directly into a "Look-Back Fund," together with any non-allocated funds owed by PaineWebber pursuant to the Guarantees and any amounts which may remain in the Net Cash Settlement Fund. The Look-Back Fund will in turn be allocated among the class as a whole, again on a pro rata basis, to compensate any Class Members who still have Recognized Losses remaining. [32]

31 Because the Par Guarantees for the Pegasus II and Preferred Yield II Partnerships are capped, assigned fees and compensation arising from those Partnerships will be held in separate escrow accounts and applied specifically toward the recoupment of Par Value for those Partnerships' investors. Once those investors have recovered 100% of their Recognized Losses, any remaining balance of assigned fees and compensation will revert to the Look-Back Fund.

32 12% of the Look-Back Fund (not to exceed $ 2.5 million) will be segregated in a special escrow account for the benefit of any Geodyne investors who have not recovered their initial investments.

[49]** J. *Objections to the Proposed Settlement and Plan of Allocation*

As noted above, on July 17, 1996, this Court preliminarily approved the Settlement Agreement, and directed the Parties to provide notice to the Class. On August 5, 1996, almost 200,000 copies of the Settlement Notice were mailed to all identifiable class members, setting forth the material terms of the Settlement, including the Plan of Allocation and the proposed award of attorneys' fees. [33] Class members were also apprised of the deadline for filing any objections to the settlement, as well as the date, location and purpose of the fairness hearing. A summary version of the same notice was subsequently published in the national editions of *The Wall Street Journal, The New York Times* and *USA Today* on August 12 and 15, 1996. Three objections to the Settlement terms were received from Class Members in response **[*119]** to these notices. [34] Two of the objections involved individual situations and have been addressed and resolved. [35]

33 *See* Affidavit of Rudolph, Palitz LLP in Connection with Notice by Mailing and Publication, dated October 8, 1996. As with the Notice of Pendency, the number of copies mailed exceeds the potential number of Class Members, in part because investors with multiple accounts received multiple notices.

[50]**

34 A small number of objections to the proposed award of attorneys' fees were also received and will be addressed in this Court's forthcoming Order regarding those fees.

35 One objection, by Richard G. Clemens, concerned an issue relevant only to the PaineWebber CMJ Properties Partnership, and was resolved with the issuance of a Supplemental Notice to all CMJ investors (see Order dated December 11, 1996). The second objection, by Jerome Petrisko, involved the effect of certain proposed Settlement language on a pending litigation he had brought in Pennsylvania; that objection was ultimately withdrawn.

(*See* Transcript of Fairness Hearing, October 25, 1996, at 9-10.)

The third objection to the proposed Settlement was lodged by Robert and Vera Jacobson of Chicago, Illinois, on behalf of all Class Members in the Pegasus I and Pegasus II Partnerships and needs to be considered in some depth. The filing of this objection was part of an extended effort on the part of the Jacobsons and their counsel to participate in the litigation and settlement of the Pegasus-related claims against PaineWebber.

[51]** On March 28, 1995, the Jacobsons filed a class action complaint against PaineWebber and other defendants in state court in Chicago, alleging fraud, breach of fiduciary duty and negligent misrepresentation. After the Jacobsons received the Notice of Pendency, they sought access to all discovery materials produced by PaineWebber to Class Counsel in this litigation, in order to assist them in deciding whether or not to opt out of the Class. This Court directed that they be provided with discovery materials relating to the Pegasus Partnerships. (*See* Transcript of Oral Argument, July 19, 1995, at 54-56.) After reviewing those documents, the Jacobsons moved: (a) to intervene in this action and to be appointed as representatives of a Pegasus subclass pursuant to Fed. R. Civ. P. 23(c)(4)(B); (b) to have their counsel appointed as lead counsel on behalf of that subclass; and (c) to have their counsel appointed to plaintiffs' Executive Committee. (*See* Sandler Aff. in Supp. of Motion to Intervene at P 1.) The Jacobsons alleged that the Class as certified was overly broad and inherently conflicted, and that its representatives and counsel therefore could not fairly represent the interests **[**52]** of Pegasus investors, whose claims were stronger on the merits than those of most other Class Members. (*Id.* at PP 15-17; Transcript of Oral Argument, January 19, 1996, at 13-14.) That motion was subsequently denied. (*See* Order dated February 26, 1996.)

The Jacobsons later sought and received further discovery and an extension of their time to file an objection. (*See* Transcript of Oral Argument, September 30, 1996, at 25; Order dated August 16, 1996, at 2.) Their objection was filed on October 3, 1996, together with notice of their intention to appear at the fairness hearing, and a list of exhibits and intended witnesses. Subsequently, the Jacobsons deposed several of Class Counsel's experts, including Kathleen Balon and David Treitel, and Class Counsel deposed the Jacobsons' two proposed expert witnesses, Susan Koniak and Carmen Macca.

The fairness hearing was held before this Court on October 25 and November 8, 1996. Following the presentation of argument by counsel for the Parties and for the Jacobsons, Susan Koniak and Carmen Macca were called to the stand as expert witnesses. Koniak, a Professor of Law at Boston University, was presented as an expert in legal ethics **[**53]** and class actions, and stated that her most recent research and writing have focused specifically on "the ethics of class counsel and class action abuse." (Transcript of Fairness Hearing, November 8, 1996, at 13-15, 28-29.) [36] She did not claim to have particular expertise in securities law, nor did she profess to hold a view concerning the fairness and adequacy of the proposed Settlement; **[*120]** the proper method of allocating that Settlement; the merits and settlement value of the claims in this case; or the creation of subclasses. (

Id. at 26-27, 34-35, 70-73.) Rather, as set forth more particularly below, Koniak testified that in her opinion Class Counsel rendered inadequate representation to the Class, and may have colluded with the Defendants to the detriment of the Class Members. (*Id.* at 30, 46-47.)

36 Class Counsel have challenged Koniak's qualifications as an expert in class actions, citing her admitted lack of such expertise in 1994 when she testified in another class action fairness hearing. Class Counsel also emphasize Koniak's failure to review many of the relevant documents in this case, including the affidavits of Class Counsel and experts. See Class Supp. Mem. at 24. It is unnecessary to reach a decision regarding Koniak's expert status, however, because her actual testimony was substantively indistinguishable from legal argument, and is considered as such by this Court.

[54]** Carmen Macca, a Certified Public Accountant who has reviewed class action settlement notices for clients on "over fifty" occasions, (*id.* at 100-101), testified that he had reviewed the Settlement Notice, the Settlement Agreement, the Data Appendix, and "various correspondence among the attorneys," and that in his opinion, an individual Class Member would not be able to determine from those documents how much money he or she would stand to receive in the proposed Settlement. (*Id.* at 103-105.) The latter point is conceded by Class Counsel. (*Id.* at 106.)

The heart of the Jacobsons' objection is the claim that the Pegasus investors' recovery under the Settlement is too small, both in terms of their potential damages at trial and in comparison with the recoveries of other Class Members. The objection raises at least six distinct issues. First, the Jacobsons allege that the Class -- and the Pegasus investors in particular -- have been deprived of the adequate representation of counsel that is mandated by Fed. R. Civ. P. 23(a). Specifically, they contend that the Parties stipulated to a hasty Class certification in order to advance their own interests at the expense of the plaintiffs, **[**55]** that the Court improperly approved that certification without undertaking an independent investigation, and that consequently the Class is too broad and is fraught with conflicts among members whose claims are of vastly differing strengths. [37] Although Class Counsel purports to represent the interests of all Class Members simultaneously and has opposed all efforts to create subclasses, the Jacobsons assert that Class Counsel is in fact inherently conflicted, and that its representation of the Class is therefore inadequate. (*See* Jacobsons' Objection to Proposed Settlement ("Obj. Mem.") at 23-24; Jacobsons' Supplemental Memorandum in Further Support of Objection ("Obj. Supp. Mem.") at 5, 38-40; Transcript of Fairness Hearing, October 25, 1996 Tr. 10/25/96 at 54-57.) Evidence of such inadequacy can be found, the Jacobsons contend, in the Settlement itself, which fails to take account of variances among the claims, yet at the same time obtains different results for different Class Members with no merit-based explanation. (Obj. Supp. Mem. at 40-44; Tr. 11/08/96 at 30-33.)

37 This is essentially the same argument that was made by the Jacobsons in their earlier motion to intervene and to create a subclass for Pegasus investors.

[56]** Second, the Jacobsons claim that the Settlement Notice is inadequate because it ignores differences between Class Members' claims, obfuscates complexities contained in the Settlement, and glosses over special exceptions that have been made for particular Partnerships. (Obj. Mem. at 15-18, 20; Obj. Supp. Mem. at 7; Tr. 10/25/96 at 52.) In addition, the Jacobsons emphasize that because of missing or incomplete information, it would be impossible for an individual Class Member to determine from the Notice and its supporting documents what he or she might expect to receive from the settlement. (Obj. Mem. at 3-4; Obj. Supp. Mem. at 8.) This lack of accurate information, they suggest, led to the low number of objections that have been received from other Class Members. (Tr. 10/25/96 at 47.)

Third, the Jacobsons charge that the Settlement provides an inadequate recovery -- both for the Class as a whole and for Pegasus investors in particular -- given the magnitude of the legal damages that have been claimed and the relatively low risk of prevailing at trial. The proposed Settlement, they contend, represents a small fraction of the total amount invested by Class Members in the Partnerships. **[**57]** (Obj. Mem. at 2, 4-5.) More importantly, however, they assert that Class Counsel has made no attempt to relate the Settlement to any reasonable range of amounts that the Class, if successful, would stand to recover at trial. (Tr. 10/25/96 at 43-44.) Instead, the amount of the Settlement is justified by Class Counsel in terms of **[*121]** "Recognized Loss," a measure which, the Jacobsons contend, was invented for these proceedings, is arbitrary and unfair, and bears little or no resemblance to actual economic loss or legal damages. (Obj. Supp. Mem. at 28.) In particular, it is asserted that the Settlement ignores the time value of money, collapses the distinction between taxable income and return of capital, and relies on residual value calculations without regard to marketability discounts. (Obj. Mem. at 20; Obj. Supp. Mem. at 28-29.) With regard to the Pegasus Partnerships specifically, the Jacobsons contend that pursuant to the various theories of legal damages claimed in the Complaint, they would stand to recover between $ 0.52 and $ 2.15 per dollar invested if they were to prevail at trial. (Obj. Supp. Mem. at 22-30.) Accordingly, even assuming a discount to reflect the risks of litigation, **[**58]** the Jacobsons claim that their likely cash recovery under the Settlement -- zero for Pegasus I, and between 3 and 8 cents on the dollar for Pegasus II -- is an inadequate result. (Obj. Supp. Mem. at 30-37.)

Fourth, the Jacobsons claim that the Settlement is unfair because although it purports to treat all Class Members equally, in fact it provides better recoveries to some than to others, and it does so with no adequate explanation. Specifically, they contend that the various Additional Benefits guarantees, if they create any real economic value at all, do so selectively and without any relation to the merits of Class Members' claims. (Obj. Supp. Mem. at 40-44; Tr. 11/08/96 at 33.) They also contend that there is no reason for the Par Guarantee for Pegasus II and another Partnership to be capped, except as an accommodation to PaineWebber. (Obj. Supp. Mem. at 34-35, 42.) Finally, the Jacobsons assert that the Settlement unfairly and inexplicably favors certain Partnerships with special rules and exceptions relating to the calculation of Recognized Loss. (Obj. Mem. at 15-19.)

The fifth, and most important, claim made by the Jacobsons is that the Plan of Allocation, while ostensibly **[**59]** uniform in its application, is unfair in its effect, because it fails to take account of differences that exist among the claims in this case, both in terms of substantive merit and in terms of vulnerability to statute of limitations defenses. (*See* Obj. Supp. Mem. at 15-21 & App. A.) The Jacobsons further note that when this issue was raised in connection with their earlier motion to create a subclass, Class Counsel assured the Court that any conflicts between the merits of different claims would be resolved in the Plan of Allocation. (Obj. Supp. Mem. at 5; Tr. 1/19/96 at 25-26.) Instead, the Jacobsons contend, the proposed loss-based (rather than merits-based) Plan of Allocation will divert the bulk of Settlement proceeds to Class Members whose claims are weak on the merits and most vulnerable to limitations defenses, while the Pegasus investors, whose claims are ostensibly among the strongest in the Class, [38] will emerge with little or no cash recovery. (Obj. Mem at 5-7, 20-21.)

38 The Jacobsons assert that the Pegasus claims are stronger than those of other investors because, among other grounds, (1) they are the subject of specific findings in the SEC report; (2) there is evidence that the Pegasus Uniform Sales Materials were orchestrated by the Direct Investment Department ("DID") at PaineWebber headquarters; and (3) Pegasus units were purchased later than most other Partnerships and so are subject to fewer limitations defenses. (Obj. Mem. at 7-13; Obj. Supp. Mem. at 21-22.)

[60]** Finally, the Jacobsons claim -- largely through Prof. Koniak -- that the terms of the Settlement and the circumstances of its negotiation raise the possibility of collusion between the Parties, and undermine the fundamental requirement of arm's length negotiation. In support of this allegation, the Jacobsons point to the Parties' common interest in settling as many claims as possible in the wake of the liability exposure created by the SEC investigation. (Tr. 10/25/96 at 53.) In particular, they contend that the filing of the $ 125 million settlement on January 18, 1996, one day after the issuance of an SEC Order which included a $ 125 million "flipback" provision, indicates that the size of the settlement was driven by PaineWebber's interest and was not the product of arm's length negotiation. (Obj. Supp. Mem. at 18; Tr. 11/08/96 at 48-49.) The Jacobsons offer the following alleged **[*122]** indicia of collusion: (a) the certification of the Class by stipulation of the Parties and on a conditional basis, and PaineWebber's subsequent announcement of a charge to earnings to cover all liabilities, which together suggest that the Class is akin to a "settlement class"; (b) the failure of the Parties **[**61]** to provide Class Members with a second opportunity to opt out following the Settlement, and the cooperation of the Parties in resisting the creation of subclasses; (c) the terms of the Settlement and Plan of Allocation, which "roll up" many dissimilar claims and in some instances benefit PaineWebber at the expense of Class Members; and (d) the Parties' alleged concealment of relevant documents and overall lack of candor regarding the settlement process and the substance of the recovery, particularly with regard to the comparative merits of the various claims. (Obj. Mem. at 23-25; Obj. Supp. Mem. 18-19; Tr. 10/25/96 at 53, 67-74; Tr. 11/08/96 at 43-49.) The effect of these indicia, the Jacobsons claim, is to raise the level of scrutiny the Court should utilize in evaluating the Settlement's fairness, and to defeat the traditional presumption of deference to the recommendations of Counsel. (Obj. Mem. at 2; Obj. Supp. Mem. at 20.)

On the basis of these allegations, the Jacobsons have requested that this Court refuse to approve the Settlement in its entirety, or, in the alternative, refuse to approve the Settlement insofar as it relates to Pegasus I and II investors. (Obj. Supp. Mem. **[**62]** at 44.) Those issues are addressed below.

II.

DISCUSSION

A. *The Federal Class Certification is Fair*

The certification of the Federal Class was so ordered by Judge Haight on May 30, 1995, in accordance with the stipulation of the Parties. That stipulation addressed the elements of Rules 23(a) and 23(b)(3) and provided that "the requirements for class certification pursuant to Rule 23 of the Federal Rules of Civil Procedure are satisfied." (*See* Certification Order at P E, §§ 3-9.) The fairness of the certification, particularly with regard to adequacy of representation, was subsequently challenged by the Jacobsons in their motion to intervene and create a subclass, which was denied. (*See* Order dated February 26, 1996 at 7.) *See also In re PaineWebber Inc. Ltd. Partnerships Litig.*, 94 F.3d 49, 51-52 (2d Cir. 1996). Although the present objection by the Jacobsons is largely duplicative of that earlier motion, the fairness of the Class certification will be revisited briefly here in light of this Court's affirmative obligation to insure that all class members have been adequately represented. *See Malchman v. Davis*, 706 F.2d 426, 432-33 (2d Cir. 1983); **[**63]** *Plummer v. Chemical Bank*, 668 F.2d 654, 659 & n.4 (2d Cir. 1982).

As a starting point, it is worth noting that although the Class was certified without the benefit of an adversarial hearing, it is not a "settlement class" as that term is properly defined. [HN1] A settlement class "is a device whereby the court postpones the formal certification procedure until the parties have successfully negotiated a settlement . . . Because the court indulges the assumption of the class's existence only until a settlement is reached or the parties abandon the negotiations, settlement classes are also sometimes referred to as temporary or provisional classes." *In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig.*, 55 F.3d 768, 786 (3d Cir. 1995) ("*GM Trucks*"). *See Weinberger v. Kendrick*, 698 F.2d 61, 72 (2d Cir. 1982); *Malchman*, 706 F.2d at 433-34 (2d Cir. 1983); *Manual for Complex Litigation* § 30.45 (3d ed. 1995). In this action, class certification took place long before any settlement was reached or negotiated, and it is undisputed that extensive discovery and litigation efforts were undertaken by the Parties in the interim. Accordingly, the "higher" or "closer" **[**64]** level of scrutiny that applies to the judicial review of settlements involving settlement classes [39] is not required here.

39 *See Manual for Complex Litigation* § 30.45 (3d ed. 1995); *Weinberger*, 698 F.2d at 73.

[HN2] In determining whether a federal class should be certified, the Court must consider the four factors set forth in Rule 23(a) -- i.e., numerosity, commonality, typicality and representativeness -- **[*123]** and must also determine, pursuant to Rule 23(b), whether a class action is the appropriate avenue of recovery. *See* Fed R. Civ. P. 23; *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 290 (2d Cir. 1992); *In re Prudential Sec. Inc. Ltd Partnerships Litig.*, 1995 U.S. Dist. LEXIS 18142, MDL No. 1005, M-21-67 (MP), 1995 WL 798907 at *12 (S.D.N.Y. Nov. 20, 1995).

Rule 23(a)(1), which requires that "the class [be] so numerous that joinder of all members is impracticable," is clearly satisfied here. Tens of thousands of investors purchased Partnership shares from or through PaineWebber between 1980 and 1992; joinder **[**65]** of all such plaintiffs individually would obviously be unmanageable. Similarly, Rule 23(b)(3), which requires that a class action be "superior to other available methods for the fair and efficient adjudication of the controversy" is also satisfied here. Given the difficulty and expense involved in the prosecution of the claims in this case, the interests of justice and judicial efficiency underscore the superiority of the class action device.

Rule 23(a)(2), which requires the existence of "questions of law or fact common to the class," and Rule 23(b)(3), which requires that such questions "predominate over any questions affecting only individual members," are both satisfied here. The Complaint asserts essentially the same claims on behalf of all Class Members, and "alleges, in numerous places, that PaineWebber defrauded investors in *all* the applicable entities pursuant to a uniform pattern of conduct." (emphasis in original) (Order dated Feb. 26, 1996 at 4.) Common questions of law and fact include: whether PaineWebber's sales materials were false or misleading; whether PaineWebber engaged in a "common course of conduct" with respect to the statements made and the sales materials **[**66]** used; whether PaineWebber misrepresented the suitability of investments for individual clients or failed to take sufficient steps to insure such suitability; whether a conspiracy existed among two or more Defendants; whether a RICO "pattern" existed; whether Defendants' actions constituted fraud, negligence, breach of fiduciary duty or violation of the federal securities laws; and whether the Class Members were injured by Defendants' actions. (*See* Certification Order at P E, § 5.) These questions of law and fact overwhelmingly predominate over any issues that might affect individual Class Members only.

Rule 23(a)(3), which requires that "the claims or defenses of the representative parties [be] typical of the claims or defenses of the class," is also satisfied here. The named class representatives are investors in 20 of the 70 Partnerships, including Pegasus II. (*See* Order dated Feb. 26, 1996 at 1-2; Complaint at PP 27-45.) Their claims are materially indistinguishable from those of other Class Members.

Finally, Rule 23(a)(4), which requires that "the representative parties will fairly and adequately protect the interests of the class," is satisfied here as well. The standard **[**67]** for adequate representation has two parts: first, "class counsel must be 'qualified, experienced and generally able' to conduct the litigation"; and second, "the class members must not have interests that are 'antagonistic' to one another." *Drexel*, 960 F.2d at 291 (citing *Eisen v. Carlisle & Jacquelin*, 391 F.2d 555, 562 (2d Cir. 1968)). The Jacobsons focus their attack on the second prong of this test, contending, just as they did in their prior motion, that inherent conflicts among investors in the different entities prevent the current named plaintiffs and their attorneys from adequately representing Pegasus I and II investors. In support of this objection, they assert primarily that the Pegasus plaintiffs' recovery under the Settlement does not adequately reflect the strength of their claims on the merits.

This position is no more persuasive now than it was one year ago. Potential conflict between class members is often a danger in large class actions, but those conflicts are best resolved through "the normal pull and tug" of factions within the class itself. (Tr. 1/19/96 at 29.) The Court's role in this process is not to substitute its own judgment for that of Class Counsel, **[**68]** but rather to insure that the interests of all class members are fairly and impartially represented throughout the negotiation of the settlement and allocation **[*124]** plan. In this action, the assignment of separate law firms and independent experts to represent each Partnership group was a reasonable and adequate means of protecting the interests of all Class Members; the Jacobsons' contention that their recovery should be greater is an insufficient basis on which to conclude that those safeguards failed or were corrupted in any way. Accordingly, the Rule 23(a)(4) requirement of adequate representation is satisfied.

Because the record establishes that all necessary elements of Rule 23 have been met, the fairness of the class certification is reaffirmed and the Jacobsons' renewed request for decertification of the class or the creation of a subclass is denied.

B. *The Notice of Settlement is Adequate*

[HN3] Fed. R. Civ. P. 23(e) provides that "notice of [a] proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs." On July 17, 1996, this Court held that the Settlement Notice in this case "meet[s] the requirements of Fed. R. Civ. **[**69]** P. 23 and due process, constitute[s] the best notice practicable under the circumstances, and shall constitute due and sufficient notice to all persons and entities entitled thereto." (Preliminary Order dated July 11, 1996 at PP 5-6.) The Jacobsons now challenge the adequacy of the Settlement Notice on the grounds that it is misleading and incomplete, and does not provide sufficient information to allow a Class Member to calculate his or her actual recovery under the settlement.

[HN4] Notice of settlement in a class action "must 'fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options that are open to them in connection with [the] proceedings.'" *Weinberger*, 698 F.2d at 70 (citing *Grunin v. Int'l House of Pancakes*, 513

F.2d 114, 122 (8th Cir. 1975)). The notice need not be highly specific, and indeed "numerous decisions, no doubt recognizing that notices to class members can practicably contain only a limited amount of information, have approved 'very general description[s] of the proposed settlement.'" *Id.; see also In re Michael Milken & Assoc. Sec. Litig.*, 150 F.R.D. 57, 60 (S.D.N.Y. 1993) (relying on *Handschu* **[**70]** *v. Special Servs. Div.*, 787 F.2d 828, 833 (2d Cir. 1986)). Nor does the adequacy of notice turn on the ability of an individual Class Member to calculate the amount of his or her actual recovery under the settlement. *See Torrisi v. Tucson Elec. Power Co.*, 8 F.3d 1370, 1374 (9th Cir. 1993); *In re Catfish Antitrust Litig.*, 939 F. Supp. 493, 499 (N.D. Miss. 1996); *Cannon v. Texas Gulf Sulphur Co.*, 55 F.R.D. 308, 313 n.2 (S.D.N.Y. 1972).

The Settlement Notice in this case meets the required standard. Its level of detail apprises the class members of the salient terms of the settlement and affords them a reasonable opportunity to present any objections. *See Milken*, 150 F.R.D. 57 at 60. Moreover, it is by design "only a summary of the litigation and of the proposed settlement," and it incorporates by reference all remaining documents on file with this Court. (Settlement Notice at P 73.) Accordingly, the Notice of Settlement is fair and is approved.

C. ***The Proposed Settlement is Fair, Reasonable and Adequate***

[HN5] Fed. R. Civ. P. 23(e) provides that "[a] class action shall not be dismissed or compromised without the approval of the court." The decision to grant or **[**71]** deny such approval lies squarely within the discretion of the trial court, *see In re Ivan F. Boesky Sec. Litig.*, 948 F.2d 1358, 1368 (2d Cir. 1991); *Newman v. Stein*, 464 F.2d 689, 692 (2d Cir. 1972), and this discretion should be exercised in light of the general judicial policy favoring settlement. *Weinberger*, 698 F.2d at 73; *In re Michael Milken & Assoc. Sec. Litig.*, 150 F.R.D. 46, 53 (S.D.N.Y. 1993); *Chatelain v. Prudential-Bache Sec., Inc.*, 805 F. Supp. 209, 212 (S.D.N.Y. 1992). [HN6] Ultimately, the Court, as protector of the interests of absent class members, must determine whether the proposed settlement is "fair, reasonable and adequate." *Weinberger*, 698 F.2d at 73; *Malchman*, 706 F.2d at 433.

This determination "involves consideration of two types of evidence." *Weinberger*, 698 F.2d at 73; *Women in City Gov't United v. City of New York*, 1989 U.S. Dist. LEXIS 14874, No. 75 Civ. 2868 (MJL), 1989 WL 153059 at *4 (S.D.N.Y. Dec. 13, **[*125]** 1989). The Court's primary concern is with "the substantive terms of the settlement compared to the likely result of a trial," *Malchman*, 706 F.2d at 433, and to that end "the trial judge must 'apprise[] himself of all the facts necessary for an **[**72]** intelligent and objective opinion of the probabilities of ultimate success should the claim[s] be litigated.'" *Weinberger*, 698 F.2d at 74 (quoting *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry Inc. v. Anderson*, 390 U.S. 414, 424, 88 S. Ct. 1157, 1163, 20 L. Ed. 2d 1 (1968)).

The Court's second concern is with "the negotiating process by which the settlement was reached," *Weinberger*, 698 F.2d at 73, which must be examined "in light of the experience of counsel, the vigor with which the case was prosecuted, and the coercion or collusion that may have marred the negotiations themselves." *Malchman*, 706 F.2d at 433 (citing *Weinberger*, 698 F.2d at 73). The Court has a fiduciary duty to ensure that the settlement is not the product of collusion. *In re Warner Communications Securities Litigation*, 798 F.2d 35, 37 (2d Cir. 1986). [HN7] So long as the integrity of the arm's length negotiation process is preserved, however, a strong initial presumption of fairness attaches to the proposed settlement, *Chatelain*, 805 F. Supp. at 212 (citing *Ross v. A.H. Robins Co., Inc.*, 700 F. Supp. 682, 683 (S.D.N.Y. 1988)), and "great weight" is accorded to the recommendations **[**73]** of counsel, who are most closely acquainted with the facts of the underlying litigation. *Id.* (citing *Cannon v. Texas Gulf Sulphur Co.*, 55 F.R.D. 308 (S.D.N.Y. 1972)).

(1) *Substantive Fairness: The Grinnell Factors*

The analytical framework for evaluating the substantive fairness of a class-action settlement was set forth by the Second Circuit in *City of Detroit v. Grinnell Corp.*, 495 F.2d 448, 463 (2d Cir. 1974), more than two decades ago, and is now well established. [HN8] In determining whether to approve a proposed Settlement a district court should consider the following nine factors:

> (1) the complexity, expense and likely duration of the litigation; (2) the reaction of the class to the settlement; (3) the stage of the proceedings and the amount of discovery completed; (4) the risks of establishing liability; (5) the risks of establishing damages; (6) the risks of maintaining the class action through the trial; (7) the ability of the defendants to withstand a greater judgment; (8) the range of reasonableness of the settlement fund in light of the best possible recovery; and (9) the range of reasonableness of the settlement fund in light of all the attendant risks **[**74]** of litigation.

Id. at 463 (internal citations omitted). In its consideration of these factors, "the Court must eschew any rubber stamp approval in favor of an independent evaluation, yet, at the same time, it must stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case." *Id.* at 462. As discussed below, the facts in this case satisfy the elements of the *Grinnell* test and support approval of the Settlement.

(a) *The Complexity, Expense and Likely Duration of the Litigation.*

[HN9] "Avoiding wasteful litigation and expense are factors which 'lay behind the Congressional infusion of a power to compromise.'" *Milken*, 150 F.R.D. 46 at 55 (citing *Florida Trailer and Equip. Co. v. Deal*, 284 F.2d 567, 571 (5th Cir. 1960)). Accordingly, this Court must consider the complexity, expense and likely duration of the litigations that the parties seek to avoid. This factor weighs heavily in favor of the proposed Settlement. The legal and factual issues presented in both the Federal and Texas Actions are complex, and would, if litigated, require substantial expenditures of both private and public resources. The Consolidated **[**75]** Federal Complaint involves 70 partnerships, tens of thousands of potential plaintiffs, and claims arising under RICO, federal securities laws, and state common law. The RICO allegations alone raise such multifaceted issues of fact as whether a pattern exists and whether underlying predicate acts and a RICO injury can be established. *See Prudential*, 1995 U.S. Dist. LEXIS 18142, 1995 WL 798907 at *11. The Consolidated Texas Petition is similarly complex, involving 23 Partnerships, **[*126]** thousands of class members, and multiple statutory and common-law claims.

The parties' litigation of these claims during the past nearly 1,000 days has already consumed large sums of money and many thousands of hours of labor. Absent a settlement, these costs will only escalate as a result of discovery proceedings, motion practice, trials, and likely appeals. Such burdensome and protracted litigation would carry with it no guarantee of success for the plaintiff class, and a recovery would in any event be eroded by the costs of prosecuting the action. Accordingly, the first element of the *Grinnell* test supports approval of the proposed Settlement.

(b) *The Reaction of the Class to the Settlement.*

The second factor to be considered **[**76]** by the Court is the reaction of the Class to the proposed settlement. [HN10] A favorable reception by the Class constitutes "strong evidence" of the fairness of a proposed settlement and supports judicial approval. *See Grinnell*, 495 F.2d at 462. In particular, "the absence of objectants may itself be taken as evidencing the fairness of a settlement." *Weiss v. A.H. Robins*, 700 F. Supp. 682, 684 (S.D.N.Y. 1988) (citing *Weiss v. Drew National Corp.*, 465 F. Supp. 548, 551 (S.D.N.Y. 1979)); *see also Torrisi v. Tucson Electric Power Co.*, 8 F.3d 1370, 1378 (9th Cir. 1993). As set forth previously in this Opinion, notice of the proposed Settlement was mailed to the entire Class in August of 1996, and summary notice was published in the national editions of *The Wall Street Journal, The New York Times* and *USA Today*. Class Members were thereby informed of all material terms of the Settlement and were apprised of the deadline for filing objections and the date and purpose of the fairness hearing. In response to these notices, only three objections to the substantive terms of the settlement [40] were received from Class Members, two of which have subsequently been resolved. This **[**77]** is an extremely favorable response, particularly in light of the large size of the Class. [41] Accordingly, as the Class appears to have acquiesced in the Settlement by an overwhelming margin, the second element of the *Grinnell* test is satisfied.

40 As previously noted, objections to the amount of attorneys' fees will be the subject of a separate Order.

41 The number of opt-out requests received from class members is normally also taken into account in the determination of a settlement's fairness. *See, e.g., Chatelain*, 805 F. Supp. at 213. In the present case, however, the number of opt-out requests is not an appropriate factor to consider in the fairness evaluation, because the exclusion deadline -- July 21, 1995 -- expired more than a year before the terms of the proposed settlement were known to the Class Members.

(c) *The Stage of the Proceedings and the Amount of Discovery Completed.*

[HN11] The stage of the proceedings and the amount of discovery completed at the time a Settlement is reached is **[**78]** relevant to the parties' knowledge of the strengths and weaknesses of the various claims in the case, and consequently affects the determination of the settlement's fairness. *See Milken*, 150 F.R.D. 46 at 55-56. It is undisputed that extensive discovery took place prior to the commencement of settlement negotiations in October of 1995; that the discovery documents had been analyzed and losses had been calculated for each Partnership prior to the execution of the Memorandum of Understanding in January of 1996; and that a comprehensive evaluation of the facts and merits of each Partnership had been performed prior to the execution of the Settlement Agreement in July of 1996. It is therefore apparent that Class Counsel "has had sufficient information to act intelligently on behalf of the class," *Schwartz v. Novo Industries A/S*, 119 F.R.D. 359, 362 (S.D.N.Y. 1988), and accordingly this third element of the *Grinnell* test weighs in favor of approval of the Settlement.

(d) *The Risks of Establishing Liability*

[HN12] Litigation inherently involves risks. Indeed "if settlement has any purpose at all, it is to avoid a trial on the merits because of the uncertainty of the outcome." **[**79]** *In re Ira Haupt & Co.*, 304 F. Supp. 917, 934 (S.D.N.Y. 1969). In the absence of a settlement in this **[*127]** case, substantial litigation risks would exist for the Class at trial. [42]

42 It should be noted that when settlement negotiations began, Paine Webber had already announced that it would take a $ 200 million charge and that it expected to reach a settlement with the SEC regarding Partnership-related claims. Also, the Settlement in this action was concluded nearly six months after the filing of the SEC Consent Order, which contains extensive findings against the Defendants. However, the SEC Order, by its terms, does not adjudicate the merits of any claims and is not admissible "to prove underlying facts of liability." *U.S. v. Gilbert*, 668 F.2d 94, 97 (2d Cir. 1981).

Importantly, the Class would face serious obstacles to establishing the elements of its claims. The central allegation in the Texas and Federal Actions is that PaineWebber marketed and sold Partnership units to investors on the basis of false **[**80]** or misleading statements. PaineWebber denies making any such misrepresentations, and contends that its prospectuses provided adequate disclosures of risk. PaineWebber further contends that any losses suffered by Class Members were caused not by any fraud on its part, but rather by unforeseeable market downturns.

In order to establish fraud as a common law claim, the Class would have to prove "the hotly contested elements of falsity, materiality, scienter and reliance." *In re Ambase Corp.*, 1995 U.S. Dist. LEXIS 15516, No. 90 Civ. 2011 (CHS), 1995 WL 619856 at *1 (S.D.N.Y. Oct. 23, 1995). These elements might also be required to establish the Class's RICO claims, which are predicated on alleged acts of mail fraud, wire fraud and fraud in the offer and sale of securities. (Complaint at PP 179-81, 190-91). *See, e.g., Compania Sud-Americana de Vapores, S.A. v. IBJ Schroder Bank &*

Trust Co., 785 F. Supp. 411, 424 (S.D.N.Y. 1992); *Morin v. Trupin*, 711 F. Supp. 97, 105 (S.D.N.Y. 1989). *But see Shaw v. Rolex Watch U.S.A., Inc.*, 726 F. Supp. 969, 972 (S.D.N.Y. 1989); *GLM Corp. v. Klein*, 684 F. Supp. 1242, 1244-45 (S.D.N.Y. 1988). At a minimum, in order to establish the predicate acts of mail or wire **[**81]** fraud for RICO purposes, the Class would have to show that PaineWebber "participated in a scheme to defraud" and evinced a "specific intent to defraud." *See Vapores*, 785 F. Supp. at 424 (citing *U.S. v. Rodolitz*, 786 F.2d 77, 80 (2d Cir. 1986) and *U.S. v. Gelb*, 700 F.2d 875, 879 (2d Cir. 1983)). Specifically, the Class would have to prove that risky and unprofitable Partnerships were knowingly or recklessly portrayed by PaineWebber as safe investments; it would not be sufficient merely to show that the Partnerships failed to perform as predicted. *See Olkey v. Hyperion 1999 Term Trust Inc.*, 98 F.3d 2, 9 (2d Cir. 1996). In addition, it is uncertain whether the Class would be able to prove the existence of an overarching fraud or cover-up conspiracy, since such a scheme would implicate an enormous number of PaineWebber employees and third parties in offices all over the country, who dealt with tens of thousands of clients over the course of 12 years.

Assuming that the Class could prove predicate acts of fraud as well as the other requirements to establish a substantive violation of 18 U.S.C. § 1962, it still would not have standing to recover treble damages or attorneys' **[**82]** fees under RICO unless it could also show injury and causation. *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 767 (2d Cir. 1994). It is possible that no RICO injury will be found to exist here, since "as a general rule, [HN13] a cause of action does not accrue under RICO until the amount of damages becomes clear and definite," and in this case most of the Partnerships are still operating and could provide distributions beyond the life of the litigation. *Id.*, 27 F.3d at 768 (relying on *Bankers Trust Co. v. Rhoades*, 859 F.2d 1096, 1104 (2d Cir. 1988)).

In addition, even if it could be proven that Class Members were induced to invest in the Partnerships by misrepresentations or omissions on the part of PaineWebber, plaintiffs cannot prevail unless they further prove that any losses suffered by the Class were actually caused by those misrepresentations rather than by external market conditions. [HN14] A civil RICO suit requires pleading and proof of loss "by reason of" the defendant's violation. 18 U.S.C. § 1964(c). "In the context of predicate acts grounded in fraud," the plaintiff must show that "the misstatements were the reason the transaction turned out to be a losing **[**83]** one." *Gelt Funding*, 27 F.3d at 769 **[*128]** (relying on *Citibank N.A. v. K-H Corp.*, 968 F.2d 1489, 1495 (2d Cir. 1992)). Thus, "when factors other than the defendant's fraud are an intervening direct cause of a plaintiff's injury, that same injury cannot be said to have occurred by reason of the defendant's actions." *Id.* (relying on *Brandenburg v. Seidel*, 859 F.2d 1179, 1186 (4th Cir. 1988)). Many of the assets owned by the Partnerships in this action arguably were subject to price fluctuations, economic shifts, regulatory and governmental actions, and other factors that Paine Webber could argue were primary or intervening causes of the diminution in Partnership values. *See Bastian v. Petren Resources Corp.*, 892 F.2d 680, 684 (7th Cir. 1990); *Porter v. Shearson Lehman Bros., Inc.*, 802 F. Supp. 41, 60 (S.D. Tex. 1992); *Platsis v. E.F. Hutton & Co.*, 642 F. Supp. 1277, 1299 (W.D. Mich. 1986).

PaineWebber would have at least two potentially strong defenses at trial. First, it would argue that the Prospectuses for certain of the Partnerships in this case carry obvious warnings, i.e., they "bespeak caution," and that investors are therefore charged with knowledge of those **[**84]** warnings and may not rely on oral statements to the contrary. *See Hyperion*, 98 F.3d at 8-9; *Brown v. E.F. Hutton Group Inc.* 991 F.2d 1020, 1032-33 (2d Cir. 1993). Class Members, whatever their actual level of sophistication, would be held to a "reasonable investor" standard regarding whether they had been put on notice of investment risks. *Dodds v. Cigna Sec., Inc.*, 12 F.3d 346, 351 (2d Cir. 1993).

In addition, PaineWebber would undoubtedly raise statute of limitations defenses. [HN15] The applicable statute of limitations for RICO is four years from the moment when a plaintiff discovers or "should have discovered" the injury. *Rhoades*, 859 F.2d at 1103. "Where plaintiffs acquire an interest in a limited partnership in reliance on allegedly fraudulent offering material -- the injury . . . is the actual purchase of the partnership interest." *Ackerman v. Nat'l Property Analysts, Inc.*, 887 F. Supp. 494, 503 (S.D.N.Y. 1992). The plaintiff's duty of inquiry with regard to that injury arises -- and the RICO cause of action thereby accrues -- when "the circumstances are such as to suggest to a person of ordinary intelligence the probability that he has been defrauded." *In re* **[**85]** *Prudential Sec. Inc. Ltd. Partnership Litig.*, 930 F. Supp. 68, 76, (quoting *Armstrong v. McAlpin*, 699 F.2d 79, 88 (2d Cir. 1983)). Here, PaineWebber would likely contend that diminished quarterly distributions and letters sent to Class Members stating that Partnerships would not perform as well as predicted constituted "storm warnings" sufficient to place investors on notice of their injuries and thus start the running of the statute of limitations prior to November 23, 1990. *See Prudential*, 930 F. Supp. at 75. Accordingly, there is a risk that most Class Members [43] are potentially subject to limitations defenses against their RICO claims. [44]

43 Some investors in 11 of the 70 Partnerships apparently purchased units after November 23, 1990 and would not be vulnerable to a RICO limitations defense. *See* Obj. Mem. at Exh. 7.

44 The applicable statute of limitations for common law fraud in this case may also be subject to equitable tolling. *See Weisl v. Polaris Holding Co.*, 226 A.D.2d 286, 641 N.Y.S.2d 288, 289 (1st Dep't 1996).

[86]** Finally, the Class's ability to prevail at trial would be further hampered by the fact that much of its case will depend on the testimony of witnesses who are employees, agents or affiliates of PaineWebber, and therefore likely to be hostile, as well as on complex expert testimony likely to be contested by PaineWebber's own witnesses. In any event, there can no guarantee of what the jury will conclude. For all of the foregoing reasons, the Class would face substantial risks of establishing liability should this litigation go to trial, and accordingly the fourth element of the *Grinnell* test supports approval of the proposed Settlement.

(e) *The Risks of Establishing Damages*

Even if the Class were to prevail on liability against PaineWebber, it would still face substantial risks in proving its damages at trial. [HN16] "In class actions, the 'complexities of calculating damages increase geometrically.'" *Chatelain*, 805 F. Supp. at 214 (citation omitted). In this action, the plaintiffs' damage claims under tort, contract and RICO **[*129]** depend in large part on calculations of residual values for each of the nonliquidated Partnerships, and those calculations are driven in turn by speculative **[**87]** projections of future earnings. At trial, PaineWebber would most likely present evidence of higher earning projections for each Partnership, which would correlate to higher residual values and thus lower damages. The issue would undoubtedly devolve into a battle of experts whose outcome cannot be accurately ascertained in advance.

With regard to the Class's RICO claim, there is a substantial risk that the Class would be limited to out of pocket damages, since New York law precludes the recovery of lost profits in fraud actions, and the RICO claim in this case is predicated on fraud. *See First Nationwide Bank v. Gelt Funding Corp.*, 820 F. Supp. 89, 95 (S.D.N.Y. 1993) (relying on *AFA Protective Sys., Inc., v. A.T.&T. Co.*, 57 N.Y.2d 912, 456 N.Y.S.2d 757, 442 N.E.2d 1268 (1982)); *Ostano Commerzanstalt v. Telewide Sys., Inc.*, 794 F.2d 763, 766 (2d Cir. 1986). Moreover, as previously noted, there is authority in this Circuit that RICO damages cannot be definitively calculated or recovered while the Partnerships continue to operate and generate distributions. *Gelt Funding*, 27 F.3d at 768-69. With regard to contract damages, Class Members would bear. the risk of establishing **[**88]** lost profits with reasonable specificity based on the promised returns for each Partnership. Finally, [HN17] damages are a matter for the jury, whose determinations can never be predicted with certainty. For all of these reasons, proving damages would be a lengthy, time-consuming and ultimately uncertain process, and accordingly this element of the *Grinnell* test weighs in favor of approval of the proposed Settlement.

(f) *The Risks of Maintaining the Classes Through the Trial.*

As previously noted, the Federal and Texas Classes were certified in 1995. While the certification of the Texas Class has not been challenged, the structure of the Federal Class and the adequacy of Class Counsel's representation have already been the subject of two motions and an appeal to the Second Circuit. The fairness and adequacy of the Federal Class has been affirmed by this Court in its Order dated February 26, 1996 as well as in this Opinion. Nevertheless, in the absence of a settlement of these actions, there can be no guarantee that the Jacobsons or other objectors will not continue to challenge the maintenance of the Classes as certified. Accordingly, this element of the *Grinnell* test weighs **[**89]** in favor of approval of the Settlement.

(g) *The Ability of the Defendants to Withstand a Greater Judgment.*

[HN18] The ability of the defendant to pay a judgment greater than the amount offered in a settlement can be relevant to the Court's determination of the Settlement's fairness. In particular, evidence that the defendant will not be able to pay a larger award at trial tends to weigh in favor of approval of a settlement, since the "prospect of a bankrupt judgment debtor down at the end of the road does not satisfy anyone involved in the use of class action procedures." *In re Warner Communications Sec. Litig.*, 618 F. Supp. 735, 746 (S.D.N.Y. 1985) (quoting *City of Detroit v. Grinnell Corp.*, 356 F. Supp. 1380, 1389 (S.D.N.Y. 1972)). However, the converse is not necessarily true; i.e., the fact that a defendant is able to pay more than it offers in settlement does not, standing alone, indicate that the settlement is unreasonable or inadequate. Regardless of whether one looks at PaineWebber's total equity of $ 1.6 billion -- as the Jacobsons maintain -- or at its "excess net capital" of approximately $ 350 million -- as Class Counsel contends -- PaineWebber has the ability to **[**90]** withstand a judgment in this action of greater than $ 200 million. (*See* Obj. Supp. Mem. at 17 n.12; Class Mem. at 45.) Accordingly, this element of the *Grinnell* test weighs neither for nor against approval of the Settlement.

(h, i) *The Range of Reasonableness of the Settlement Fund in Light of the Best Possible Recovery and in Light of All the Attendant Risks of Litigation.*

[HN19] Fundamental to analyzing a settlement's fairness is "the need to compare the terms of the compromise with the likely rewards of litigation." *Weinberger*, 698 F.2d at 73 (citing **[*130]** *TMT Trailer Ferry*, 390 U.S. at 424-25, 88 S. Ct. at 1163). This determination "is not susceptible of a mathematical equation yielding a particularized sum," but turns on whether the settlement falls within "a range of reasonableness." *Milken*, 150 F.R.D. 57 at 66 (citing *Newman*, 464 F.2d at 693.) The adequacy of the amount offered in settlement must be judged "not in comparison with the best possible recovery in the best of all possible worlds, but rather in light of the strengths and weaknesses of the plaintiffs' case." *In re "Agent Orange" Prod. Liab. Litig.*, 597 F. Supp. 740, 762 (E.D.N.Y. 1984) (citing **[**91]** *Grinnell*, 495 F.2d at 455). However, as noted above, it is not necessary in making this determination for the Court "to try the case which is before it for settlement," since such a procedure "would emasculate the very purpose for which settlements are made." *Grinnell*, 495 F.2d at 462. Rather, the Court is called upon "to consider and weigh the nature of the claim, the possible defenses, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable." *Id.*

The size of the largest possible recovery in this action is speculative and can only be estimated in the most general terms. The Class's capital investment in the Partnerships equals approximately $ 2.3 billion, of which roughly $ 1.46 billion has already been returned to Class Members through cash distributions. Although the parties contend that the aggregate value remaining in the unliquidated Partnerships is approximately $ 600 million, in order to make a conservative estimate of remaining values, the Court will assume that only half of the amount claimed, or $ 300 million, is valid.

The Class would seek compensatory damages at trial under tort theories, **[**92]** which would compensate the plaintiffs for their lost investment, less distributions and remaining value. Based on the figures set forth above, the amount of that loss is approximately $ 540 million. In addition, prejudgment interest would be assessed at 9% in accordance with New York C.P.L.R. §§ 5001(a) and 5004, starting from a range of possible dates extending back into the mid-1980's, (*see* Class Mem. Data App. at Exh. B, § 1), or, if necessary for ease of administration, a single designated point such as the date of the filing of this action. *See* NY CPLR § 5001(b); *Conway v. Icahn & Co.*, 16 F.3d 504, 512 (2d Cir. 1994); *In re Crazy Eddie Sec. Litig.*, 948 F. Supp. 1154, 1167 (E.D.N.Y. 1996). Depending on what that starting date is determined to be, tort damages at trial would likely reach $ 1 billion and conceivably could rise as high as approximately $ 3 billion.

In the alternative, the Class seeks rescission damages, which would equal Class Members' lost investments, plus interest, minus distributions, without regard to any remaining value in the Partnerships. Because the remaining values of the Partnerships are assumed here to be relatively low, however, rescission **[**93]** damages would not be significantly different from the estimate for tort damages.

The Class also seeks treble damages pursuant to RICO. Since RICO plaintiffs are entitled to damages proximately caused by the alleged predicate acts, *American Nat'l Bank and Trust Co. v. Haroco, Inc.*, 473 U.S. 606, 608-9, 105 S. Ct. 3291, 3291-92, 87 L. Ed. 2d 437 (1985), and the predicate acts in this case are of fraud, the Class's RICO damages would involve the same basic calculations as for its fraud claim, *see Crazy Eddie*, 948 F. Supp. at 1167, but with a sharply decreased likelihood of an award of prejudgment interest. *See Abou-Khadra v. Mahshie*, 4 F.3d 1071, 1083 (2d Cir. 1993); *Wickham Contracting Co. v. Local Union No. 3, IBEW*, 955 F.2d 831, 834 (2d Cir. 1992); *Bingham v. Zolt*, 810 F. Supp. 100, 101-102 (S.D.N.Y. 1993); *Crazy Eddie*, 948 F. Supp. at 1166; *Nu-Life Construction Corp. v. Board of Educ. of the City of N.Y.*, 789 F. Supp. 103, 105 (E.D.N.Y. 1992). Accordingly, the Class's foreseeable RICO recovery, inclusive of trebling, would likely be less than $ 2 billion.

Finally, the Class also seeks to recover contract damages on the theory that PaineWebber promised **[**94]** to produce particular annual returns to Partnership investors. Assuming that such a contractual duty could be proven, Class Members would be entitled to recover the benefit of their bargains, but such damages are too speculative to be estimated for the purposes of assessing the fairness of this Settlement.

[*131] Thus, the most optimistic estimates of the Class's recovery would range between approximately $ 1 billion and an upper limit of approximately $ 3 billion. The cash portion alone of the proposed Settlement, which will return $ 125 million to Class Members, represents between 4% and 12.5% of Defendants' exposure, and with the Additional Benefits, the Settlement recovery increases to between 7% and 20% of the most generous forecasts of recovery. Class Members in virtually all of the Partnerships are expected to recover at least 50%, and in some instances up to 100%, of their original investments -- a very favorable result. (*See* Class Mem. at 46.) *See also Prudential*, 1995 U.S. Dist. LEXIS 18142, 1995 WL 798907 at *15.

However, [HN20] the dollar amount of the settlement by itself is not decisive in the fairness determination, and the fact that the settlement fund may equal only a fraction of the potential recovery **[**95]** at trial does not render the settlement inadequate. "In fact there is no reason, at least in theory, why a satisfactory settlement could not amount to a hundredth or even a thousandth part of a single percent of the potential recovery." *Grinnell*, 495 F.2d at 455 n. 2. Naturally, the settlement does not provide for a full recovery of legal damages; but that is the hallmark of compromise. Given the very considerable litigation risks that would be faced by the Class at trial, the amount of the settlement cash fund is very much within the "range of reasonableness" required for judicial approval.

The Jacobsons further contend that the settlement is unfair because it treats different Class Members differently with regard to the Additional Benefits. However, [HN21] "there is no rule that settlements benefit all class members equally," *In re "Agent Orange" Product Liability Litigation*, 611 F. Supp. 1396, 1411 (*citing Holmes v. Continental Can Co.*, 706 F.2d 1144, 1148 (11th Cir. 1983), as long as the settlement terms are "rationally based on legitimate considerations." *Id.* The record in this action indicates that the Additional Benefits were not arbitrarily assigned, but rather were **[**96]** the direct result of negotiations between Class Counsel and PaineWebber. Specifically, in those Partnerships where PaineWebber would continue to control the operations, PaineWebber was willing to assume more risk in the form of the Remaining Value Guarantees. (*See* Class Mem. at 54; Chimicles Aff. at P 73.) By working to maximize the performance and distributions of these Partnerships, PaineWebber would be able to avoid making cash payouts later. The risk that PaineWebber was willing to assume in the Par Guarantees was a function of the asset composition of each Par Guarantee Partnership. (*Id.*) For the Geodyne Partnerships, where PaineWebber no longer has any control or economic interest, Remaining Value and Par guarantees were not offered, although PaineWebber assumed some risk in the form of price guarantees. (*Id.*) A settlement requires compromises by both sides, and it is not unreasonable for concessions to have been made to PaineWebber's interests in this way.

As noted above, the applicable standard for approval is whether the settlement is fair, reasonable and adequate, not whether it is perfect, or whether every Class Member receives an identical recovery. The guiding **[**97]** principle of this settlement is to return as much lost investment as possible to all Class Members, and the Additional Benefits contribute to that goal. Moreover, Class Members get a second bite at the apple in the Look-Back Fund, which is distributed among all plaintiffs who still have Recognized Loss following the payment of the Additional Benefits, further mitigating any potential inequalities. Indeed, the assignment of Additional Benefits may actually produce yet a fairer result, since the settlement fund is otherwise allocated on a straight pro rata basis without consideration of any differences between Partnerships. (*See* Settlement Notice at PP 24-41.)

Finally, the Pegasus investors do quite well under the Additional Benefits; their par guarantees (albeit capped for Pegasus II) are a very favorable benefit compared to most other investors. If they ultimately receive a relatively small cash recovery through these guarantees (or via the cash fund), it will be because their investments have retained more value than others, or because they will already have received higher cash distributions **[*132]** than other investors as of December 31, 2000.

For all of these reasons, the proposed **[**98]** Settlement is well within the range of reasonableness in light of the best recovery at trial and all the attendant risks of litigation, and accordingly the final elements of the *Grinnell* test weigh heavily in favor of approval.

(2) *Procedural Integrity*

[HN22] The second fundamental indicator of a settlement's fairness is the fact that it was properly negotiated at arm's length by the Parties. As long as the integrity of the negotiating process is ensured by the Court, it is assumed that the forces of self-interest and vigorous advocacy will of their own accord produce the best possible result for all sides. Accordingly, the Court has an obligation to satisfy itself that the settlement process has not been corrupted and that the Class Members have been adequately represented by qualified counsel. See *Weinberger*, 698 F.2d at 74; *Malchman*, 706 F.2d at 433; *Chatelain*, 805 F. Supp. at 212. The Jacobsons assert that Class Counsel's representation of the Class was not adequate in this case, and they further suggest that collusion may have occurred between the Parties.

The first of these contentions is rejected for the reasons set forth *supra* in Section A of this Part. **[**99]** As for their second allegation, the Jacobsons contend that the negotiation process was undermined by the alignment of Class Counsel's interests with those of PaineWebber to resolve this case quickly and to roll up as many claims as possible in the Settlement. If proven, such collusion might prevent the approval of the Settlement, and at the very least would raise the Court's scrutiny and rebut the presumption of deference to the recommendations of counsel.

However, [HN23] an allegation of collusion will not stand in the absence of any credible evidence. *See, e.g., Smith v. Alleghany Corp.*, 394 F.2d 381, 391-92 (2d Cir. 1968). The Jacobsons have had every opportunity over the last eighteen months to develop the facts supporting their theory. They have obtained discovery documents from Class Counsel, they have filed numerous submissions -- both in support of their present objection and in connection with two previous related motions -- and they have appeared before this Court on at least five occasions, including at the fairness hearing. Nevertheless, they have mustered only the weakest of circumstantial evidence of any possible collusion between PaineWebber and Class Counsel. In particular, **[**100]** the testimony at the fairness hearing of the Jacobson's witness, Professor Koniak, added virtually nothing to the record to indicate that any improper behavior actually occurred in this case or that the integrity of the settlement negotiation process was corrupted in any way.

Indeed, Professor Koniak's testimony suggested that any class certification is collusive if it is conditional or stipulated to by the Parties, a position which is obviously untenable. Nor is the Court swayed by the Jacobsons' argument that the settlement must be collusive because it does not return an adequate recovery to Pegasus investors. Accordingly, as there is no credible evidence that the integrity of the negotiating process was impaired, this Court finds that the Settlement was achieved at arm's length.

For all of the aforementioned reasons, the proposed Settlement is fair, reasonable and adequate, and is found to be in the best interests of the Class.

D. *The Plan of Allocation is Fair and Reasonable*

[HN24] The Court's responsibility for ensuring that the proposed Settlement is equitably allocated among Class Members derives from the requirement of Rule 23(e) that the settlement of a class action have **[**101]** court approval, and the standard of fairness, adequacy and reasonableness "'applies with as much force to the review of the allocation [plan] as it does to the review of the overall settlement.'" *Agent Orange*, 611 F. Supp. at 1402 (E.D.N.Y. 1985) (citing *In re Chicken Antitrust Litig. Am. Poultry*, 669 F.2d 228, 238 (5th Cir. 1982). The review of the plan of allocation is squarely within the discretion of the district court, *In re Equity Funding Corporation of America Securities Litigation,* 603 F.2d 1353, 1362 (9th Cir. 1979); *State of West Virginia v. Pfizer & Co.*, 440 F.2d 1079, 1085 **[*133]** (2d Cir. 1971), and in this function -- as in its review of the settlement itself -- the Court acts as the fiduciary of all Class Members. This role is especially important where, as here, Class Members were required to bind themselves to the Class before the terms of any Settlement had been determined.

The Jacobsons object to the Plan of Allocation on the ground that it does not account for variations in the strengths of different Class Members' claims. At a minimum, it is obvious that [HN25] in the case of a large class action the apportionment of a settlement can never be tailored to the **[**102]** rights of each plaintiff with mathematical precision. To determine precisely "the distribution of the settlement fund among the myriad claimants" in such a class would require counsel or the district court "to weigh the strengths and weaknesses of the claims of each class member" and would be an "almost impossible task." *Equity Funding*, 603 F.2d at 1365 (9th Cir. 1979); *see also In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 219 (5th Cir. 1981). In such cases, the requirements of efficiency and administrability "undoubtedly would permit alternative methods of disbursement." *Agent Orange*, 611 F. Supp. at 1403; *see also Women in City Gov't*, 1989 U.S. Dist. LEXIS 14874, 1989 WL 153059 at *5.

However, it is also true that [HN26] when real and cognizable differences exist between the "likelihood of ultimate success" for different plaintiffs, "it is appropriate to weigh 'distribution of the settlement . . . in favor of plaintiffs whose claims comprise the set' that was more likely to succeed." *Agent Orange*, 611 F. Supp. at 1411 (citing *Corrugated Container*, 643 F.2d at 220). Such merit-based weighting has been approved by courts in this Circuit and elsewhere where substantially different **[**103]** or additional claims have been asserted by certain class members and not others (*see Agent Orange*, 611 F. Supp. at 1410-11; *In re Salomon Inc. Sec. Litig.*, 1994 U.S. Dist. LEXIS 8038, No. 91 Civ. 5442 (RPP), 1994 WL 265917 at *6-7 (S.D.N.Y. June 16, 1994); where the liability of a defendant has been altered in relation to some class members because of a separate settlement or judicial determination (*see Equity Funding*, 603 F.2d at 1363-67; *In re Investors Funding Corp. of N.Y. Sec. Litig.*, 9 Bankr. 962, 965 (S.D.N.Y. 1981); *Milken*, 150 F.R.D. 46 at 50-51); where different plaintiffs have "substantially" different vulnerabilities to statute of limitations defenses (*see Corrugated Container*, 643 F.2d at 220; *see also Prudential*, 1995 U.S.

Dist. LEXIS 18142, 1995 WL 798907 at *11); and where the injuries claimed by different class members have been sustained under significantly different legal or factual circumstances (*see, e.g., Women in City Gov't*, 1989 U.S. Dist. LEXIS 14874, 1989 WL 153059 at *4; *Dunn v. Porter*, 78 F.R.D. 50, 53 (E.D.Pa 1978); *Cagan v. Anchor Savings Bank*, 1990 U.S. Dist. LEXIS 11450, No. CV-88-3024, 1990 WL 73423 at *4 (E.D.N.Y. May 22, 1990); *Salomon* 1994 U.S. Dist. LEXIS 8038, 1994 WL 265917 at *12; *Prudential*, 1995 U.S. Dist. LEXIS 18142, 1995 WL 798907 at *11; *Investors Funding*, **[**104]** 9 Bankr. at 965). As a general rule, [HN27] the adequacy of an allocation plan turns on whether counsel has properly apprised itself of the merits of all claims, and whether the proposed apportionment is fair and reasonable in light of that information. *See Corrugated Container*, 643 F.2d at 219-20; *Milken*, 150 F.R.D. 46 at 55; *Dunn*, 78 F.R.D. at 53-54.

Class Counsel has performed a thorough and detailed analysis of the merits of all the claims in this case. The Executive Committee performed initial calculations of losses for each Partnership in late 1995, and more importantly, throughout the allocation process in early 1996, each Partnership group was represented by a separate law firm and by outside experts. [45] Specifically, the Pegasus investors were represented by the firm of Goodkind Labaton Rudoff & Sucharow, and the merits of the Pegasus claims were reviewed **[*134]** and analyzed by two independent experts, i.e., Prof. Jordan and Mr. Treitel. (*See* Tr. 1/19/96 at 23-24.) Reports by each Partnership team were presented to the Allocation Committee, and the conclusions of those reports are set forth in the record. (*See* Compendium of Affidavits and Reports of Experts Retained **[**105]** by Class Counsel in Support of Settlement and Plan of Allocation, Exh. 1-8; Chimicles Aff. at PP 62-65.)

45 At a hearing before this Court on January 19, 1996 regarding the Jacobsons' motion to create a subclass, Class Counsel described the structure of the Allocation Committee as follows:

> Mr. Labaton's firm represents Pegasus. He sits on the committee representing the Pegasus experts. Miss Rodriguez's firm represents the real estate partnerships. They have retained a real estate expert [Vitola] . . . Mr. Bert Finkelstein [and Texas Counsel] represent the Geodyne partnerships exclusively, and they have retained experts in that field. Bernstein Liebowitz represents the R&D Partnerships . . . Therefore, each of those firms has now been given its own mandate to represent its client . . . and get as much as they can for their partnerships.

(Tr. 1/19/96 at 28.)

The dispositive question, therefore, is whether Class Counsel's decision in this case to allocate the settlement fund on a pro rata basis **[**106]** was fair and reasonable in light of the information collected and the analyses performed. Class Counsel assert that the plan should be approved because although the claims of all Class Members are not identical, their similarities greatly outweigh any differences, and every Class Member would have a comparable chance of success on the merits at trial. In other words, it is contended that the Plan of Allocation is indeed "based on a rational analysis of the relative strengths and weaknesses of the claims related to each of the

Partnerships," *Prudential*, 1995 U.S. Dist. LEXIS 18142, 1995 WL 798907 at *19, but that the appropriate weighting of the plan in this case in fact is no weighting at all. [46] The Jacobsons contend that this is an unreasonable result, because certain plaintiffs, and in particular the Pegasus investors, have stronger claims than others on the facts and with regard to statute of limitations defenses.

46 The Executive Committee is no stranger to the process of weighting an allocation plan; many of its member firms were involved in the creation of such plans in other class action settlements. *See, e.g., Prudential*, 1995 U.S. Dist. LEXIS 18142, 1995 WL 798907; *Milken*, 150 F.R.D. 57; *Investors Funding*, 9 Bankr. 962.

[107]** With regard to the facts, the Jacobsons allege that Pegasus I and II units were marketed pursuant to a unique and uniform "sales pitch" which was orchestrated by PaineWebber's Direct Investment Department and which involved misrepresentations not involved in the marketing of other Partnerships. The Jacobsons also contend that Pegasus investors have a stronger litigation position because the SEC's Consent Order made specific findings with regard to PaineWebber's marketing and sale of Pegasus units.

These arguments are unpersuasive. As previously set forth in this Court's Order of February 26, 1996 as well as here, the claims asserted by all Class Members in the Consolidated Complaint are materially the same. In every case there are allegations of Uniform Sales Materials and scripts and of centralized fraud and conspiracy by PaineWebber. (Order dated Feb. 26, 1996 at 4-5.) Furthermore, the Allocation Committee analyzed the merits of all claims and found evidence of similar illegal activity by PaineWebber in every Partnership group. (*See* Chimicles Aff. at PP 62-65.) Based on these findings, it was reasonable for Class Counsel to conclude that all plaintiffs would have generally **[**108]** comparable odds of prevailing at trial and that any differences between their claims are not appreciable compared to their similarities. The fact that certain Partnerships were discussed in the SEC's Consent Order does not alter this result, since, as previously noted, the SEC Order is not admissible at trial to prove liability.

With regard to statutes of limitations, the Jacobsons contend that the Plan of Allocation fails to account for different levels of risk faced by different Class Members. Class Counsel asserts that no sufficient basis exists for differentiating between Class Members, because all RICO claims and certain state law claims are subject to the doctrine of "equitable tolling" and could be timely depending on when Class Members discovered or should have discovered their injuries. It is sufficient to state that the determination of when such notice occurred for various Class Members is a question to be resolved by motion or at trial, *see Prudential*, 930 F. Supp. at 75-76; *Butala v. Agashiwala*, 916 F. Supp. 314, 318 (S.D.N.Y. 1996), as would be such issues as whether the damages suffered are sufficiently definite to constitute a RICO injury and start the limitations **[**109]** clock. *See Bingham*, 66 F.3d at 561; *Gelt Funding*, 27 F.3d at 768; *Cruden v. Bank of N.Y.*, 957 F.2d 961, 977-78 (2d Cir. 1992). In its role as arbiter of the fairness of the proposed Settlement, this Court is not called upon to determine these statute of limitations issues. Indeed, settlements are reached precisely to **[*135]** avoid such binding judicial determinations. The existence of these unresolved issues is sufficient to support the reasonableness of the Parties' determination that "no distinction should be made between or among Partnerships based on statute of limitations grounds" for the purposes of the proposed Settlement. [47]

47 In this regard, it bears noting that the Geodyne plaintiffs, many of whose claims are subject to the fewest statute of limitations defenses, have not objected to a pro rata allocation of the Settlement.

This Court's review of the proposed Plan of Allocation is informed not only by the goal of matching each plaintiff's recovery to the strength of his or her claim, *Grinnell*, **[**110]** 495 at 455, but also "by the strong judicial policy favoring settlements as well as the realization that compromise is the essence of settlement." *Chicken Antitrust*, 669 F.2d at 238. [HN28] Efficiency, ease of administration and conservation of public and private resources are highly relevant to the reasonableness of a settlement, *see Women in City Gov't*, 1989 U.S. Dist. LEXIS 14874, 1989 WL 153059 at *5 (citing *In re "Agent Orange" Prod. Liab. Litig.*, 818 F.2d 179, 183), particularly where, as here, the issues are complex, the outcome of the litigation unclear, and the class large. Based on the extensive record in this case, a pro rata distribution of the Settlement on the basis of Recognized Loss will provide a straightforward and equitable nexus for allocation and will avoid a costly, speculative and bootless comparison of the merits of the Class Members' claims. Accordingly, the Plan of Allocation is fair and reasonable and is approved.

III.

CONCLUSION

For all of the foregoing reasons, the Court concludes that the proposed Settlement and the proposed Plan of Allocation are fair, reasonable and adequate, and are in the best interests of the Class. Accordingly, all objections are overruled, the **[**111]** present motion is GRANTED, and the settlement of this class action is hereby APPROVED pursuant to Rule 23(e) of the Federal Rules of Civil Procedure. NOW, THEREFORE, IT IS HEREBY ORDERED THAT:

1. The Settlement Agreement is fair, reasonable and adequate and is in the best interests of the Class.

2. The Settlement Agreement shall have the full force and effect of an Order of this Court and shall be implemented in accordance with its terms and provisions.

3. The "Settled Claims" as defined in the Settlement Agreement are dismissed on the merits and

with prejudice.

4. The Clerk of Court is directed to enter judgment dismissing the Consolidated Complaint with prejudice in favor of the Settling Defendants.

5. This Court retains exclusive jurisdiction over the Parties and Class Members for all matters relating to this litigation, including the award of attorneys' fees and costs, and the administration, interpretation and enforcement of this Opinion and Order.

Dated: New York, New York

March 20, 1997

SO ORDERED:

Sidney H. Stein, U.S.D.J.

In re PaineWebber Incorporated Limited Partnerships Litigation; ROCHELLE RITTMASTER, on behalf of herself and all others similarly situated, Plaintiff-Appellee, - v. - ROBERT JACOBSON, VERA JACOBSON, Appellants, PAINEWEBBER GROUP, INC.; PAINEWEBBER, INC., Defendants-Appellees.

Docket No. 97-7540

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

117 F.3d 721; 1997 U.S. App. LEXIS 19304

July 15, 1997, Argued
July 30, 1997, Decided

PRIOR HISTORY: **[**1]** Appeal from orders by the United States District Court for the Southern District of New York (Sidney H. Stein, Judge), approving a settlement and allocation in this class action and denying appellants' motions to intervene and to be certified as representatives for their proposed subclass.

DISPOSITION: Affirmed.

COUNSEL: EDWARD T. JOYCE, Chicago, Illinois, for Appellants.

EDWARD LABATON, New York, New York (Nicholas E. Chimicles, Fred Taylor Isquith, Edward Grossmann, Burton H. Finkelstein, David J. Bershad, Of Counsel), for Plaintiff-Appellee.

MATTHEW GLUCK, New York, New York (Peter L. Simmons, Rachel S. Fleishman, Of Counsel), for Defendants-Appellees.

JUDGES: Before: WINTER, Chief Judge, JACOBS and LEVAL, Circuit Judges.

OPINION

[*722] PER CURIAM:

Robert and Vera Jacobson appeal from Judge Stein's approval of a settlement and allocation agreement in this class action and denial of the Jacobsons' motions to intervene and to be certified as subclass representatives. We affirm for the reasons set forth in Judge Stein's opinions. *In re*

PaineWebber Ltd. Partnership Litig., 171 F.R.D. 104 (S.D.N.Y. 1997); *In re PaineWebber Ltd. Partnership Litig.*, F.R.D. , No. 94 Civ. **[**2]** 8547 (SHS) (S.D.N.Y. Feb. 26, 1996).

SELWYN SILBERBLATT, on behalf of himself and all others similarly situated, Plaintiff, -against- MORGAN STANLEY and MORGAN STANLEY DW INC., Defendants.

05 Civ. 7569 (PKC)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

524 F. Supp. 2d 425; 2007 U.S. Dist. LEXIS 85895

November 19, 2007, Decided
November 19, 2007, Filed

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiff buyers, who entered into contracts to purchase precious metals, filed a class lawsuit against defendant seller, alleging breach of contract, breach of fiduciary duty, and other claims arising from the payment of storage fees associated with their purchases. Pursuant to Fed. R. Civ. P. 23(e), the parties presented the court with an application for final approval of a settlement of the class claims.

OVERVIEW: The buyers contended that they were misled into believing that specific units of precious metals were allocated to them and that the seller did not fully disclose its storage practices so that the buyers paid excessive storage fees for the metals they purchased. Although these claims were relatively straightforward, the court noted that the buyers would have had to overcome difficult obstacles in proving them, particularly as no class member suffered a loss. The proposed settlement consisted of a cash component as well as remedial consideration, which included revisions to the seller's sales brochures, alterations to its storage agreements, and temporary modifications of pricing policies. In approving the settlement, the court concluded that the cash component was fair, reasonable, and adequate to the class members, as required by Rule 23(e). The court rejected the proposed attorney fee award and set counsel's fee at 20 % of the cash component of the settlement, plus expenses. The court also rejected in part the class representative's claim for a differential payment, finding that he was only entitled to reimbursement of time and expenses for two trips made on behalf of the class.

OUTCOME: The court approved the settlement, awarded class counsel fees of $ 300,000 and expenses of $ 150,016. The court also awarded the class representative expenses of $ 2,760 out of the class funds.

CORE TERMS: settlement, storage, class members, precious metals, class representative, coupon, customer, valuation, fee award, reasonableness, allocated, lodestar, class action, attorneys' fees, unallocated, reduction, disclosure, proposed settlement, per hour, notice, cross-check, discovery, metals, spent, modification, valuing, limitations period, common fund, deposition, discount

LexisNexis(R) Headnotes

Civil Procedure > Class Actions > Compromises
[HN1] See Fed. R. Civ. P. 23(e)(1)(A).

Civil Procedure > Class Actions > Compromises
[HN2] Fed. R. Civ. P. 23(e)(1)(C) requires, as a precondition to approval of a settlement that would bind class members, that a court find, after conducting a hearing, that the settlement is fair, reasonable, and adequate.

Civil Procedure > Class Actions > Compromises
[HN3] In conducting the review mandated by Fed. R. Civ. P. 23(e), a court has a duty to make a considered and detailed assessment of the reasonableness of proposed settlements. A district court must consider many factors, including the complexity of the litigation, comparison of the proposed settlement with the likely result of litigation, experience of class counsel, scope of discovery preceding settlement, and the ability of the defendant to satisfy a greater judgment.

Civil Procedure > Class Actions > Class Counsel > Fees
[HN4] In reviewing a fee application in the class action context a court is to act as a fiduciary who must serve as a guardian of the rights of absent class members. An award must reflect the actual effort made by an attorney to benefit the class.

Civil Procedure > Class Actions > Class Counsel > Fees
Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
[HN5] Both the lodestar and the percentage of the fund methods are available to district judges in calculating attorneys' fees in common fund cases. No matter which method is chosen, district courts should continue to be guided by the traditional criteria in determining a reasonable common fund fee. The lodestar remains useful as a baseline even if the percentage method is eventually chosen. It serves as a crosscheck on the reasonableness of the requested percentage. Where used as a mere crosscheck, the hours documented by counsel need not be exhaustively scrutinized by a district court. The reasonableness of a claimed lodestar can be tested by a court's familiarity with a case. Court have moved away from the concept of a lodestar in favor of a presumptively reasonable fee. The reasonable hourly rate is the rate a paying client would be willing to pay.

Civil Procedure > Class Actions > Class Counsel > Fees
Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees

[HN6] The first of the traditional factors in determining a reasonable common fund fee requires consideration of the time and labor expended by counsel.

Civil Procedure > Class Actions > Class Counsel > Fees
Civil Procedure > Remedies > Costs & Attorney Fees > Attorney Expenses & Fees > Reasonable Fees
[HN7] In a common fund case, a fee award should be assessed based on scrutiny of the unique circumstances of each case, and a jealous regard to the rights of those who are interested in the fund.

Civil Procedure > Class Actions > Class Members > Named Members
Civil Procedure > Class Actions > Compromises
[HN8] Payments to class representatives, while not foreclosed, should be closely scrutinized. A differential payment may be appropriate in order to make the class representative whole. A representative plaintiff may have lost wages, vacation time or commissions from sales because of time spent at depositions or other proceedings. A class representative who has been exposed to a demonstrable risk of employer retaliation or whose future employability has been impaired may be worthy of receiving an additional payment, lest others be dissuaded. A balance must be struck so that a class representative does not view his prospect for rewards as materially different from other members of the class, yet is not disadvantaged by his service in pursuing worthy claims.

COUNSEL: **[**1]** For Selwyn Silberblatt, on behalf of Himself and All Those Similarly Situated, Plaintiff: Ashley H. Kim, Joel Paul Laitman, Kurt Michael Hunciker, Samuel P. Sporn, LEAD ATTORNEYS, Frank Rocco Schirripa, Schoengold Sporn Laitman & Lometti, P.C., New York, NY.

For Morgan Stanley Dean Witter & Co., Defendant: Richard A. Rosen, LEAD ATTORNEY, Paul, Weiss, Rifkind, Wharton & Garrison LLP (NY), New York, NY.

For Morgan Stanley, Morgan Stanley DW Inc., Defendants: Richard A. Rosen, Paul, Weiss, Rifkind, Wharton & Garrison LLP (NY), New York, NY.

JUDGES: P. Kevin Castel, United States District Judge.

OPINION BY: P. Kevin Castel

OPINION

[*427] MEMORANDUM AND ORDER

P. KEVIN CASTEL, U.S.D.J.

This is an application for final approval of a settlement of the claims of a certified class. In this context, plaintiff's counsel seeks an award of attorneys' fees on a percentage basis, valuing the recovery at $ 4,355,000, of which $ 2,855,000 is referred to as "Remedial Consideration." The Remedial Consideration is a potpourri, including revisions to sales brochures, alterations to third-party agreements and temporary modification of pricing policies to which class members and non-class members benefit equally. Plaintiff's valuation is flawed **[**2]** and grossly inflated. Even at that, only 500 of the approximately 23,000 class members, those who have open accounts, would be in a position to benefit from the Remedial (NI Consideration. If plaintiff's request for fees and expenses were granted in full, counsel would receive 63% of the cash component of the settlement, an unfair result.

The Court concludes, after a hearing, that the cash component of the settlement, $ 1.5 million, is fair, reasonable and adequate to the members of the class and, on this basis, the settlement is approved. Plaintiff's counsel's fee award will be set at $ 300,000 or 20% of the cash component of the settlement, plus expenses of $ 150,016.44. [1]

1 The award for expenses includes $ 44,318.52, which either was paid or will be paid by plaintiff's counsel to Garden City Group for the performance of administrative functions in connection with the settlement, including dissemination of the notice of proposed settlement to class members. Any additional amounts owed to Garden City Group will be paid from the Cash Settlement Fund, as set forth in the Stipulation and Agreement of Settlement.

The application of Selwyn Silberblatt, class representative, to be paid $ **[**3]** 9,600 in addition to the amount awarded to other members of the class is denied. A payment to him of $ 1,920 will be approved plus expenses of $ 840.

[*428] I. Prior Proceedings

This action was commenced on August 26, 2005. By Order dated October 18, 2006, this Court certified a class consisting of all persons who entered into contracts to purchase precious metals from and through Morgan Stanley DW Inc., the retail broker-dealer subsidiary of Morgan Stanley, during the period February 19, 1986 through August 26, 2005.

The parties engaged in extensive discovery and expert discovery closed on January 31, 2007. Thereafter, I set a schedule for defendants' proposed motion for summary judgment. Proceeding on a separate track, the parties engaged in private mediation. On April 20, the Court was informed that the parties had entered into a Memorandum of Understanding, setting forth the terms of a proposed settlement.

I granted a motion for preliminary approval of the settlement and directed that notice be given to the members of the class. The proposed notice was clear and gave fair notice of the terms of the settlement and of the application for fees. I set September 14, 2007 as the date for individuals **[**4]** to opt out of the class and also as the date for class members to object to the settlement or to the request for attorneys' fees.

Notices were mailed to over 24,317 individuals. (Senzer Aff't, P 4-6.) Notice was also published in the Wall Street Journal. (Id., P 7.) Opt outs were timely received from 27 individuals. (Id., P 10.) No class member objected to the settlement or fee application. (Id., P 10.) At the hearing on September 24, no objector appeared and no witnesses were called by the parties to the settlement. (Hearing Tr. 2-3.) Counsel orally argued their positions and responded to questioning from the Court.

II. Fairness, Reasonableness and Adequacy of The Settlement from the Standpoint of the Class

A. Standard for Reviewing the Fairness of the Settlement

Rule 23(e)(1)(A) provides that [HN1] "[t]he court must approve any settlement . . . or compromise of the claims, issues, or defenses of a certified class." [HN2] Rule 23(e)(1)(C) requires, as a precondition to approval of a settlement that would bind class members, that the Court find, after conducting a hearing, that the settlement "is fair, reasonable, and adequate." The parties have submitted to the Court a "Stipulation and Agreement **[**5]** of Settlement" (the "Settlement Agreement"), containing all of the terms of their agreement.

[HN3] In conducting the review mandated by Rule 23(e), I have a duty "to make a considered and detailed assessment of the reasonableness of proposed settlements . . . ." Weinberger v. Kendrick, 698 F.2d 61, 82 (2d Cir. 1982) (Friendly, J.). "The district court must consider many factors, including the complexity of the litigation, comparison of the proposed settlement with the likely result of litigation, experience of class counsel, scope of discovery preceding settlement, and the ability of the defendant to satisfy a greater judgment." In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 292 (2d Cir. 1992) (citing Weinberger, 698 F.2d at 73-74 and City of Detroit v. Grinnell Corp., 495 F.2d 448, 463 (2d Cir. 1974)).

B. Complexity and the Likely Results of Litigation

This is a diversity action for breach of contract, breach of fiduciary duty, fraud, unjust enrichment, negligent misrepresentation, and violations of N.Y. Gen. Bus. Law § 349-a and N.Y.U.C.C. § 2-313, arising out of the payment of storage fees associated with precious metals purchases. **[*429]** Plaintiff alleges that he and other members of **[**6]** the class were misled into believing that specific bars or units of precious metals were allocated to them and, therefore, not subject to claims of creditors of defendants. He further alleges that defendants did not fully and truthfully disclose the true nature of defendants' purchase and storage practices and that plaintiff and members of the class paid excessive storage fees. Defendants assert that they did, indeed, purchase actual, physical metals for customers, albeit on an unallocated basis. They further assert that they made no misrepresentations regarding purchase or storage of precious metals and, in any event, no customer sustained any economic injury.

Although the claims were relatively straightforward in terms of the theories of liability, plaintiff would have had to overcome difficult obstacles in proving them. Plaintiff would have endeavored to prove that the nature of the contractual documents and surrounding representations left the impression that a quantity of precious metal would be segregated or allocated for the specific buyer. It is fair to observe that defendants' statements did not drive home the point that no specific metals were segregated for the particular **[**7]** purchaser. Yet, no single document indisputably excluded the possibility of unallocated holdings. For example, a silver purchaser was not given the number of a specific bar owned by him, which would have pointed toward an allocated purchase.

Among the hurdles for plaintiff was that no class member suffered a loss. Unallocated metals *could* have been subject to a lien by a creditor of defendants or the warehouseman but none were. Also, it would have been difficult to establish that there was illegality in charging a storage fee for unallocated precious metals, absent a misstatement. Proving that a storage fee of .75% was excessive and unlawful would have been difficult in both legal theory and in fact.

C. The Proposed Settlement and Its Value

As noted, the settlement consists of $ 1,500,000 in cash and $ 2,855,000 in so-called Remedial Consideration. Plaintiff's counsel asks that the Remedial Consideration be included in the overall valuation of the settlement. However, counsel seeks payment of all attorneys' fees and expenses out of the cash consideration. I will first address the cash component, next the allocation, and, finally, the Remedial Consideration.

1. Cash

In evaluating the adequacy **[**8]** of the cash component, I note that the storage fees were a very small portion of the overall precious metal transaction. Storage fees charged by defendants were 0.75% of the value of the customer's precious metal holdings. The aggregate amount of storage fees collected by defendants from class members over the class period was about $ 4 million. (Hearing Tr. 19.)

The full amount of all customer payments, $ 4 million, would have been at the high end of the range of any reasonably likely recovery, if liability had been established. A settlement of $ 1.5 million which amounts to 37.5% of all sums paid as storage fees during the class period is a very good settlement. This was not a good case for punitive damages because it would have been difficult to prove knowing misstatements or any extreme or outrageous behavior.

Standing alone and without the Remedial Consideration, the cash component renders the settlement fair, reasonable and adequate to the members of the class.

[*430] 2. Plan of Allocation: Pre-2000 versus Post-2000 Claimants

Under the terms of the settlement, the cash portion of the settlement, which is $ 1.5 million less amounts paid to class counsel and the class representative, will **[**9]** be allocated such that 20% will be paid to the those incurring storage fees prior to January 1, 2000 and 80% to those incurring storage fees from January 1, 2000 to the end of the class period. The distinction was drawn in part because of the arguable bar of the statute of limitations for some pre-2000 claims.

I conclude that the distinction is warranted. New York, whose law would likely govern this diversity action, has a six-year limitations period for claims asserted in contract. N.Y. CPLR § 213(2). None of the claims in the Amended Complaint have a longer limitations period, with the possible exception of the fraud claim to which tolling might apply. N.Y. CPLR § 213(8). It would be difficult to establish scienter on the part of defendants, a requirement of a fraud claim.

Exactitude is not required in allocating consideration to the class, provided that the overall result is fair, reasonable and adequate. While there are some claimants who held precious metals from August 26, 1999 to December 31, 1999 whose claims would be timely under New York's six-year limitations period for claims asserted in contract, the limitations period is not the sole factor in assessing the reasonableness **[**10]** of the allocation. Older claims, even if not time-barred, would have been more difficult to prove. The plan of allocation meets the threshold of fairness.

3. Remedial Consideration

There are some 22,653 members of the class with accounts no longer open as of the last day of the class period, January 10, 2007. There were approximately 500 class members with accounts open on that date. (Hearing Tr. 18.) To those who had open accounts, the so-called Remedial Consideration was available.

No declaratory or injunctive relief was sought in the complaint. The claims of those with open accounts were not analytically stronger than those in the post-2000 period with closed accounts.

The Remedial Consideration consists of modifications to the customer disclosure statements explaining, among other things, the difference between "allocated" and "unallocated" ownership. Plaintiff's expert, Jeffery M. Christian of CPM Group, describes himself as "one of the world's foremost authorities on the precious metals markets . . . ." (Christian Aff't, P 1). He breaks down the value of the revised disclosures into the following sub-categories: modification of customer disclosure, valued at $ 339,502.39; modification **[**11]** of Internal Broker Website, valued at $ 339,502.39 and modification of customer brochure, $ 339,502.39. A well-crafted letter on fancy, embossed stationary sent by overnight courier to each of the 500 holders could have conveyed the same information with much the same effectiveness at a fraction of the combined value exceeding $ 1 million. The methodology of valuation does not tie the disclosures to the approximately 500 holders to whom the new disclosures will be made. Class counsel conceded that the number of holders was not known as of the date of the expert's valuation. (Hearing Tr. 35-42.)

The Remedial Consideration also includes revisions to certain agreements between defendants or their affiliates and JP Morgan Chase and FideliTrade. The revisions afford better protections to customers. However, in each instance, the Settlement Agreement recites that "[d]efendants reserve the right to amend the **[*431]** terms of the agreement at any time." Thus, the value of such a revision is inherently uncertain.

Defendants also have liquidated the precious metal holdings at a London storage facility and now use a Delaware facility. 2 Also, defendants agree that, during the next five years if any storage **[**12]** facility assigns its assets for the benefit of creditors or is in bankruptcy proceedings, then defendants will move the precious metals out of the warehouse or otherwise take steps to protect the customers.

2 The physical location of the precious metals is somewhat tangential to plaintiff's claim, although, if a lien issue were ever to arise, it may be more burdensome for some class members to litigate a lien challenge in the U.K. rather than Delaware.

Finally, there is (1) an adoption of quarterly billing, rather than a nonrefundable annual fee, so that an investor who holds for fewer than four quarters pays less in fees; and (2) a one-year storage fee cap reduction (from .75% per year to either .36% per year for unallocated precious metals or .60% per year for allocated precious metals). Class members and non-class members will benefit from these changes. The method of valuation utilized by the expert for these two items is exemplary of the flaws throughout the report. For the purposes of valuing the change to quarterly billing, the expert assumes that those who hold precious metals will keep them in unallocated metals and sell them off in equal installments over the four quarters of **[**13]** the following year; this is the low-end scenario to which he assigns a value of $ 144,288, including interest. For the high-end scenario, he assumes that all the metals will be stored on an allocated basis (with a higher fee) but will all be sold in the first quarter (a period the expert describes as the traditionally heavy selling period); this produces a figure of $ 543,203.82, including interest. He then averages the two figures to arrive at a value of $ 343,746.17. However, when valuing the reduction in storage fees, the expert reverses fields and instead assumes no sales during any of the first three quarters and that all precious metals will be held at least into the fourth quarter. The inconsistent application of fundamental assumptions in a manner that inflates values to the benefit of plaintiff's counsel renders the expert's report unreliable.

The Remedial Consideration undoubtedly has some value but that value has not been proven. The methodology offered by the plaintiff's expert is so flawed as to be entitled to little weight. It assumes continued holdings for valuing one item but assumes the opposite in valuing another. It places a value on disclosures without knowing to **[**14]** how many investors the disclosures would be made. It was the plaintiff's privilege to offer credible evidence in support of valuation. Plaintiff was given the opportunity to call live witnesses but declined to do so. (Hearing Tr. 2-3.) The Court is incapable of fashioning an alternative valuation in the absence of a record that would enable it to do so in a reliable manner. No application to supplement the record was made at or since the hearing and do-overs are not an encouraged practice.

Of course, were the Court to assign some value to the Remedial Consideration, it would be unfair to saddle the 22,653 class members with closed accounts with a subsidization of the attorneys' fees attributable to Remedial Consideration that they will not receive. The creation of a subclass of those with open accounts on January 10, 2007 may have been appropriate, if the parties had provided a factual record adequate to do so. Unless fundamentally restructured, those in the subclass would receive a fraction of the cash, all of the **[*432]** Remedial Consideration and any attorneys' fees attributable to the Remedial Consideration.

The Class Action Fairness Act of 2005 ("CAFA") governs the Court's consideration **[**15]** of proposed settlements in cases to which Rule 23 applies. 28 U.S.C. § 1711(2). It requires written findings as to any settlement in which class members receive coupons and permits the court to receive expert testimony on the "actual value" of the coupons. 28 U.S.C. § 1712(d) and (e). Further, it places restrictions on how attorney's fees are awarded in coupon settlements by, for example, requiring that the award be based on the value to the class of the coupons that are redeemed. 28 U.S.C. § 1712(a). The statute does not apply to all forms of non-monetary relief and, indeed, permits the use of "a lodestar with a multiplier method" in awarding fees where injunctive relief is obtained. 28 U.S.C. § 1712(b)(2) and (c).

The Seventh Circuit has had occasion to observe that a non-monetary benefit to class members -- pre-paid express envelopes -- had characteristics in common with coupons but were not coupons within the meaning of CAFA, principally because they represented the entire product and not just a discount on the price of the product. Synfuel Technologies, Inc. v. DHL Express (USA), Inc., 463 F.3d 646, 654 (7th Cir. 2006).

Here, the reduction in storage fees may be viewed as a discount **[**16]** on a future purchase and, thus, has an important characteristic in common with a coupon. But unlike a coupon, the discount is not limited to class members. The discount is incapable of transfer because there would be no point to a transfer because the price reduction has no relationship to class membership. Thus, it can have no value in a secondary market. [3] It fairly may be viewed as an across-the-board re-pricing of a component of the total price. Nothing is known of how this pricing component factors into the overall price to the customer. The parties have not presented me with any commitment to refrain from other charges or price increases so that the value of the reduction is quite uncertain.

3 The Third Circuit considered the likely rate of utilization, the transfer feature and the value of the coupons in a secondary market as potential indicators of value. In re General Motors Corp. Pick-Up Truck Fuel Tank Litig., 55 F.3d 768, 806-10 (3d Cir. 1995).

The issue of whether a price reduction available to non-class members is a "coupon" under CAFA is an issue that has not been briefed by the parties, is likely to recur in future cases and need not be resolved in this case. That an item **[**17]** of non-monetary consideration may not fall within the statute's use of the term "coupon" does not make it any less worthy of close judicial scrutiny.

Whether or not the storage fee reduction is a "coupon," its value has not been proven. I recognize that (with or without CAFA) I have the discretion to hear expert testimony on valuation and, indeed, could appoint an expert. Rule 706, Fed. R. Evid. The parties have been afforded the opportunity to present live witnesses but declined to do so and I see no good reason for the Court to appoint an expert under the circumstances described herein.

On this record, the value of the Remedial Consideration has not been proven.

D. Experience of Counsel

Lead plaintiff's counsel has been admitted to practice in the State of New York for 50 years. He and his firm have had extensive class action experience. Defendants' counsel is a top national law firm with extensive experience defending complex **[*433]** and difficult lawsuits. Defendants had the resources to fight the claims through trial and on appeal.

E. The Negotiations

The settlement was achieved as a result of arm's-length negotiations conducted under the supervision of an experienced private mediator, Michael **[**18]** D. Young.

F. Scope and Extent of Discovery

Judging by one of the disputes that came before me, plaintiff's counsel were aggressive in the pursuit of discovery. The parties report that plaintiff conducted nine depositions in this case and that defendants produced thousands of pages of documents.

G. Ability of Defendants to Withstand a Judgment for a Greater Sum

There is no serious question that the defendants could have withstood a judgment for an amount greater than that proposed to be paid in settlement.

H. Reaction of the Class

No class member has objected to the settlement. This speaks in favor of its reasonableness but is not conclusive.

* * * *

Taking all of these factors into account, I conclude that a cash payment of $ 1,500,000 to the members of the class, allocated as indicated above, is fair, reasonable and adequate and it is approved.

III. Attorneys' Fees and Expenses

Plaintiff's counsel seeks a fee award of $ 783,900. In support of the reasonableness of the figure, it reports a "lodestar" of $ 1,310,853. For the reasons more fully explained below, I conclude that an attorneys' fee award of 20% of the cash consideration or $ 300,000 is fair and appropriate.

[HN4] In reviewing a fee application **[**19]** in the class action context "the court is 'to act as a fiduciary who must serve as a guardian of the rights of absent class members'". Cent. States Southeast & Southwest Areas Health & Welfare Fund v. Merck-Medco Managed Care, L.L.C., 504 F.3d 229, 249, 2007 U.S. App. LEXIS 23090, 2007 WL 3033489 at *16 (2d Cir. 2007) (quoting City of Detroit v. Grinnell Corp., 560 F.2d 1093, 1099 (2d Cir. 1977)). The award "must reflect 'the actual effort made by the attorney to benefit the class'." Id.

The Second Circuit has provided substantial guidance to the district courts on common fund fee applications in Goldberger v. Integrated Resources, Inc., 209 F.3d 43 (2d Cir. 2000). Goldberger made plain that the district court has discretion to use either the lodestar or percentage in setting a fee award.

> In sum, we hold that [HN5] both the lodestar and the percentage of the fund methods are available to district judges in calculating attorneys' fees in common fund cases. Of course, no matter which method is chosen, district courts should continue to be guided by the traditional criteria in determining a reasonable common fund fee . . . .

Id. at 50.

Goldberger notes that "the lodestar remains useful as a baseline **[**20]** even if the percentage method is eventually chosen." Id. It serves as "a 'cross-check' on the reasonableness of the requested percentage." Id. (quoting General Motors, 55 F.3d at 820). "Of course, where used as a mere cross-check, the hours documented by counsel need not be exhaustively scrutinized by the district court . . . . Instead, the reasonableness of the claimed lodestar can be tested by the court's familiarity with the case (as well as encouraged by the strictures of Rule 11)." Id. (citations **[*434]** omitted). The Second Circuit's recent opinion in Arbor Hill Concerned Citizens Neighborhood Ass'n v. County of Albany, 493 F.3d 110, 117-18 (2d Cir. 2007), moves away from the concept of a "lodestar" in favor of a "presumptively reasonable fee." "The reasonable hourly rate is the rate a paying client would be willing to pay." Id. at 117.

A. The time and labor expended by counsel.

[HN6] The first of the traditional factors in determining a reasonable common fund fee requires consideration of the time and labor expended by counsel. Id. Here, partner Samuel P. Sporn of Schoengold, Sporn, Laitman & Lometti, P.C., bills at the, rate of $ 675 per hour. One other partner and an "of counsel" each bill **[**21]** at $ 550 per hour. Three associates of varying seniority and experience bill at $ 290, $ 350 and $ 425 per hour. While the record developed by plaintiff's counsel is skimpy, I nevertheless conclude -- for the limited purpose of a cross-check -- that, taking account of the Arbor Hill factors, a paying client would be willing to pay these rates. [4] The 2,838.15 hours are not well-documented beyond a cursory summary. Nevertheless, I will use the $ 1,310,853.50, solely as a cross-check on the reasonableness of the percentage of recovery award.

4 In other areas of the law and based on better developed records, I have approved fees in the $ 400 to $ 555 range. BMS Entertainment/Heat Music LLC v. Bridges, No. 04 Civ. 2584,

2007 U.S. Dist. LEXIS 50256, 2007 WL 1989292 at *2, *4 (S.D.N.Y. July 6, 2007) (partners in copyright suit: $ 400-555; associates: $ 225-440); Martinez v. Port Authority of N.Y. and N.J., No. 01 Civ. 721, 2005 U.S. Dist. LEXIS 19141, 2005 WL 2143333 at *26 (S.D.N.Y. Sept. 2, 2005) (lead trial counsel in civil rights case: $ 400); In re AMF, 334 F. Supp. 2d 462, 467-68 (S.D.N.Y. 2004) (securities class action: partners in range of $ 315 to $ 545 per hour). If I were to reduce Mr. Sporn's rate to $ 550, it would reduce the overall **[**22]** fee calculation by a mere $ 36,625. The figure proposed by plaintiff's counsel is sufficient for cross-check purposes.

B. The magnitude, complexities and risk of the litigation and quality of representation.

In discussing the fairness of the consideration to be paid in settlement, I have addressed the nature and magnitude of the claims, their complexity and the risk of success or failure and I will not do so again.

C. The requested fee in relation to the settlement.

Plaintiff's counsel's proposed fee of $ 783,900 is 18% of plaintiff's full valuation of the settlement, including Remedial Consideration, of $ 4,355,000. When the $ 783,900 is added to the expenses of $ 150,016.44, the total requested fees and expenses, $ 943,916.44, would amount to 63% of the cash component. A fee award of $ 300,000, which I conclude is reasonable, represents 20% of the cash consideration. It is a negative multiplier of the "lodestar" of 4.4. Expenses in this case are $ 150,016.44 and I conclude they are reasonable under the circumstances. Total fees and expenses of $ 450,016.44 will be awarded, which amounts to 30% of the cash component.

D. Public policy considerations.

While at least one other Circuit has **[**23]** viewed 25% of the recovery as a "benchmark," the Goldberger court noted that "we adhere to our prior practice that [HN7] a fee award should be assessed based on scrutiny of the unique circumstances of each case, and 'a jealous regard to the rights of those who are interested in the fund.' 209 F.3d at 53 (citation omitted). Goldberger affirmed a fee award that amounted to 4% of the total recovery. Percentages of 11% to **[*435]** 19% have been awarded in cases with recoveries in the $ 50-75 million range. See id. at 52. Judges of this court have approved fees of 20% of the recovery net of expenses, In re Independent Energy Holdings PLC, No. 00 Civ. 6689, 2003 U.S. Dist. LEXIS 17090, 2003 WL 22244676 at *7-*9 (S.D.N.Y. Sept. 29, 2003), and 20% of the cash and stock, Varljen v. H.J. Meyers & Co., Inc., No. 97 Civ. 6742, 2000 U.S. Dist. LEXIS 16205, 2000 WL 1683656 at *5 (S.D.N.Y. Nov. 8, 2000). One court has approved a fee award of 8% of the total settlement amount. Klein v. Salvi, No. 02 Civ. 1862, 2004 U.S. Dist. LEXIS 4844, 2004 WL 596109 at *11 (S.D.N.Y. March 30, 2004). I recognize that there are judges of this court who have awarded higher percentages in other circumstances.

IV. Differential Payment to Class Representative

The class representative seeks $ 9,600 as an "award" and $ **[**24]** 840 in reimbursement of out-of-pocket expenses in this case. Mr. Silberblatt undertook the selfless task of serving as a representative for the class, a fiduciary responsibility. Absent class members are entitled to repose confidence and trust in a class representative to pursue claims with diligence and refrain from proposing a settlement which is unreasonably low. This confidence derives in large measure from knowing that the class representative stands in the same shoes as all other members of the class. If the class does well, the class representative will do well in the same proportion to others.

[HN8] Payments to class representatives, while not foreclosed, should be closely scrutinized. See Weseley v. Spear, Leeds & Kellogg, 711 F. Supp. 713, 720 (E.D.N.Y. 1989) (Nickerson, J.); see also Brown v. Steinberg, Nos. 84 Civ. 4654, 84 Civ. 4665 and 84 Civ. 8001, 1990 U.S. Dist. LEXIS 13516, 1990 WL 161023 at *3-*4 (S.D.N.Y. Oct. 13, 1990) (Motley, J.). [5] A differential payment may be appropriate in order to make the class representative whole. The representative plaintiff may have lost wages, vacation time or commissions from sales because of time spent at depositions or other proceedings. See, e.g., Varljen v. H.J. Meyers & Co., No. 97 Civ. 6742, 2000 U.S. Dist. LEXIS 16205, 2000 WL 1683656 at *5 n.2 (S.D.N.Y. Nov 8, 2000) **[**25]** ("lost wages" may be recovered). A class representative who has been exposed to a demonstrable risk of employer retaliation or whose future employability has been impaired may be worthy of receiving an additional payment, lest others be dissuaded. See Roberts v. Texaco, Inc., 979 F. Supp. 185, 200-05 (S.D.N.Y. 1997) (extensive findings on risk of retaliation) (Brieant, J.). A balance must be struck so that a class representative does not view his prospect for rewards as materially different from other members of the class, yet is not disadvantaged by his service in pursuing worthy claims. [6]

5 I note that at the outset of a suit brought under the Private Securities Litigation Reform Act ("PSLRA"), a lead plaintiff would be required to certify that he "will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4)." 15 U.S.C. § 78u-4(a)(2)(A)(vi). The PSLRA also provides that "[t]he share of any final judgment or of any settlement that is awarded to a representative party serving on behalf of the class **[**26]** shall be equal, on a per share basis" to the amount awarded to all other members of the class, but goes on to state that "[n]othing in this paragraph shall be construed to limit the award of reasonable costs and expenses (including lost wages) directly relating to the representation of the class to any representative party." 15 U.S.C. § 78u-4(a)(4). This case is not brought under the PSLRA and I give its provisions no weight in this case.

6 I am mindful that other respected judges have viewed a willingness to come forward to faithfully pursue a worthy claim with diligence and success as grounds for some level of award. See, e.g., In re Polaroid, No. 03 Civ. 8335, 2007 U.S. Dist. LEXIS 51983, 2007 WL 2116398 at *3 (S.D.N.Y. July 19, 2007); Sheppard v. Consolidated Edisons, No. 94-cv-0403,

2002 U.S. Dist. LEXIS 16314, 2002 WL 2003206 at *5-*7 (E.D.N.Y. Aug. 1, 2002); Dornberger v. Metropolitan Life Ins. Co., 203 F.R.D. 118, 124-25 (S.D.N.Y. 2001); Genden v. Merrill Lynch, 700 F. Supp. 208, 210 (S.D.N.Y. 1988). An empirical study of incentive awards reveals that they have been granted in 28% of 374 examined cases, including 59% of consumer credit class actions, 46% of employment discrimination class actions and 7% of mass tort actions. T. Eisenberg **[**27]** and G. Miller, Incentive Awards to Class Action Plaintiffs: An Empirical Study, 53 U.C.L.A. L. Rev. 1303, 1322 (2006).

[*436] Here, Mr. Silberblatt reports that he operates an herb farm in Maine and is endeavoring to launch "an entrepreneurial venture in the field of music education." (Silberblatt Aff't, P 2) He spent time "staying informed and involved in the case during the settlement and Court hearing in this matter." (Id., P 4) Prior to the litigation, he pursued the issue with Morgan Stanley and read numerous articles on the subject. (Id., P 6-8) He reviewed drafts of the complaint and traveled to New York before the filing of the action and again for his deposition. (Id., P 10) He asserts that he has spent 240 hours on the matter and should be compensated at the rate of $ 40 per hour. (Id., P 16) Most of the work described is that which any person undertaking the task of class representative ought to expect and should not be compensated out of class funds. The two trips to New York, for which he spent a total of 48 working hours, stand in a different posture and presented a substantial inconvenience to him. Cf. Matter of Cont'l Illinois Sec. Litig., 962 F.2d 566, 571-72 (7th Cir. 1992) **[**28]** (denial of incentive award affirmed where representative spent a few hours at a deposition and there was only a slight risk of exposure to costs or sanctions). Reimbursement of these hours at $ 40 per hour ($ 1,920), plus out-of-pocket expenses of $ 840, is reasonable. The total amount approved for payment to Mr. Silberblatt is $ 2,760.

Conclusion

The settlement is approved. Attorneys' fees of $ 300,000 and expenses of $ 150,016.44 are awarded to plaintiff's counsel. Selwyn Silberblatt may be paid $ 2,760 out of class funds.

SO ORDERED.

/s/ P. Kevin Castel

P. Kevin Castel

United States District Judge

Dated: New York, New York

November 19, 2007

News

knotia.ca

INTERNATIONAL ACCOUNTING STANDARD 2 inventories

CONTENTS

Objective

1 The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

2 **This Standard applies to all inventories, except:**

(a) **work in progress arising under construction contracts, including directly related service contracts (see IAS 11 *Construction Contracts*);**

(b) **financial instruments (see IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*); and**

(c) **biological assets related to agricultural activity and agricultural produce at the point of harvest (see IAS 41 *Agriculture*).**

3 **This Standard does not apply to the measurement of inventories held by:**

(a) **producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.**

(b) **commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.**

4 The inventories referred to in paragraph 3(a) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded from only the measurement requirements of this Standard.

5 Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

Definitions

6 **The following terms are used in this Standard with the meanings specified:**

***Inventories* are assets:**

(a) **held for sale in the ordinary course of business;**

(b) **in the process of production for such sale; or**

(c) **in the form of materials or supplies to be consumed in the production process or in the rendering of services.**

***Net realisable value* is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.**

***Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13 *Fair Value Measurement*.)**

7 Net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

8 Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in

progress being produced, by the entity and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 19, for which the entity has not yet recognised the related revenue (see IAS 18 *Revenue*).

Measurement of inventories

9 **Inventories shall be measured at the lower of cost and net realisable value.**

Cost of inventories

10 **The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

Costs of purchase

11 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

Costs of conversion

12 The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

13 The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

14 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other costs

15 Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For

example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

16 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

17 IAS 23 *Borrowing Costs* identifies limited circumstances where borrowing costs are included in the cost of inventories.

18 An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Cost of inventories of a service provider

19 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

20 In accordance with IAS 41 *Agriculture* inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

Techniques for the measurement of cost

21 Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

22 The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. An average percentage for each retail department is often used.

Cost formulas

23 The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

24 Specific identification of cost means that specific costs are attributed to identified items of inventory. This is the appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable. In such circumstances, the method of

selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss.

25 The cost of inventories, other than those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

26 For example, inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

27 The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net realisable value

28 The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

29 Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

30 Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

31 Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices. Provisions may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions are dealt with under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

32 Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value,

the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

33 A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Recognition as an expense

34 When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

35 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Disclosure

36 The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less costs to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;

(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and

(h) the carrying amount of inventories pledged as security for liabilities.

37 Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.

38 The amount of inventories recognised as an expense during the period, which is often referred to as cost of sales, consists of those costs previously included in the measurement of inventory that has now been sold and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other amounts, such as

distribution costs.

39 Some entities adopt a format for profit or loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.

Effective date

40 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.

40A [Deleted]

40B [used in future updates]

40C IFRS 13, issued in May 2011, amended the definition of fair value in paragraph 6 and amended paragraph 7. An entity shall apply those amendments when it applies IFRS 13.

Withdrawal of other pronouncements

41 This Standard supersedes IAS 2 *Inventories* (revised in 1993).

42 This Standard supersedes SIC-1 *Consistency — Different Cost Formulas for Inventories.*

Court File No. 59725

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE MR.	)	Friday, THE 1st
	)	
JUSTICE TAUSENDFREUND	)	DAY OF June, 2012

BETWEEN:

ALEXANDER DOBBIE and MICHAEL BENSON

Plaintiffs

- and -

ARCTIC GLACIER INCOME FUND, ARCTIC GLACIER INC., KEITH W. MCMAHON, DOUGLAS A. BAILEY, and, in their personal capacities and as trustees of Arctic Glacier Income Fund, JAMES E. CLARK, ROBERT J. NAGY GARY A. FILMON, DAVID R. SWAINE, FRANK G. LARSON and GARY D. COOLEY

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiffs for an Order approving the Settlement Agreement, dated April 25, 2012, was heard on June 1, 2012, at the Belleville Courthouse, 235 Pinnacle Street, Belleville, Ontario

ON READING the materials filed, including the Settlement Agreement, dated April 25, 2012, attached hereto as **Schedule "A"** (the "Settlement Agreement") and on hearing the submissions of counsel for the Plaintiffs and counsel for the Defendants:

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Settlement Agreement.

2. **THIS COURT DECLARES** that the Settlement Agreement is fair, reasonable and in the best interests of the Class.

3. **THIS COURT ORDERS** that the Settlement Agreement is approved pursuant to s.29 of the *CPA*.

4. **THIS COURT ORDERS** that the Settlement Agreement shall be implemented in accordance with its terms.

5. **THIS COURT DECLARES** that the Settlement Agreement, in its entirety, forms part of this Order and is binding upon the Defendants, the Representative Plaintiffs, and upon all Class Members who do not opt out of the Class in accordance with the Approval Notices (as defined below), including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are hereby disposed of.

6. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "B"**, is hereby approved as fair and reasonable and that the Settlement Amount shall be distributed in accordance with the Plan of Allocation after the payment of Class Counsel Fees and Administration Expenses.

7. **THIS COURT ORDERS** that NPT RicePoint be and hereby is appointed the Administrator as defined in the Settlement Agreement.

8. **THIS COURT ORDERS** that the form and content of the Second Long Form Notice, attached hereto as **Schedule "C"**, is hereby approved.

9. **THIS COURT ORDERS** that the form and content of the Second Short Form Notice, attached hereto as **Schedule "D"** (together with the Second Long-Form Notice, the "Approval Notices"), is hereby approved.

10. **THIS COURT ORDERS** that the Opt-Out Form, substantially in the form attached hereto as **Schedule "E"**, is hereby approved.

11. **THIS COURT ORDERS** that the Claim Form, substantially in the form attached hereto as **Schedule "F"**, is hereby approved.

12. **THIS COURT ORDERS** that the Approval Notices, Claim Form and Opt-Out Form shall be disseminated in accordance with the Plan of Notice.

13. **THIS COURT ORDERS** that a person who would otherwise be a Class Member may opt out in accordance with the directions contained in the Second Long Form Notice attached hereto as **Schedule "C"**.

14. **THIS COURT ORDERS** that on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

15. **THIS COURT ORDERS AND DECLARES** that, other than as provided in s. 4.1 (1)(e) of the Settlement Agreement, the Releasees have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

16. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

(a) the Order (except for paragraphs 1, 15 and 16 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party; and

(b) each party to the Action shall be restored to his, her or its respective position in the Action as it existed immediately prior to the execution of the Settlement Agreement.

17. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees from the Released Claims.

18. **THIS COURT ORDERS** that, upon the Effective Date, no Class Member shall institute, continue, maintain or assert, either directly or indirectly, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Released Party or any other person who may claim any form of contribution or indemnity from any Released Party in respect of the Released Claims or any matter related thereto, and are permanently barred and enjoined from doing so.

19. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against the Defendants with prejudice and without costs.

THE HONOURABLE JUSTICE W. TAUSENDFREUND

ORDER ENTERED
77-72
JUN 0 5 2012
1165

SCHEDULE "B"

Court File No.: 59725

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

ALEXANDER DOBBIE and MICHAEL BENSON

Plaintiffs

- and –

ARCTIC GLACIER INCOME FUND, ARCTIC GLACIER INC., RICHARD L. JOHNSON, KEITH W. MCMAHON, DOUGLAS A. BAILEY, FRANK LARSON, GARY COOLEY and, in their personal capacities and as Trustees of Arctic Glacier Income Fund, JAMES E. CLARK, ROBERT J. NAGY, GARY A. FILMON and DAVID R. SWAINE

Proceeding under the *Class Proceedings Act*, 1992

PLAN OF ALLOCATION

(Supplement to the Settlement Agreement, dated April 25, 2012)

DEFINED TERMS

1. For the purposes of this Plan of Allocation, the definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation and, in addition, the following definitions apply:

   (a) "**Acquisition Expense**" means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Units;

   (b) "**Claimant**" means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

   (c) "**Disposition Proceeds**" means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration of the sale of all of his/her/its Eligible Units; provided, however, that with respect to any Eligible Units that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Units still held, multiplied by $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 17, 2008 to September 30, 2008 inclusive];

   (d) "**FIFO**" means the principle of first-in, first-out, wherein Units are deemed to be sold in the same order that they were purchased (i.e. the first Units purchased are deemed to be the first sold); and which requires, in the case of a Claimant who held Units of Arctic Glacier at the commencement of the Class Period, that those Units be deemed to have been sold completely before Eligible Units are sold or deemed sold;

(e) "**Net Loss**" means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(f) "**Net Settlement Amount**" means the Escrow Settlement Amount remaining after payment of Administration Expenses and Class Counsel Fees; and

(g) "**Nominal Entitlement**" means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis upon which each Claimant's *pro rata* share of the Net Settlement Amount is determined.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. A Claimant must have sustained a Net Loss in order to be eligible to receive a payment from the Net Settlement Amount. A Claimant who has not suffered a net loss as calculated hereunder shall not be entitled to receive any portion of the Net Settlement Amount.

3. The Administrator shall first determine whether a Claimant sustained a Net Loss. If the Claimant has sustained a Net Loss, they become an Authorized Claimant, and the Administrator will go on to calculate his/her/its Nominal Entitlement.

4. No Nominal Entitlement shall be allocated in respect Eligible Units acquired by a Class Member in its capacity as an underwriter to an offering of Units made during the Class Period.

5. The Administrator will apply FIFO to distinguish the sale of Arctic Glacier Units held at the beginning of the Class Period from the sale of Eligible Units, and will continue to apply FIFO to determine the purchase transactions which correspond to the sale of Eligible Units. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulas listed below.

6. The date of a purchase, sale or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

7. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any unit splits or consolidations that occur during and after the Class Period, such that the Claimants' holdings for the purposes of the calculations are completed in units equivalent to those traded during the Class Period.

8. A Claimant's Nominal Entitlement will be calculated as follows:

   I. **No Nominal Entitlement shall be attributed to any Eligible Units *disposed of* prior to the first alleged corrective disclosure, that is, *prior to March 6, 2008.***

   II. **For Eligible Units *disposed of* between the first alleged corrective disclosure and the end of the 10 trading day period following the final alleged corrective disclosure on September 17, 2008, that is, *on or between March 6, 2008 and September 30, 2008*, the Nominal Entitlement shall be:**

      A. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Units (without deducting any commissions paid in respect of the disposition).

   III. **For Eligible Units *disposed of* after the 10 trading day period following the second alleged corrective disclosure, that is, *on or after September 30, 2008*, the Nominal Entitlement shall be the lesser of:**

      A. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and the price per share received upon the disposition of those Eligible Units (without deducting any commissions paid in respect of the disposition); and

      B. an amount equal to the number of Eligible Units thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 17, 2008 to September 30, 2008 inclusive].

IV. **For Eligible Units still held at the time the Claim Form is completed, the Nominal Entitlement shall be:**

A. an amount equal to the number of Eligible Units still held, multiplied by the difference between the volume weighted average price paid for those Eligible Units (including any commissions paid in respect thereof) and $1.84 [being the 10 trading day volume weighted average trading price of Arctic Glacier Units on the TSX from September 18, 2008 to September 30, 2008 inclusive].

FINAL DISTRIBUTION

9. Each Claimant's actual compensation shall be the portion of the Net Settlement Amount equivalent to the ratio of his/her/its Nominal Entitlement to the total Nominal Entitlements of all Authorized Claimants multiplied by the Net Settlement Amount, as calculated by the Administrator.

10. Compensation shall be paid to Claimants in Canadian currency.

11. The Administrator will not distribute entitlements of less than $1.00. Such amounts will instead be redistributed pro rata to the other Authorized Claimants.

12. The Administrator shall be authorized to distribute the Net Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

13. If, one hundred eighty (180) days from the date on which the Administrator distributes the Net Settlement Amount to Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques or otherwise), the Administrator shall, if feasible, reallocate such balance among the Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAN$25,000.00, such balance will be donated to FAIR Canada. Under no circumstances will any repayment be made to the Contributing Parties.

Court File No. 08-36143600CP

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	)	Tuesday, THE 4th
	)	
JUSTICE E. BELOBABA	)	DAY OF December, 2012

BETWEEN:

ED J. MCKENNA

Plaintiff

- and -

GAMMON GOLD INC., RUSSELL BARWICK, COLIN P. SUTHERLAND, DALE M. HENDRICK, FRED GEORGE, FRANK CONTE, KENT NOSEWORTHY, CANEK RANGEL, BRADLEY LANGILLE, ALEJANDRO CARAVEO, BMO NESBITT BURNS INC., SCOTIA CAPITAL INC. and TD SECURITIES INC.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiff for an Order approving the settlement agreement, dated October 5, 2012, was heard on December 4, 2012, at 361 University Ave., Toronto, ON, M5G 1T3.

ON READING the materials filed, including the settlement agreement, dated October 5, 2012, attached hereto as **Schedule "A"** (the "Settlement Agreement") and on hearing the submissions of counsel for the Plaintiff and counsel for the Defendants:

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Settlement Agreement.

2. **THIS COURT DECLARES** that the Settlement Agreement is fair, reasonable, and in the best interests of the Class.

3. **THIS COURT DECLARES** that the Settlement Agreement, in its entirety, forms part of this Order and is binding upon the Defendants, the Plaintiff, and upon all Class Members who do not opt out of the Class in accordance with the Approval Notices (as defined below), including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are hereby disposed of.

4. **THIS COURT ORDERS** that the Settlement Agreement is approved pursuant to s.29 of the *Class Proceedings Act, 1992.*

5. **THIS COURT ORDERS** that the Settlement Agreement shall be implemented in accordance with its terms.

6. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "B"**, is hereby approved as fair and appropriate and that the Settlement Amount shall be distributed in accordance with the Plan of Allocation after the payment of Class Counsel Fees and Administration Expenses.

7. **THIS COURT ORDERS** that the form and content of the Second Long Form Notice, attached hereto as **Schedule "C"**, is hereby approved.

8. **THIS COURT ORDERS** that the form and content of the Second Short Form Notice, attached hereto as **Schedule "D"** (together with the Second Long Form Notice, the "Approval Notices"), is hereby approved.

9. **THIS COURT ORDERS** that the Opt-Out Form, attached hereto as **Schedule "E"**, is hereby approved.

10. **THIS COURT ORDERS** that the Claim Form, attached hereto as **Schedule "F"**, is hereby approved.

11. **THIS COURT ORDERS** that the Approval Notices, Claim Form and Opt-Out Form shall be disseminated in accordance with the Plan of Notice.

12. **THIS COURT ORDERS** that a person who would otherwise be a Class Member may opt out in accordance with the directions contained in the Second Long Form Notice.

13. **THIS COURT ORDERS** that on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

14. **THIS COURT ORDERS AND DECLARES** that, other than as provided in s. 4.1(1)(e) of the Settlement Agreement, the Releasees have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

15. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

(a) this Order (except for paragraphs 1, 14 and 15 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party; and

(b) each party to the Action shall be restored to his, her or its respective position in the Action as it existed immediately prior to the execution of the Settlement Agreement.

16. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees from the Released Claims.

17. **THIS COURT ORDERS** that, as of the Effective Date, the Releasors shall not institute, continue, maintain or assert, either directly or indirectly, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Releasee or any other person who may claim any form of contribution or indemnity from any Releasee in respect of the Released Claims or any matter related thereto, and are permanently barred and enjoined from doing so.

18. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against the Defendants with prejudice and without costs.

Ed Belobaba J.

THE HONOURABLE JUSTICE E. BELOBABA

ENTERED AT / INSCRIT A TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

DEC - 6 2012

AS DOCUMENT NO.:
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SCHEDULE "B" - PLAN OF ALLOCATION

Court File No.: 08-36143600CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

ED J. MCKENNA

Plaintiff

- and –

GAMMON GOLD INC., RUSSELL BARWICK, COLIN P. SUTHERLAND, DALE M. HENDRICK, FRED GEORGE, FRANK CONTE, KENT NOSEWORTHY, CANEK RANGEL, BRADLEY LANGILLE, ALEJANDRO CARAVEO, BMO NESBITT BURNS INC., SCOTIA CAPITAL INC. and TD SECURITIES INC.

Defendants

Proceeding under the *Class Proceedings Act, 1992*

PLAN OF ALLOCATION

(Supplement to the Settlement Agreement, dated October 5th, 2012)

DEFINED TERMS

1. The definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation, in addition to the following definitions:

   (a) "**Acquisition Expense**" means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Shares;

   (b) "**Claimant**" means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

   (c) "**Disposition Proceeds**" means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration for the sale of all of the Claimant's Eligible Shares; provided, however, that with respect to any Eligible Shares that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Shares still held, multiplied by CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive];

(d) **"FIFO"** means the principle of first-in, first-out, wherein Shares are deemed to be sold in the same order that they were purchased (i.e. the first Shares purchased are deemed to be the first sold); and which requires, in the case of a Claimant who held Shares of Gammon at the commencement of the Class Period, that those Shares be deemed to have been sold completely before Eligible Shares are sold or deemed to have been sold;

(e) "**Net Loss**" means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(f) "**Net Settlement Amount**" means the Escrow Settlement Amount remaining after payment of Administration Expenses and Class Counsel Fees; and

(g) "**Nominal Entitlement**" means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis upon which each Claimant's *pro rata* share of the Net Settlement Amount is determined.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. A Claimant must have sustained a Net Loss on all purchases in order to be eligible to receive a payment from the Net Settlement Amount. A Claimant that has not suffered a Net Loss as calculated under the Plan of Allocation will not be entitled to receive any portion of the Net Settlement Amount.

3. The Administrator will first determine whether a Claimant has sustained a Net Loss on all purchases. If the Claimant has sustained a Net Loss, the Claimant becomes an "**Authorized Claimant**", and the Administrator will proceed to calculate the Authorized Claimant's Nominal Entitlement.

4. The Administrator will apply FIFO to distinguish the sale of Gammon Shares held at the beginning of the Class Period from the sale of Eligible Shares, and will continue to apply FIFO to determine the purchase transactions that correspond to the sale of Eligible Shares. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulae listed below.

5. The date of a purchase, sale, or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

6. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any splits or consolidations that occurred during and after the Class Period,

such that the Claimants' holdings for the purposes of the calculations are completed in Shares equivalent to those traded during the Class Period.

7. The Net Settlement Amount will be allocated into two separate funds, one for claims relating to Eligible Shares acquired in Gammon's offering conducted pursuant to the Short Form Prospectus dated April 19, 2007 (the "Primary Market Fund"), and one for claims relating to Eligible Shares acquired on the secondary market (the "Secondary Market Fund").

8. An Authorized Claimant's Nominal Entitlement will be calculated as follows:

   I. **No Nominal Entitlement shall be attributed to any Eligible Shares *disposed of* prior to the first alleged corrective disclosure, that is, *prior to May 10, 2007.***

   II. **For Eligible Shares *disposed of* between the first alleged corrective disclosure and the end of the 10 trading day period following the final alleged corrective disclosure on August 10, 2007, that is, *on or between May 10, 2007 and August 24, 2007*, the Nominal Entitlement shall be:**

      A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition);

   III. **For Eligible Shares *disposed of* after the 10 trading day period following the second alleged corrective disclosure, that is, *on or after August 24, 2007*, the Nominal Entitlement shall be the lesser of:**

      A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); and

      B. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive].

IV. **For Eligible Shares still held at the time the Claim Form is completed, the Nominal Entitlement shall be:**

A. an amount equal to the number of Eligible Shares still held, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and CAD$8.85 [being the 10 trading day volume weighted average trading price of Gammon Shares on the TSX from August 13, 2007 to August 24, 2007 inclusive].

FINAL DISTRIBUTION

9. A separate Nominal Entitlement will be calculated for each Authorized Claimant's secondary market and primary market purchases. Whether particular dispositions are of securities purchased on the primary market or on the secondary market will be determined using FIFO.

10. Each Authorized Claimant's actual compensation in respect of primary market purchases will be the portion of the Primary Market Fund equivalent to the ratio of that Claimant's Nominal Entitlement arising from primary market purchases to the total Nominal Entitlements arising from primary market purchases of all Authorized Claimants multiplied by the Primary Market Fund, as calculated by the Administrator.

11. Each Authorized Claimant's actual compensation in respect of secondary market purchases will be the portion of the Secondary Market Fund equivalent to the ratio of that Claimant's Nominal Entitlement arising from secondary market purchases to the total Nominal Entitlements arising from secondary market purchases of all Authorized Claimants multiplied by the Secondary Market Fund, as calculated by the Administrator.

12. The Administrator will not distribute entitlements of less than CAD$5.00 to Class Members. Such amounts will instead be redistributed *pro rata* to the other Authorized Claimants.

13. The Administrator shall be authorized to distribute the Net Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

14. If, one hundred eighty (180) days from the date on which the Administrator distributes the Net Settlement Amount to Authorized Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques, or otherwise), the Administrator shall, if feasible, reallocate such balance among the Authorized Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAD$25,000.00, such balance will be donated to FAIR Canada. Under no circumstances will any repayment be made to the Contributing Parties.

DISPUTE RESOLUTION

15. In the event that a Class Member disputes the Administrator's decision, whether in whole or in part, the Class Member may appeal the decision by submitting a dispute in writing to the Ontario Superior Court of Justice.

Court File No. CV-11-436360-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	)	Monday, THE 26th
	)	
JUSTICE P. M. PERELL	)	DAY OF August, 2013

BETWEEN:

JERZY ROBERT ZANIEWICZ and EDWARD C. CLARKE

Plaintiffs

\- and -

RPORATION, ERNST & YOUNG LLP, FENGYI CAI, JIXU CAI, YANDA
OBIN, MICHAEL W. MANLEY, PATRICK A. RYAN, ELLIOTT WAHLE,
RNISH, CIBC WORLD MARKETS INC., CANACCORD GENUITY CORP.
CORD FINANCIAL LTD)., GMP SECURITIES LP and MACKIE RESEARCH
CAPITAL CORPORATION
(f.k.a. RESEARCH CAPITAL CORPORATION)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION, made by the Plaintiffs for an Order approving (i) a Settlement Agreement dated February 13, 2013 with the defendant, Ernst & Young LLP, (ii) a Settlement Agreement dated April 26, 2013 with the defendants, Matthew Gottlieb as Litigation Receiver of Zungui Haixi Corporation, Michelle Gobin, Michael W. Manley, Patrick A. Ryan, Elliott Wahle and Margaret Cornish, and (iii) a Settlement Agreement dated August 19, 2013 with the defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation, was heard this day at Osgoode Hall, 130 Queen Street West, Toronto, Ontario.

ON READING the materials filed, including the Settlement Agreement dated February 13, 2013 attached hereto as **Schedule "A"** ("Auditor Agreement"), the Settlement Agreement dated April 26, 2013 attached hereto as **Schedule "B"** ("Zungui Agreement"), the Settlement Agreement dated August 19, 2013 attached hereto as **Schedule "C"** ("Underwriter Agreement", collectively with the Auditor Agreement and Zungui Agreement, the "Agreements", and any one which is an "Agreement"), the affidavits of J. Robert Zaniewicz and Edward C. Clarke sworn June 24, 2013 and June 28, 2013, respectively, and the affidavits of Nicholas C. Baker sworn June 28, 2013 and August 20, 2013, and on hearing the submissions of Class Counsel and counsel for the [illegible] appeared in the Action and are signatories under an Agreement (such defendants being the "Settling Defendants");

ON BEING ADVISED that the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP and Mackie Research Capital Corporation consent to the certification of the Action against them, solely for the purposes of settlement;

AND ON BEING ADVISED that the Settling Defendants consent to the relief sought in respect of the Agreements, notice and administration of the Settlements;

AND ON BEING ADVISED that NPT RicePoint Class Action Services Inc. has consented to being appointed the Administrator pursuant to each of the Agreements;

1. **THIS COURT DECLARES** that except as otherwise stated, this Order incorporates and adopts the definitions set out in the Agreements, respectively.

2. **THIS COURT ORDERS** that this action is certified as a class proceeding as against the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., GMP Securities LP and

Mackie Research Capital Corporation for the purpose of settlement only, pursuant to the *Class Proceedings Act, 1992,* S.O. 1992 c.6 ("*CPA*"), ss. 2 and 5, but subject to Articles 8.3 and 10 of the Underwriter Agreement.

3. **THIS COURT ORDERS** that the class certified ("Class"), for the purpose of settlement in accordance with the terms of the Underwriter Agreement is defined as:

> All persons or entities wherever they may reside or be domiciled, other than Excluded Persons and Opt-Out Parties, who acquired Eligible Shares.

4. **THIS COURT ORDERS** that Jerzy Robert Zaniewicz and Edward C. Clarke are appointed as Representative Plaintiffs for the Class for the purpose of settlement in accordance with the terms of the Underwriter Agreement.

5. **THIS COURT ORDERS** that the following issue is common to the Class for the purposes of settlement in accordance with the terms of the Underwriter Agreement:

> Did the IPO Prospectus contain one or more misrepresentations within the meaning of the Securities Act, R.S.O. 1990, c. S.5, as amended, or at common law?

6. **THIS COURT ORDERS** that notice of the certification of the Action against the Settling Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation is hereby dispensed pursuant to section 17(2) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

7. **THIS COURT DECLARES** that the Agreements, individually and collectively, are fair, reasonable and in the best interests of the Class.

8. **THIS COURT ORDERS** that the Agreements are approved pursuant to section 29 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

9. **THIS COURT DECLARES** that all provisions of each of the Agreements in its entirety (including the Recitals and Definitions set out in sections 1 and 2 of each) form part of this Order and are binding upon the Settling Defendants (and the Related Defendants for purposes of section 13 of the Auditor Agreement) in accordance with the terms thereof, and upon the Plaintiffs and all Class Members that did not opt-out of this Action in accordance with paragraph 6 of the Certification and First Notice Orders in this Action, both of which were dated May 21, 2013, including those persons that are minors or mentally incapable.

10. **THIS COURT ORDERS** that all claims, direct and indirect, including but not limited to claims for contribution and indemnity or other claims over, whether asserted, unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims and any other claims which were or could have been brought in this Action or otherwise by any Defendant or any other Person against any other Defendant are barred, prohibited and enjoined.

11. **THIS COURT DECLARES** that compliance with the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure*, R.R.O. Reg. 194 is hereby dispensed with.

12. **THIS COURT ORDERS** that each Agreement shall be implemented in accordance with its terms.

13. **THIS COURT DECLARES** that the Plan of Allocation, attached hereto as **Schedule "D"**, is fair and appropriate.

14. **THIS COURT ORDERS** that the Plan of Allocation is approved and that the Settlement Amount under each Agreement shall be distributed in accordance with the terms of the applicable

Agreement, following payment of Class Counsel Fees (to be approved) and Administration Expenses.

15. **THIS COURT ORDERS** that NPT RicePoint Class Action Services Inc. is hereby appointed as the Administrator pursuant to each Agreement.

16. **THIS COURT ORDERS** that the Plan of Notice, attached hereto as **Schedule "E"**, is hereby approved for the purpose of the publication and dissemination of the Short Form Notice of Settlement, Long Form Notice of Settlement and Claim Form.

17. **THIS COURT ORDERS** that the form and content of the Short Form Notice of Settlement, attached hereto as **Schedule "F"** is hereby approved.

18. **THIS COURT ORDERS** that the form and content of the Long Form Notice of Settlement, attached hereto as **Schedule "G"**, is hereby approved.

19. **THIS COURT ORDERS** that the form and content of the Claim Form, attached hereto as **Schedule "H"**, is hereby approved.

20. **THIS COURT ORDERS** that the Plaintiffs and the Settling Defendants may, on notice to the Court but without the need for a further order of the Court, agree to reasonable extensions of time to carry out any of the provisions of the Agreements.

21. **THIS COURT ORDERS AND DECLARES** that, other than as provided in section 4.1 of each Agreement, respectively, the Releasees (however defined) have no responsibility for and no liability whatsoever with respect to the administration of the Agreement pursuant to which they have been released.

22. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Releasors under each Agreement shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Releasees under each Agreement from the Released Claims (however defined) in each Agreement.

23. **THIS COURT ORDERS** that, within ten (10) business days of this Order, the insurer of Zungui Haixi Corporation shall pay to Siskinds LLP in trust the sum of CAD $100,000.00 which shall be added to the existing Settlement Amount paid under the Zungui Agreement.

24. **THIS COURT ORDERS** that, upon the Effective Date, the Action shall be dismissed against all Defendants with prejudice and without costs.

25. **THIS COURT ORDERS** that, upon the Effective Date, the Bardi Action be dismissed with prejudice and without costs.

Perell. J

THE HONOURABLE JUSTICE P.M. PERELL

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO:

AUG 27 2013

AS DOCUMENT NO.:
À TITRE DE DOCUMENT NO.:
PER / PAR:

Court File No.: CV-11-436360-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

JERZY ROBERT ZANIEWICZ and EDWARD C. CLARKE

Plaintiffs

- and -

ZUNGUI HAIXI CORPORATION, ERNST & YOUNG LLP, FENGYI CAI, JIXU CAI, YANDA CAI, MICHELLE GOBIN, MICHAEL W. MANLEY, PATRICK A. RYAN, ELLIOTT WAHLE, MARGARET CORNISH, CIBC WORLD MARKETS INC., CANACCORD GENUITY CORP. (f.k.a. CANACCORD FINANCIAL LTD)., GMP SECURITIES LP and MACKIE RESEARCH CAPITAL CORPORATION (f.k.a. RESEARCH CAPITAL CORPORATION)

Defendants

Proceeding under the *Class Proceedings Act, 1992*

PLAN OF ALLOCATION

(Supplement to the Settlement Agreements, dated February 13, 2013 and April 26, 2013)

DEFINED TERMS

1. The definitions set out in the Settlement Agreements, dated February 13, 2013 and April 26, 2013 apply to and are incorporated into this Plan of Allocation, in addition to the following definitions:

   (a) **"Acquisition Expense"** means the total monies paid by the Claimant (including brokerage commissions) to acquire Eligible Shares;

   (b) **"Allocation Pool"** means the sum of the Settlement Amounts paid under the Settlement Agreements dated February 13, 2013 and April 26, 2013 after payment of Administration Expenses and Class Counsel Fees. For greater certainty, Allocation Pool includes the after tax amount of any accrued interest income on the Settlement Amounts;

   (c) **"Claimant"** means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Bar Deadline;

(d) **"Discounted Nominal Entitlement"** means a Claimant's Nominal Entitlement less the discount provided for herein, and which forms the second step upon which each Claimant's *pro rata* share of the Allocation Pool is determined;

(e) **"Disposition Proceeds"** means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration for the sale of all of the Claimant's Eligible Shares;

(f) **"FIFO"** means the principle of first-in, first-out, wherein shares are deemed to be sold in the same order that they were purchased (i.e. the first shares purchased are deemed to be the first sold);

(g) **"Net Loss"** means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(h) **"Net Other Settlement Amount"** means the settlement amount of the approved settlement in the Action with the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation, after payment of Administration Expenses and Class Counsel Fees. For greater certainty, Net Other Settlement Amount includes the after tax amount of any accrued interest income on the settlement amount;

(i) **"Nominal Entitlement"** means a Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the first step upon which each Claimant's *pro rata* share of the Allocation Pool is determined;

(j) **"Primary Market Purchasers"** means Claimants who bought Eligible Shares on an "if, as and when issued" basis under Zungui's initial public offering pursuant the Zungui IPO Prospectus dated December 11, 2009;

(k) **"Secondary Market Purchasers"** means Claimants who bought Eligible Shares on a stock exchange (e.g. the Toronto Stock Exchange) or alternative trading system (e.g. Pure Trading, Omegan and Alpha Venture);

(l) **"Settlement Amounts"** means CAD $8.1 million, and CAD $2 million; and

(m) **"Share Exchange Acquirors"** means Claimants who received Eligible Shares under the Share Exchange Agreement.

CALCULATION OF NET LOSS AND NOMINAL ENTITLEMENT

2. The Allocation Pool and any Net Other Settlement Amount will be distributed in accordance with the Plan of Allocation described herein.

3. A Claimant must have sustained a Net Loss on all Eligible Shares in order to be eligible to receive a payment from the Allocation Pool and, if applicable, any Net Other

Settlement Amount. A Claimant that has not suffered a Net Loss as calculated under the Plan of Allocation will not be entitled to receive any portion of the Allocation Pool or any portion of a Net Other Settlement Amount.

4. First, the Administrator will determine whether a Claimant has sustained a Net Loss on all Eligible Shares. If the Claimant has sustained a Net Loss, the Claimant becomes an **"Authorized Claimant"**, and the Administrator will proceed to calculate the Authorized Claimant's Nominal Entitlement.

5. The date of an acquisition, sale or deemed disposition shall be the trade date of the transaction, as opposed to the settlement date, except for an acquisition of Eligible Shares under the Share Exchange Agreement in which case it shall be the date of acquisition recorded in Zungui's securities register or branch register as may be the case.

6. For the purposes of any calculation relating to Eligible Shares acquired under the Share Exchange Agreement, the Administrator will account for such shares on a post-exchange cost of acquisition basis.

7. Second, the Administrator will calculate an Authorized Claimant's Nominal Entitlement according to the formulae listed below. The formulae reflect the opinion of the Plaintiffs' valuation expert as advanced in the Proceeding; namely, that the price of Zungui shares was corrected by statistically significant events on June 2, 2011, and August 22, 2011. Where applicable, certain formulae also reflect that Zungui shares last traded at CAD $0.34, and have been unable to trade since August 23, 2011.

8. Third, the Administrator will calculate an Authorized Claimant's Discounted Nominal Entitlement by applying the appropriate percentage discounts listed below. The discounts take into account the strengths and weaknesses of the claims made and proposed to be made in the Action by and on behalf of Primary Market Purchasers, Secondary Market Purchasers and Share Exchange Acquirors against the Settling Defendants.

<u>**Primary Market Purchasers**</u>

9. The Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be recognized for any Eligible Shares *disposed of before June 2, 2011.***

II. **For Eligible Shares *disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. **For Eligible Shares *disposed of on or after August 22, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

IV. **For Eligible Shares *still held at the time the Claim Form is completed*, the Nominal Entitlement shall be the sum of Eligible Shares still held multiplied by CAD $1.86 per share.**

<u>Secondary Market Purchasers</u>

10. The Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be recognized for any Eligible Shares *purchased and disposed of before June 2, 2011.***

II. **For Eligible Shares *purchased before June 2, 2011 and disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. **For Eligible Shares** ***purchased from June 2, 2011 to and including August 19, 2011 and disposed of on or after August 22, 2011*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.26.

IV. **For Eligible Shares** ***purchased from June 2, 2011 to and including August 19, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.60 per share.

V. **For Eligible Shares** ***purchased before June 2, 2011 and disposed of on or after August 22, 2011*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

VI. **For Eligible Shares** ***purchased before June 2, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.86 per share.

VII. **For Eligible Shares** ***purchased on August 22, 2011 and still held at the time the Claim Form is completed*****, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares still held multiplied by the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $0.34.

<u>Share Exchange Acquirors</u>

11. The Nominal Entitlement will be calculated as follows:

I. No Nominal Entitlement shall be recognized for any Eligible Shares *disposed of before June 2, 2011.*

II. For Eligible Shares *disposed of from June 2, 2011 to and including August 19, 2011*, the Nominal Entitlement shall be the lesser of:

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $0.26.

III. For Eligible Shares *disposed of on or after August 22, 2011*, the Nominal Entitlement shall be the lesser of:

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the price paid for those Eligible Shares (including any commissions paid in respect thereof) and the average price per share received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); or

B. the sum of Eligible Shares disposed of multiplied by CAD $1.52.

IV. For Eligible Shares *still held at the time the Claim Form is completed*, the Nominal Entitlement shall be the lesser of:

A. an amount equal to the number of Eligible Shares still held multiplied by the price paid for those Eligible Shares (including any commissions paid in respect thereof); or

B. the sum of Eligible Shares still held multiplied by CAD $1.86 per share.

FINAL DISTRIBUTION

12. A separate Nominal Entitlement will be calculated for each Authorized Claimant's Share Exchange acquisition, Primary Market and Secondary Market purchases, as may be the case. Whether particular dispositions are of Zungui shares acquired pursuant to the Share Exchange Agreement, purchased in the Primary Market or in the Secondary Market will be determined using FIFO.

13. The Discounted Nominal Entitlement will be calculated for Authorized Claimants' Share Exchange acquisition, Primary Market and Secondary Market purchases by subtracting the applicable percentage amount below from the Nominal Entitlement:

(a) For Share Exchange Acquirors, 40%;

(b) For Primary Market Purchasers, 0%; and

(c) For Secondary Market Purchasers

(i) that purchased in the period from and including December 21, 2009 to and including August 19, 2011, 8%; and

(ii) that purchased on August 22, 2011 and still held some of those Zungui shares at the time the Claim Form is completed, ~~98.5%~~ 80.0% ✓PMP.

14. Each Authorized Claimant's actual compensation shall be the portion of the Allocation Pool equivalent to the ratio of his/her/its Discounted Nominal Entitlement, to the total Discounted Nominal Entitlements of all Authorized Claimants multiplied by the Allocation Pool, as calculated by the Administrator.

15. In the event of an approved settlement in the Action with the Defendants, CIBC World Markets Inc., Canaccord Genuity Corp., f.k.a. Canaccord Financial Ltd., GMP Securities LP, and Mackie Research Capital Corporation, f.k.a. Research Capital Corporation:

(a) the Net Other Settlement Amount shall be solely for the benefit of and distribution to Authorized Claimants who are Primary Market Purchasers; and

(b) the compensation to be paid to an Authorized Claimant who is a Primary Market Purchaser from any Net Other Settlement Amount shall be:

(i) in addition to any compensation received from the Allocation Pool for Primary Market purchases; and

(ii) that portion of the Net Other Settlement Amount equivalent to the ratio of his/her/its Discounted Nominal Entitlement for Primary Market purchases, to the total Discounted Nominal Entitlements for all Primary Market purchases multiplied by the Net Other Settlement Amount.

16. The Administrator will not distribute entitlements of less than CAD$5.00 to Class Members. Such amounts will instead be redistributed *pro rata* to the other Authorized Claimants.

17. The Administrator shall be authorized to distribute the Allocation Pool and any Net Other Settlement Amount in accordance with this Plan of Allocation upon having received and reviewed the Claim Forms submitted by the Claims Bar Deadline without further order of the Court.

18. If, one hundred eighty (180) days from the date on which the Administrator distributes the Allocation Pool and any Net Other Settlement Amount to Authorized Claimants, the Escrow Account remains in a positive balance (whether due to tax refunds, uncashed cheques, or otherwise), the Administrator shall, if feasible, reallocate such balance among the Authorized Claimants in an equitable and economic fashion. In the event any such remaining balance is less than CAD$25,000.00 or less than $5.00 per Claimant, the Administrator will donate such balance to the Small Investor Protection Association (Canada), *cy pres*.

Court File No. 58574CP

ONTARIO
SUPERIOR COURT OF JUSTICE

THE HONOURABLE	)	Friday, THE 18 DAY
	)	
JUSTICE LYNNE LEITCH	)	OF Feb., 2011

BETWEEN:

METZLER INVESTMENT GMBH

Plaintiff

and

GILDAN ACTIVEWEAR INC., GLENN J. CHAMANDY, GLENN J. CHAMANDY HOLDINGS CORPORATION, and LAURENCE G. SELLYN

Defendants

Proceeding under the *Class Proceedings Act, 1992*

ORDER

THIS MOTION made by the Representative Plaintiff for, *inter alia,* an Order approving and implementing the Settlement Agreement dated August 2, 2010 (the "Settlement Agreement"), entered into between the parties herein and the parties to parallel class actions proceeding in Québec and in the United States was heard was heard in London, Ontario on January 25, 2011.

ON READING the materials filed, including the Settlement Agreement attached as Schedule "A," and on hearing the submissions of counsel for the Representative Plaintiff and counsel for the Defendants:

1. **THIS COURT DECLARES** that, except as otherwise stated, this Order incorporates and adopts the definitions set forth in the Settlement Agreement.

2. **THIS COURT DECLARES** that the settlement provided for in the Settlement Agreement is fair, reasonable and in the best interests of members of the Ontario Class.

3. **THIS COURT ORDERS** that the Settlement Agreement attached to this Order as **Schedule "A"** is hereby approved pursuant to s.29 of the *Class Proceedings Act, 1992*.

4. **THIS COURT ORDERS** that the Settlement Agreement forms part of this Order and is binding upon the Representative Plaintiff and upon all members of the Ontario Class including those persons who are minors or mentally incapable, and that the requirements of Rules 7.04(1) and 7.08(4) of the *Rules of Civil Procedure* are disposed of in respect of the Ontario Action, and the Settlement Agreement shall be implemented in accordance with its terms.

5. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, the Representative Plaintiff and each member of the Ontario Class, on behalf of themselves, their personal representatives, agents, heirs, executors, administrators, trustees, beneficiaries, former and current employee plan members and contributors, successors and assigns, and any person they represent in relation to Gildan common stock purchased or otherwise acquired during the Class Period or in relation to the Settled Claims (all of the foregoing persons and entities are collectively referred to as the "Ontario Class Releasors"), shall release and discharge, and shall be conclusively deemed to have fully, finally and forever released and discharged the Released Parties from the Settled Claims.

6. **THIS COURT ORDERS AND DECLARES** that, upon the Effective Date, each of the Ontario Class Releasors shall consent and shall be deemed to have consented to the dismissal without costs and with prejudice of any other action or proceeding he, she or it has commenced against the Released Parties with respect to a Settled Claim, and is

hereby permanently barred and enjoined from instituting, commencing or prosecuting any Settled Claim against the Released Parties.

7. **THIS COURT ORDERS** that, upon the Effective Date, the Ontario Class Releasors shall not institute, continue, maintain or assert, either directly or indirectly, whether in the United States, Canada or elsewhere, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, proceeding, complaint, claim or demand against any Released Party or any other person who may claim any form of contribution or indemnity from any Released Party in respect of any Settled Claim or any matter related thereto, and are permanently barred and enjoined from doing so.

8. **THIS COURT ORDERS** that, upon the Effective Date, the Defendant Releasors release and forever discharge each and every one of the Settled Defendants' Claims against any of the Released Plaintiff Parties, and are hereby forever barred and enjoined from prosecuting a Settled Defendants' Claim against the Released Plaintiff Parties.

9. **THIS COURT ORDERS** that neither this Order, the Settlement Agreement, nor any of their terms and provisions, nor any of the negotiations or proceedings connected with the Settlement Agreement, nor any of the documents or statements referred to therein shall be:

(a) offered or received against the Released Parties as evidence of or construed as or deemed to be evidence of any presumption, concession or admission by any of the Defendants with respect to the truth of any fact alleged in the Fresh as Amended Statement of Claim or the validity of any claim that has been or could have been asserted in the Ontario Action or in any litigation, or the deficiency of any defence that has been or could have been asserted in the Ontario Action, or in any litigation, or of any liability, negligence, fault, or wrongdoing of the Released Parties;

(b) offered or received against the Released Parties as evidence of a presumption, concession or admission of any fault, misrepresentation or omission with respect to any statement or written document approved or made by any of the Released Parties;

(c) offered or received against the Released Parties as evidence of a presumption, concession or admission with respect to any liability, negligence, fault or wrongdoing or in any way referred to for any other reason as against any of the Released Parties, in any other civil, criminal or administrative action or proceeding, other than such proceedings as may be necessary to enforce and give effect to the provisions of the Settlement Agreement; provided, however, that the Released Parties may refer to it to effect the release and liability protection granted them hereunder;

(d) construed against the Released Parties as an admission or concession that the consideration to be given hereunder represents the amount which could be or would have been recovered after trial; or

(e) construed as or received in evidence as an admission, concession or presumption against the Representative Plaintiff or any member of the Ontario Class that any of their claims are without merit, or that any defences asserted by the Defendants have any merit, or that damages recoverable under the Fresh as Amended Statement of Claim would not have exceeded the amounts set forth under the Settlement Agreement.

10. **THIS COURT DECLARES** that the Plan of Allocation, attached as Schedule "A" to the Settlement Agreement, is approved as fair and reasonable.

11. **THIS COURT ORDERS** that this Court shall retain jurisdiction over the parties herein, the members of the Ontario Class, the Escrow Agent and the Administrator for all matters relating to the Ontario Action and the Ontario Class, including the administration, interpretation, effectuation or enforcement of the Settlement Agreement and this Order, and including any application for fees and expenses incurred by or paid to counsel for the Plaintiff and the Administrator in overseeing and administering the Settlement Agreement, in distributing settlement proceeds to members of the Ontario Class, and in complying with the terms of this Order.

12. **THIS COURT ORDERS** that, on notice to the Court but without further order of the Court, the parties to the Settlement Agreement may agree to reasonable extensions of time to carry out any of the provisions of the Settlement Agreement.

13. **THIS COURT ORDERS AND DECLARES** that the Released Parties have no responsibility for and no liability whatsoever with respect to the administration of the Settlement Agreement.

14. **THIS COURT ORDERS** that if the Settlement Agreement is terminated pursuant to any rights of termination therein, then:

(a) this Order (except for paragraphs 1, 9, 11, 13 and 14 herein) shall be set aside, be of no further force or effect, and be without prejudice to any party;

(b) the Ontario Action shall be immediately decertified as a class proceeding pursuant to Section 10 of the *Class Proceedings Act, 1992*, without prejudice to the

Representative Plaintiff's ability to reapply for certification and the Defendants' ability to oppose certification on any and all grounds; and

(c) each party to the Ontario Action shall be restored to his, her or its respective position in the Ontario Action as it existed immediately prior to the execution of the Settlement Agreement.

15. **THIS COURT ORDERS AND ADJUDGES** that, upon the Effective Date, the Ontario Action shall be and is hereby dismissed against the Defendants with prejudice and without costs.

Date: Feb 24 - 2011

~~THE HONOURABLE JUSTICE LYNNE LEITCH~~
Registrar.

ORDER ENTERED
77-72
FEB 2 4 2011

SCHEDULE "A" – PLAN OF ALLOCATION

DEFINED TERMS

1. For the purposes of this Plan of Allocation, the definitions set out in the Settlement Agreement apply to and are incorporated into this Plan of Allocation and, in addition, the following definitions apply:

   (a) "**Acquisition Expense**" means the total monies paid by the Claimant (including brokerage commissions) to purchase or otherwise acquire Eligible Shares;

   (b) "**Authorized Canadian Claimant**" means an Authorized Claimant who purchased or otherwise acquired their Eligible Shares on the TSX, or who was a Canadian resident at the time some or all of their Eligible Shares were purchased or acquired, regardless of the exchange over which the Eligible Shares were purchased or acquired. For the purposes of this Plan of Allocation, residency shall be confirmed by consideration of a Claimant's address at the time their Eligible Shares were purchased or acquired;

   (c) "**Authorized U.S. Claimant**" means an Authorized Claimant who purchased or otherwise acquired their Eligible Shares on the NYSE, other than Canadian residents. Where an Authorized U.S. Claimant has acquired Eligible Shares on both the TSX and NYSE, such claimant will be treated as an Authorized U.S. Claimant with respect to those Eligible Shares acquired on the NYSE and as an Authorized Canadian Claimant with respect to those Eligible Shares acquired on the TSX;

   (d) "**Claimant**" means a Class Member who submits a properly completed Claim Form and all required supporting documentation to the Administrator, on or before the Claims Deadline;

   (e) "**Disposition Proceeds**" means the total proceeds paid to the Claimant (without deducting any commissions paid in respect of the dispositions) in consideration of the sale of all of their Eligible Shares; provided, however, that with respect to any Eligible Shares that the Claimant continues to hold, they shall be deemed to have been disposed of for an amount equal to the number of Eligible Shares still held, multiplied by the difference between the average price per common share paid for those Eligible Shares (including any commissions paid in respect thereof determined on a per common share basis) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97.

   (f) "**FIFO**" means the principle of first-in first-out, wherein common shares are deemed to be sold in the same order that they were purchased or otherwise acquired (i.e. the first common shares purchased or otherwise acquired are deemed to be the first sold); and which requires, in the case of a Claimant who held common shares of Gildan at the commencement of the Class Period, that those common shares be deemed to have been sold completely before Eligible Shares are sold, or deemed sold;

(g) "**Net Loss**" means that the Claimant's Disposition Proceeds are less than the Claimant's Acquisition Expense;

(h) "**Nominal Entitlement**" means an Authorized Claimant's nominal damages as calculated pursuant to the formula set forth herein, and which forms the basis of each Authorized Claimant's *pro rata* share of the Net Settlement Amount.

CALCULATION OF NET LOSS

2. A Claimant must have sustained a Net Loss in order to be eligible to receive a payment from the Net Settlement Amount.

3. The Administrator shall first determine whether a Claimant sustained a Net Loss. If the Claimant has sustained a Net Loss they become an Authorized Claimant, and the Administrator will go on to calculate their Nominal Entitlement.

CALCULATION OF COMPENSATION

4. The Administrator will apply FIFO to distinguish the sale of Gildan common shares held at the beginning of the Class Period from the sale of Eligible Shares, and will continue to apply FIFO to determine the purchase or acquisition transactions which correspond to the sale of Eligible Shares. The Administrator will use this data in the calculation of an Authorized Claimant's Nominal Entitlement according to the formulas listed below.

5. The date of sale or deemed disposition shall be the trade date, as opposed to the settlement date, of the transaction.

6. For the purposes of any calculation under the Plan of Allocation, the Administrator will account for any stock splits or consolidations that occur after the Class Period, such that Authorized Claimants' holdings for the purposes of the calculations are completed in units equivalent to those traded during the Class Period.

7. An Authorized Claimant's Nominal Entitlement will be calculated as follows:

I. **No Nominal Entitlement shall be available for any Eligible Shares *disposed of* prior to the first alleged corrective disclosure, that is, *prior to April 29, 2008.***

II. **For Eligible Shares *disposed of* during the 10 trading day period following the alleged corrective disclosure, that is, *on or between April 29 and May 12, 2008*, the Nominal Entitlement shall be:**

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the per share price received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition).

III. **For Eligible Shares *disposed of* after the 10 trading day period following the alleged corrective disclosure, that is, *after the close of trading on May 12, 2008*, the Nominal Entitlement shall be the lesser of:**

A. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and the per share price received upon the disposition of those Eligible Shares (without deducting any commissions paid in respect of the disposition); and

B. an amount equal to the number of Eligible Shares thus disposed of, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97 [in both cases being the 10 trading day volume weighted average trading price of Gildan common shares from April 29 to May 12, 2008].

IV. For Eligible Shares still held at the time the Claim Form is completed, the Nominal Entitlement shall be:

A. an amount equal to the number of Eligible Shares still held, multiplied by the difference between the volume weighted average price paid for those Eligible Shares (including any commissions paid in respect thereof) and (i) in the case of TSX transactions CAD$26.51; or (ii) in the case of NYSE transactions USD$25.97 [in both cases being the 10 trading day volume weighted average trading price of Gildan common shares from April 29 to May 12, 2008].

FINAL DISTRIBUTION

8. 89% of the Net Settlement Fund is allocated for *pro rata* distribution among Authorized Canadian Claimants. Such distributions shall be made in Canadian currency. The remaining 11% of the Net Settlement Fund shall be distributed in U.S. currency on a *pro rata* basis among Authorized U.S. Claimants.

9. Once all Nominal Entitlements have been calculated, the Administrator will convert the Nominal Entitlements of all Authorized Canadian Claimants who conducted transactions on the NYSE from U.S. currency to Canadian currency based on the exchange rate as of the date the currency conversion is performed. After currency conversion, the Nominal Entitlements of all Authorized Canadian Claimants will be recorded in Canadian currency.

IN RE AOL TIME WARNER, INC. SECURITIES AND "ERISA" LITIGATION

MDL Docket No. 1500, 02 Civ. 5575 (SWK)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2006 U.S. Dist. LEXIS 17588

April 6, 2006, Decided
April 6, 2006, Filed

SUBSEQUENT HISTORY: Stay lifted by, Objection denied by In re Aol Time Warner, Inc. Secs. Litig., 2006 U.S. Dist. LEXIS 49162 (S.D.N.Y., July 13, 2006)

PRIOR HISTORY: In re AOL Time Warner, Inc., Sec. & ERISA Litig., 2005 U.S. Dist. LEXIS 3715 (S.D.N.Y., Mar. 9, 2005)

CORE TERMS: settlement, notice, class members, class action, discovery, reasonableness, billion, settlement fund, negotiation, adequacy, stock, distributed, putative, lawsuit, securities laws, advertising, special master, citations omitted, certification, accounting, movant's, estimated, objector's, investor, shareholder, fraudulent, causation, calculation, methodology, deposition

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JUDGES: SHIRLEY WOHL KRAM, UNITED STATES DISTRICT JUDGE.

OPINION BY: SHIRLEY WOHL KRAM

OPINION

OPINION & ORDER

SHIRLEY WOHL KRAM, U.S.D.J.

This Opinion considers the fairness of a $ 2.65 billon class action settlement (the "Settlement") reached in the securities litigation arising from America Online, Inc. ("AOL") and AOL Time

Warner, Inc.'s ("AOLTW") allegedly fraudulent accounting of advertising revenue during, and in the years immediately preceding, AOL's merger with Time Warner, Inc. ("Time Warner"). [1] Coming on the heels of AOLTW's $ 150 million settlement **[*7]** with the Department of Justice ("DOJ") [2] and its $ 300 million settlement with the Securities and Exchange Commission ("SEC"), this Settlement marks the conclusion of the primary shareholder lawsuit against the Company.

1 Although Defendant AOLTW has changed its name to Time Warner, Inc., for clarity, the Court will continue to refer to the merged entity as AOLTW, or the Company.

2 The DOJ directed that the $ 150 million fund established by its settlement with the Company be used for AOLTW's settlement of securities litigation. AOLTW allocated that entire sum to the instant Settlement, in addition to the $ 2.4 billion provided by AOLTW and the $ 100 million provided by AOLTW's auditor, Ernst & Young LLP ("Ernst & Young"), under the terms of the Settlement. The Settlement's inclusion of the entire $ 150 million from the DOJ settlement is the basis of one of the objections discussed below. *See infra* Part II.E.1.

Although Lead Plaintiff's Counsel distributed approximately 4.7 million Settlement notifications **[*8]** to putative Class Members, the Court has received only six objections to various facets of the Settlement, one of which was withdrawn prior to the fairness hearing. [3] Of the remaining objections, two contest the reasonableness of the Settlement amount, and there are individual objections to the adequacy of the Class representative, the Settlement Notice, and the Plan of Allocation. After briefly commenting on the Court's earlier certification of the Settlement Class, reviewing the standards for the approval of class action settlements, and addressing the aforementioned objections, the Court grants Lead Plaintiff's petition for approval of the Settlement.

3 As explained in greater detail below, two of the six objections were filed by parties acknowledging that they are not members of the Class, including the party that withdrew its objection. *See infra* Parts I.C & II.E. Plaintiffs allege that two of the other objectors also lack standing to object to the Settlement.

I. Background

This Settlement is **[*9]** the culmination of over three years of litigation and seven months of mediation with a Court-appointed special master. The relevant history of the litigation through May 5, 2004 is described in the Court's Opinion considering Defendants' motions to dismiss. *See In re AOL Time Warner Sec. & "ERISA" Litig.,* 381 F. Supp. 2d 192 (S.D.N.Y. 2004). The Court presumes familiarity with that Opinion.

A. The Fraudulent Accounting Allegations

In brief, Plaintiffs allege that AOL and AOLTW improperly accounted for dozens of advertising transactions, inflating revenue for fifteen quarters between 1998 and 2002. These transactions were allegedly designed to create the appearance that they were generating revenue, despite providing completely illusory benefits to the Company.

Plaintiffs describe myriad sham transactions between AOLTW and over a dozen separate companies. For example, Plaintiffs allege that AOLTW engaged in a number of three-legged "round-trip" transactions with the internet vendor Homestore. In the first "leg" of such transactions, Homestore would pay a third party for services and products that it did not need. In the second leg, the third party would **[*10]** purchase advertising from AOLTW with the money it received from Homestore. Finally, AOLTW would purchase advertising from Homestore in substantially the same amount as the third-party's purchase of advertising from AOLTW. While capital flowed to each of the parties and appeared to increase AOLTW's advertising revenue, the parties received no real benefits apart from their inflated earnings statements. *See In re AOL Time Warner,* 381 F. Supp. 2d at 226. These round-trip transactions are representative, but hardly exhaustive, of Plaintiffs' allegations. [4]

4 AOLTW is also alleged to have employed such techniques as "jackpotting" (repetitive display of an advertising partner's advertisements immediately before a reporting period), the conversion of non-advertising proceeds into advertising revenues, and the impermissible double-booking of valid advertising revenue. (Second Am. Compl. P15.)

Ultimately, Plaintiffs allege that these fraudulent schemes resulted in AOLTW's overstatement of revenue by **[*11]** at least $ 1.7 billion, inflating the value of AOLTW stock and causing billions of dollars in damage to investors, in violation of the federal securities laws.

B. Motion Practice

The Court evaluated Defendants' motions to dismiss the Complaint, and, on May 5, 2004, issued an opinion denying the motions in large part and preserving a wide variety of claims against AOLTW, Ernst & Young, and a half dozen individual defendants. Shortly thereafter, the Court granted Plaintiffs leave to amend their Complaint. Plaintiffs filed a Second Amended Complaint on August 23, 2004.

Subsequent to the Court's denial of Defendants' motions to dismiss, Plaintiffs initiated formal discovery and began reviewing over 15.5 million documents turned over by AOLTW. (Heins Decl. P7, Dec. 2, 2005.) In addition, Plaintiffs responded to Defendants' substantial document requests and interrogatories, battled over various aspects of their and Defendants' discovery requests, and engaged in extensive negotiations to address Defendants' claims to privileged documents. (Heins Decl. PP65-69.) On the basis of relevant discovered materials, Plaintiffs not only supplemented their existing claims, but eventually drafted **[*12]** a Third Amended Complaint and petitioned the Court for leave to amend. Plaintiffs later indicated that they had identified "over 100 separate transactions which [they] thought were material to their allegations." (Final Approval Hr'g Tr. 4-5, Feb. 22, 2006.) By the time they entered into the Settlement, Plaintiffs had laid "the groundwork to prepare for hundreds of merits and expert depositions to occur in the fall and spring of 2005-2006." (Heins Decl. P37.)

Meanwhile, Defendants drafted a motion for summary judgment, alleging that Plaintiffs failed to establish loss causation as a matter of law. The standard for loss causation has been the subject of substantial litigation over the past several years. In the interval between the filing of the motion to dismiss and the instant Settlement, the Second Circuit and Supreme Court have weighed in with a number of influential opinions, altering the relevant legal standards for active securities lawsuits. The most recent Supreme Court precedent addressing loss causation, *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 125 S. Ct. 1627, 161 L. Ed. 2d 577 (2005), was argued and decided in the months immediately following the final briefing of Defendants' motion **[*13]** for summary judgment. With a decision on that motion pending, the parties entered a phase of intense and protracted settlement discussions.

C. The Settlement

In late 2004, the Court appointed Paul D. Wachter as special master for discovery in this litigation. Special Master Wachter proceeded to play a prominent role mediating settlement negotiations between the parties. During the mediation sessions before Special Master Wachter, the parties discussed the viability of their respective claims and defenses, the role of emerging securities law precedent, and their widely divergent views of potential outcomes.

Plaintiffs relied on their Complaint, a variety of economic experts, and the results of their massive discovery operation to buttress their claims that the Class sustained extensive damages. On the other hand, Defendants insisted, and continue to insist, that their accounting statements were not fraudulent and that, even if such allegations could be proved, such fraud did not cause the declining price of AOLTW stock. After nearly seven months of involved settlement negotiations overseen by Special Master Wachter, the parties entered into a Memorandum of Understanding on **[*14]** July 29, 2005, and began preparing a Stipulation of Settlement.

The Stipulation of Settlement resulted from a second round of negotiations between Lead Plaintiff's Counsel and representatives of the nine firms representing Defendants. The parties negotiated a number of complex issues essential to the Settlement, including the Defendants' right to termination of the Settlement, the scope of releases, and the specific language of the Stipulation. At the same time, Lead Plaintiff's Counsel drafted supplemental documents, including the Notice to the Class, the Proof of Claim and Release, and the Plan of Allocation. After finalizing the drafts of all relevant documents, the parties petitioned the Court for preliminary approval of the Settlement.

On September 28, 2005, the Court held a preliminary approval hearing to address the Settlement materials provided by the parties. After reviewing those materials (including the Stipulation of Settlement, draft notice material, the Plan of Allocation, and supporting memoranda) and considering the issues raised at the preliminary approval hearing, the Court provided the parties an opportunity to modify the notice procedures and opt-out requirements. **[*15]** On September 30, 2005, the Court issued Orders certifying the Class for settlement purposes and preliminarily approving the Settlement. Upon receiving preliminary approval of the Settlement, Plaintiffs commenced the mailing and publication of the Settlement Notice. [5]

5 A short time later, in compliance with the terms of the Stipulation of Settlement, Defendants deposited the $ 2.65 billion Settlement Fund into an escrow account. The Fund has earned approximately $ 303,000 a day for the benefit of the Settlement Class since its deposit. (Pls.' Br. In Support of Final Approval 1, Jan. 30, 2006.)

Lead Plaintiff's Counsel retained Gilardi & Co., LLC (the "Settlement Administrator" or "Gilardi") to administer the Settlement. The Settlement Administrator initially mailed 115,080 "Notice Packages" to the names and addresses provided by AOLTW's transfer agent. [6] The Settlement Administrator also contacted the brokerage houses that hold securities in "street name" for beneficial owners, giving those institutions the **[*16]** option to mail Notice Packages directly to the beneficial owners or to provide Gilardi with a list of those owners' addresses. (Forrest Decl. P5, Jan. 1, 2006.) In addition, summary notices were published over the course of two weeks on separate weekdays in the New York Times, Wall Street Journal, Financial Times, and USA Today. (Forrest Decl. P7.) The Settlement Administrator has mailed more than four and a half million more Notice Packages in response to requests from putative Class Members. (Forrest Decl. P6.)

6 Each Notice Package included a "true and correct copy of the Notice, including the Proof of Claim and Release, the Plan of Allocation, and the Request for Exclusion from Securities Class." (Forrest Decl. P2, Jan. 1, 2006.) These materials were also available at the website maintained throughout the course of this Settlement. *See* AOL Time Warner Securities Litigation Settlement, http://www.aoltimewarnersettlement.com (last visited March 20, 2006).

The Settlement Administrator initiated its mailing **[*17]** in early October, shortly after the Court's preliminary approval of the Settlement. The Notice set two important deadlines for responses to the Settlement: (1) objections to the Settlement and requests to opt out of the Settlement were to be filed by January 9, 2006, while (2) Settlement claims were to be submitted by February 21, 2006.

By the January 9 objection deadline, the Court had received four objections from putative Class Members, and two motions to intervene and object to the Settlement, one of which was withdrawn shortly thereafter. [7]

7 Plaintiffs in the ERISA action stemming from the same operative facts as the instant lawsuit initially submitted a motion to intervene and object to the Settlement on January 7, 2006, but voluntarily withdrew their motion on January 27, 2006. Accordingly, the Court declines to address their objection.

On February 22, 2006, the Court conducted the final approval hearing. At the hearing, both Lead Plaintiff's Counsel and defense counsel for AOLTW were given the opportunity **[*18]** to make final remarks supporting the fairness of the Settlement. At that time, Lead Plaintiff's Counsel reported that almost all significant holders of affected stock had filed claims to the Settlement and noted the lack of significant opposition or adverse comment by institutional investors with Settlement claims. Not one of the formal objectors attended or spoke at the hearing, each of them resting on her papers. Further, nobody attending the hearing contested the fairness of the Settlement. The Court reserved judgment, pending this written Opinion.

II. Discussion

A. Certification of the Settlement Class

On September 30, 2005, the Court certified the Class for settlement purposes. This section briefly supplements that Order with the facts supporting class certification under Federal Rule of Civil Procedure 23.

1. Numerosity

To qualify for certification, a class must be "so numerous that joinder of all members is impracticable." Fed. R. Civ. P. 23(a)(1). Here, more than 4.7 million Settlement Notices have been mailed to putative Class Members and the Settlement Administrator **[*19]** has received approximately 600,000 claims. Hence, the numerosity requirement is clearly satisfied.

2. Commonality

Rule 23(a)(2) requires that "there are questions of law or fact common to the class." Fed. R. Civ. P. 23(a)(2). "Where putative class members have been injured by similar misrepresentations and omissions, the commonality requirement is satisfied." *Fogarazzo v. Lehman Bros., Inc.,* 232 F.R.D. 176, 180 (S.D.N.Y. 2005) (citations omitted). Plaintiffs allege that the Class suffered damages as a result of three and a half years of AOLTW's misrepresentations about the Company's financial condition and its fraudulent accounting practices. Due to the public nature of Defendants' financial statements and the breadth of the alleged fraud, the issues of law and fact underlying this litigation are common to the Class.

3. Typicality

Under Rule 23(a)(3), the interests of the class representatives must be "typical of the claims . . . of the class." Fed. R. Civ. P. 23(a)(3). This requirement is satisfied if "each class member's claim arises from the same course of events, and **[*20]** each class member makes similar legal arguments to prove the defendant's liability." *Robinson v. Metro-North Commuter R.R. Co.,* 267 F.3d 147, 155 (2d Cir. 2001) (citation omitted). Further, a class representative's claims "are not typical if that representative is subject to unique defenses." *Fogarazzo,* 232 F.R.D. at 180 (citation omitted).

Here, Lead Plaintiff, like all Class members, claims damages allegedly caused by Defendants' misrepresentation of AOL's financial health, including the overstatement of advertising revenues to artificially inflate the stock of AOL and AOLTW. The legal theories pleaded by Lead Plaintiff, numerous violations of the federal securities laws, are shared by all Class Members. Furthermore, no unique defenses may be asserted against Lead Plaintiff that would make its claims atypical. As such, the typicality requirement is satisfied.

4. Adequacy

Rule 23(a)(4) requires that the class representatives "fairly and adequately protect the interests of the class." Fed. R. Civ. P. 23(a)(4). In considering a class representative's adequacy, the court asks whether the representative **[*21]** (1) has any interests that conflict with the rest of the class, and (2) is represented by qualified and capable legal counsel. *Baffa v. Donaldson, Lufkin & Jenrette Sec. Corp.,* 222 F.3d 52, 60 (2d Cir. 2000) (citation omitted).

On several occasions throughout the course of this litigation the Court has commented favorably on Lead Plaintiff's representation of the Class. *See In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.,* 2003 U.S. Dist. LEXIS 145, No. MDL 1500, 2003 WL 102806, at *2 (S.D.N.Y. Jan. 10, 2003); *In re AOL Time Warner,* 381 F. Supp. 2d at 208 n.8. Lead Plaintiff's conduct during the Settlement has not altered the Court's earlier findings. All Class Members, including Lead Plaintiff, seek to obtain the largest possible recovery for losses resulting from Defendants' alleged misconduct. Lead Plaintiff has successfully prosecuted the claims it shares with the rest of the Class, resulting in the $ 2.65 billion Settlement at issue. There is no evidence that Lead Plaintiff's interests conflict with the rest of the Class. Similarly, the Court continues to be impressed with the quality of representation provided by Lead Plaintiff's Counsel, its prosecution **[*22]** of the lawsuit, and its negotiation of the Settlement. *See also In re AOL Time Warner,* 2003 U.S. Dist. LEXIS 145, 2003 WL 102806, at *2; *infra* Part II.C. Both Lead Plaintiff and its choice of counsel satisfy the adequacy requirement of Rule 23(a)(4).

5. Maintainability

In addition to finding that a class meets the requirements of Rule 23(a), courts must ascertain whether the class is maintainable under one of the Rule 23(b) criteria. One commonly applied criterion requires "that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy." Fed. R. Civ. P. 23(b)(3).

With respect to the first Rule 23(b)(3) prong, the Supreme Court has noted that predominance is "readily met in certain cases alleging . . . securities fraud . . . ." *Amchem Prods. v. Windsor,* 521 U.S. 591, 625, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997). This case readily illustrates that principle. Allegations of Defendants' misrepresentations and the improper inflation of AOL's accounting revenues underlie **[*23]** the factual and legal claims of every Class Member. *See supra* Part II.A.2. The Court is satisfied that common questions of law and fact are predominant.

With respect to the second Rule 23(b)(3) prong--the superiority of the class action to other methods of adjudicating the controversy--securities cases like this one "easily satisfy" that requirement. *In re Blech Sec. Litig.,* 187 F.R.D. 97, 107 (S.D.N.Y. 1999). The Settlement provides a vehicle of recovery for individuals that would find the cost of individual litigation prohibitive, yet allows anyone wishing to initiate her own lawsuit to opt out of the Settlement. The Court's previous decision to consolidate this litigation is also consistent with the Settlement. The Settlement offers a single forum to resolve the common claims of millions of potential Class Members and prevents the initiation of countless claims in state and federal courts throughout the nation. Finally, at this stage, the risk of encountering any serious difficulty in managing the Class is negligible. Maintainability is satisfied here.

B. Standard for Final Approval of Class Action Settlements

Federal Rule of Civil Procedure 23(e) **[*24]** governs the settlement of class action litigation. Courts may approve class action settlements after proponents of the settlement have distributed adequate notice of the proposed settlement and the settlement has been the subject of a fairness hearing. Fed. R. Civ. P. 23(e)(1). The touchstone for court approval is that the settlement be "fair, reasonable, and adequate," Fed. R. Civ. P. 23(e)(1)(C), and "not a product of collusion." *D'Amato v. Deutsche Bank,* 236 F.3d 78, 85 (2d Cir. 2001) (citing *Joel A. v. Giuliani,* 218 F.3d 132, 138 (2d Cir. 2000)); *see also Wal-Mart Stores, Inc. v. Visa U.S.A. Inc.,* 396 F.3d 96, 116 (2d Cir. 2005), *cert denied,* 544 U.S. 1044, 125 S. Ct. 2277, 161 L. Ed. 2d 1080 (2005).

Courts analyze a settlement's fairness, reasonableness and adequacy with reference to both "the negotiating process leading up to settlement as well as the settlement's substantive terms." *D'Amato,* 236 F.3d at 85. The court may not engage in mere "rubber stamp approval" of the settlement, yet it must "stop short of the detailed and thorough investigation **[*25]** that it would undertake if it were actually trying the case." *City of Detroit v. Grinnell Corp.,* 495 F.2d 448, 462 (2d Cir. 1974).

Further, courts should be "mindful of the 'strong judicial policy in favor of settlements, particularly in the class action context.'" *Wal-Mart,* at 116 (quoting *In re PaineWebber Ltd. P'ships Litig.,* 147 F.3d 132, 138 (2d Cir. 1998)). As the Second Circuit has long recognized, "there are weighty justifications, such as the reduction of litigation and related expenses, for the general public policy favoring the settlement of litigation." *Weinberger v. Kendrick,* 698 F.2d 61, 73 (2d Cir. 1982). This concern is reinforced by the Court's analysis of both the procedural and substantive fairness of the Settlement.

C. Procedural Fairness: The Negotiation Process

"A court reviewing a proposed settlement must pay close attention to the negotiating process, to ensure that the settlement resulted from 'arms-length negotiations and that plaintiffs' counsel have possessed the experience and ability, and have engaged in the discovery, necessary to effective representation of the class's interests.'" *D'Amato,* 236 F.3d at 85 **[*26]** (quoting *Weinberger,* 698 F.2d at 74). This inquiry into a settlement's procedural fairness helps to ensure that the settlement is not the product of collusion. Evidence of arms-length negotiation between experienced counsel that have engaged in meaningful discovery may give rise to a presumption of fairness. *Wal-Mart,* 396 F.3d at 117 (citation omitted).

In evaluating a settlement's procedural fairness, the Second Circuit has noted that that "a court-appointed mediator's involvement in pre-certification settlement negotiations helps to ensure that the proceedings were free of collusion and undue pressure." *D'Amato,* 236 F.3d at 85 (citing *County of Suffolk v. Long Island Lighting,* 907 F.2d 1295, 1323 (2d Cir. 1990)). Courts in this District have also commented on the procedural safeguards inherent in cases subject to the PSLRA, wherein the lawyers are not "mere entrepreneurs acting on behalf of purely nominal plaintiffs," but are "selected by court-appointed Lead Plaintiffs who are substantial and sophisticated institutional investors with access to independent legal and financial specialists and a huge stake in the **[*27]** litigation." *In re Global Crossing Sec. & ERISA Litig.,* 225 F.R.D. 436, 462 (S.D.N.Y. 2004).

This Settlement is the product of seven months of intense arms-length negotiations, overseen and assisted by a court-appointed special master, between major financial entities, both of whom are represented by experienced, highly regarded counsel. Lead Plaintiff, the Minnesota State Board of Investment ("MSBI"), "manages the investment of retirement fund assets of the Minnesota State Retirement System, Teachers Retirement Association, and the Public Employees Retirement Association, as well as idle cash of other state agencies," with total assets exceeding $ 50 billion. Minnesota Office of the Legislative Auditor, Report Summary: Minnesota State Board of Investment, http://www.auditor.leg.state.mn.us/FAD/2006/f0604.htm (released Feb. 15, 2006). Upon assigning MSBI lead plaintiff status, this Court noted that MSBI had sustained an estimated loss of $ 249 million, thus had the largest financial stake in the litigation. *See In re AOL Time Warner,* 2003 U.S. Dist. LEXIS 145, 2003 WL 102806, at *2. [8] Lead Plaintiff's public mission, financial experience, and vested interest in obtaining the **[*28]** best terms for the Settlement Class reflect favorably on its selection of counsel here.

8 MSBI's loss was calculated on the basis of a class period nearly two years shorter than the Class Period ultimately defined in the Settlement. Accordingly, its loss is presumably greater than $ 249 million.

Indeed, Lead Plaintiff's Counsel, Heins, Mills & Olson, PLC, is a respected class action litigator, with considerable experience in major securities and antitrust class action lawsuits. *See, e.g., In re Monosodium Glutamate Antitrust Litigation,* MDL 00-1328 (D. Minn.); *In re Broadcom Corp. Sec. Litig.,* SA CV 01-0275 (C.D. Cal.). Lead Plaintiff's Counsel has garnered judicial praise for its representation in previous actions, and has continued to show its client commitment and exceptional lawyering in this case. On the other side of the table, AOLTW's counsel, Cravath, Swaine & Moore LLP ("Cravath") is generally regarded as one of the country's premier law firms. Cravath has extensive experience in the defense **[*29]** of major class action lawsuits and has vigorously defended Plaintiffs' allegations throughout this litigation. At the fairness hearing, counsel for both parties noted their continuing disagreement about Plaintiffs' allegations. With the mediation of Special Master Wachter, however, both parties concluded that the Settlement was the best and most efficient outcome for their clients in light of the costs of litigation and mutability of applicable legal standards.

Special Master Wachter assumed his role during the early stages of discovery, overseeing the terms of the discovery process before playing a vital role in the settlement negotiations between the parties. Special Master Wachter fulfilled his assignment with considerable skill and diligence, remaining in close contact with both parties and mediating dozens of face-to-face and remote meetings between them over the course of seven months. Special Master Wachter's oversight of the process lends considerable support to the Court's finding of procedural fairness.

In light of the substantial evidence that settlement negotiations were conducted at arms-length without the slightest hint of collusion, the Court credits the Settlement **[*30]** with a presumption of fairness. This presumption is supported by the fairness of the Settlement terms.

D. Substantive Fairness: The Settlement Terms

In evaluating the fairness, reasonableness, and adequacy of a settlement, the court is primarily concerned with the "substantive terms of the settlement compared to the likely result of a trial." *Malchman v. Davis,* 706 F.2d 426, 433 (2d Cir. 1983) (citations omitted). In order to make this evaluation, courts in this Circuit have consistently employed the *Grinnell* factors:

> (1) the complexity, expense and likely duration of the litigation;
>
> (2) the reaction of the class to the settlement;
>
> (3) the stage of the proceedings and the amount of discovery completed;
>
> (4) the risks of establishing liability;
>
> (5) the risks of establishing damages;
>
> (6) the risks of maintaining the class action through the trial;
>
> (7) the ability of the defendants to withstand a greater judgment;
>
> (8) the range of reasonableness of the settlement fund in light of the best possible recovery;

(9) the range of reasonableness of the settlement fund to a possible recovery in light of all the attendant risks of litigation.

[*31] *Wal-Mart,* 396 F.3d at 117 (quoting *Grinnell,* 495 F.2d at 463 (citations omitted)).

1. Complexity, Expense and Likely Duration of the Litigation

Due to its notorious complexity, securities class action litigation is often resolved by settlement, which circumvents the difficulty and uncertainty inherent in long, costly trials. *See, e.g., Hicks v. Morgan Stanley & Co.,* 2005 U.S. Dist. LEXIS 24890, No. 01 Civ. 10071, 2005 WL 2757792, at *6 (S.D.N.Y. Oct. 24, 2005); *In re American Bank Note Holographics, Inc.,* 127 F. Supp. 2d 418, 424 (S.D.N.Y. 2001); *In re Sumitomo Copper Litig.,* 189 F.R.D. 274, 281 (S.D.N.Y. 1999). This notoriety is amply illustrated by the instant case, which is particularly conducive to settlement.

Plaintiffs allege wrongdoing by one of the largest companies in the world, during the largest corporate merger in history. Plaintiffs' allegations span more than three and a half years and implicate financial statements filed over fifteen consecutive quarters. Plaintiffs point to hundreds of fraudulent transactions carried out over multiple years, employing diverse accounting techniques, and often including multiple, interrelated **[*32]** revenue components. These sophisticated and complex transactions shared just one common characteristic: their allegedly inappropriate inflation of revenue. There is no question that the presentation of these transactions, and the conflicting interpretations which they would be subject to, would stretch the patience, attention, and understanding of even the most exemplary jury.

Since the denial of Defendants' motions to dismiss and the commencement of formal discovery, Plaintiffs have pored over millions of documents, employed nine experts, added six defendants, and laid the groundwork for dozens of depositions. (Heins Decl. PP4, 7, 70, 77.) The breadth of resources dedicated to the prosecution of this lawsuit reflects the complexity of the issues involved and the expenses that lie ahead. Shortly after the denial of their motions to dismiss, Defendants initiated an extensive round of deposition and document requests and negotiated with Plaintiffs over the scope of discovery. Defendants continue to deny liability and have been subject to only limited criminal prosecution for their alleged wrongdoing. Defense counsel's vigorous defense of this lawsuit indicates Defendants' continued **[*33]** willingness to defend the allegations in the absence of the Settlement.

In addition to the complex issues of fact involved in this case, the legal requirements for recovery under the securities laws present considerable challenges, particularly with respect to loss causation and the calculation of damages. These challenges are exacerbated here, where a number of controlling decisions have recently shed new light on the standard for loss causation. *See, e.g., Dura Pharms.,* 544 U.S. at 336; *Lentell v. Merrill Lynch & Co., Inc.,* 396 F.3d 161, 173 (2d Cir. 2005). If Defendants' pending motion for summary judgment on the issue of loss causation did not prove dispositive, it would continue to be the subject of profound dispute throughout the litigation.

In the absence of the Settlement, this litigation could very well last for several more years. The parties have not yet finished discovery. At a minimum, months of depositions would precede trial. A presumably lengthy trial would then be followed by years of inevitable appeals. Each step of the way, expenses would continue to accumulate, further decreasing the funds available to Class Members. Conversely, **[*34]** the $ 2.65 billion Settlement under consideration here "results in a substantial and tangible present recovery, without the attendant risk and delay of trial." *Maley v. Del Global Techs. Corp.,* 186 F. Supp. 2d 358, 362 (S.D.N.Y. 2002).

After careful consideration of the circumstances of this litigation, the Court finds that a trial would be long, complex, and costly. This factor strongly favors the Settlement.

2. Reaction of the Class to the Settlement

The reaction of the class is generally gauged by reference to the extent of objection to the settlement. Courts in this Circuit have noted that "the lack of objections may well evidence the fairness of the Settlement." *In re American Bank Note Holographics,* 127 F. Supp. 2d at 425. Courts have also commented favorably on settlements that are not contested by institutional investors and class representatives. *In re NASDAQ Market-Makers Antitrust Litig.,* 187 F.R.D. 465, 479 (S.D.N.Y. 1998).

Here, the Settlement Administrator mailed over 4.7 million Notice Packages to putative Class Members and has received an estimated 600,000 proofs of claim. Only four such individuals filed an **[*35]** objection to any aspect of the Settlement, and just two dispute the reasonableness of the Settlement Fund. [9] Further, not a single institutional Class Member objected to the Settlement. [10] The relative lack of dissent here compares favorably with settlements previously approved in this District. *See, e.g., D'Amato,* 236 F.3d at 86-87 (eighteen objectors out of 27,883 notices); *Hicks,* 2005 U.S. Dist. LEXIS 24890, 2005 WL 2757792, at *6 (three objectors out of approximately 100,000 potential members of the class); *In re WorldCom, Inc. Sec. Litig.,* 388 F. Supp. 2d 319, 337-338 (S.D.N.Y. 2005) (seven objectors out of 4,000,000 potential class members and 830,000 claimants).

9 Moreover, Plaintiffs argue that two of the four objectors lack standing to object to the Settlement. The Court addresses all objections in considerably more detail below. *See infra* Part II.E.

10 One institutional investor seeks to intervene in order to file an objection, *see infra* Part II.E.1, but by exercising its right to opt out of the Class, that entity is protected from the binding legal effect of this Settlement.

[*36] The Settlement Administrator also noted that 10,082 persons and entities filed valid requests for exclusion from the Class. (Forrest Decl. P3, Feb. 21, 2006.) Although a large number at first glance, these opt-outs amount to less than 0.2% of the 4.7 million putative Class Members. [11] Comparably small percentages of opt-outs have favored settlement in the past. *See In re Sumitomo,* 189 F.R.D. at 281 (finding that fewer than 1% of class members requesting exclusion "strongly favored approval of the proposed settlement[]"). The small number of objections and low percentage of opt-outs here strongly favor the Settlement.

11 Additionally, as opt-outs were not required to submit transactional information in order to file a valid request for exclusion, it is impossible to ascertain what percentage of the opt-outs would have had valid claims to the Settlement.

3. Stage of Proceedings and Amount of Discovery Completed

Courts have approved settlements at all stages of the proceedings. The relevant **[*37]** inquiry for this factor is whether the plaintiffs have obtained a sufficient understanding of the case to gauge the strengths and weaknesses of their claims and the adequacy of the settlement. The parties need not "have engaged in extensive discovery" as long as "they have engaged in sufficient investigation of the facts to enable the Court to 'intelligently make . . . an appraisal' of the settlement." *In re Austrian & German Holocaust Litig.,* 80 F. Supp. 2d 164, 176 (S.D.N.Y. 2000) (quoting *Plummer v Chemical Bank,* 668 F.2d 654, 660 (2d Cir. 1982)); *see also Maley,* 186 F. Supp. 2d at 363; *In re American Bank Note Holographics,* 127 F. Supp. 2d at 425-26.

At the time of the Stipulation of Settlement, this litigation had reached an advanced stage of discovery. Even prior to formal discovery, Plaintiffs reviewed the relevant public facts pertaining to this litigation, with their review culminating in the 300 page Amended Complaint. Upon commencing formal discovery, Plaintiffs reviewed over 15 million documents, consulted with nine different economic and accounting experts, briefed numerous motions, and laid the foundation **[*38]** for hundreds of depositions. Although the final stages of discovery, including depositions, were not yet complete, it is not certain that Plaintiffs would have been able to maintain this action long enough to reach that stage of discovery. Defendants' motion for summary judgment was pending before the Court, and presented a difficult question that, if decided in favor of Defendants, may have resulted in dismissal of the lawsuit. The thorough briefing of this and other motions prior to settlement supplemented Plaintiffs' consideration of the strengths of their claims and the defenses they were likely to face at trial.

Although discovery had not been completed prior to the Settlement, Plaintiffs had conducted meaningful pre-trial discovery and had engaged in sufficient trial preparation to appraise their likelihood of success. Accordingly, the third *Grinnell* factor also weighs in favor of the Settlement.

4. Risks of Class Prevailing (Establishing Liability and Damages, and of Maintaining the Class through Trial)

One of the Court's central inquiries when appraising a settlement is the likelihood that the class would prevail at trial in the face of the risks presented by further **[*39]** litigation. *Grinnell* specifically advises courts to consider the risks of establishing liability and damages, and of maintaining the class through trial. 495 F.2d at 463. This inquiry requires courts to consider legal theories and factual situations without the benefit of a fully developed record, thus courts must heed the Supreme Court's admonition not to "decide the merits of the case or resolve unsettled legal questions." *Carson v. American Brands, Inc.,* 450 U.S. 79, 88 n.14, 101 S. Ct. 993, 67 L. Ed. 2d 59 (1981). Rather, "the Court need only assess the risks of litigation against the certainty of recovery under the proposed settlement." *In re Global Crossing,* 225 F.R.D. at 459 (citing *In re Holocaust Litig.,* 80 F. Supp. 2d at 177).

The difficulty of establishing liability is a common risk of securities litigation. *Maley,* 186 F. Supp. 2d at 364. In this case, Plaintiffs were not only challenged to establish a valid theory of loss causation, *see supra* Parts I.B & II.D.1, they also faced the risk of being unable to establish scienter for a number of the defendants. In its consideration of Defendants' motions to dismiss, the **[*40]** Court closely reviewed Plaintiffs' allegations of scienter, dismissing claims against several individual defendants while finding other allegations adequate to avoid dismissal. *See In re AOL Time Warner,* 381 F. Supp. 2d at 219-31. Of course, avoiding dismissal at the pleading stage does not guarantee that scienter will be adequately proven at trial.

The risk of establishing damages here was equally daunting. The decline in AOL and AOLTW stock prices spanned several years. Defendants argue that this decline was the result of a number of factors--including the general decline in Internet stock values--unrelated to the allegations of fraud. Plaintiffs hired a team of experts to estimate damages and would likely face a conflicting panel of experts retained by Defendants for trial. The risk of establishing damages would be further exacerbated by the difficulty of educating the jury on abstruse economic concepts necessary to the calculation of damages.

Further, Plaintiffs would have faced a considerable challenge explaining the transactions underlying the alleged fraud. The complexity and opacity of these transactions would likely hinder Plaintiffs' ability to present **[*41]** the jury with a coherent explanation of Defendants' misconduct. As their expert, Professor John C. Coffee, Jr., noted, Plaintiffs faced a serious issue "as to whether a jury could understand the convoluted 'round robin' advertising games that had been played" by Defendants. (Coffee Decl. P30, Dec. 2, 2005.)

The Court certified this Class for settlement purposes only. Plaintiffs report that they had drafted a motion for class certification prior to the Settlement and had fully anticipated that Defendants would oppose class certification as vigorously as it had contested Plaintiffs' allegations and discovery requests. As such, even the process of class certification would have subjected Plaintiffs to considerably more risk than the unopposed certification that was ordered for the sole purpose of the Settlement.

In summary, the *Grinnell* "risk factors" also favor the Settlement.

5. Ability of Defendants to Withstand a Greater Judgment

This factor typically weighs in favor of settlement where a greater judgment would put the defendant at risk of bankruptcy or other severe economic hardship. *See, e.g., In re Warner Comms. Sec. Litig.*, 618 F. Supp. 735, 746 (S.D.N.Y. 1985). **[*42]** Here, AOLTW remains a solvent, highly capitalized company, with assets greatly exceeding its $ 2.4 billion contribution to the Settlement. Neither party contends that Defendants are incapable of withstanding a greater judgment. However, the mere ability to withstand a greater judgment does not suggest that the Settlement is unfair. *See, e.g., D'Amato,* 236 F.3d at 86; *In re NASDAQ Market-Makers,* 187 F.R.D. at 477-78. This factor must be weighed in conjunction with all of the *Grinnell* factors; most notably the risk of the class prevailing and the reasonableness of the settlement fund.

6. Range of Reasonableness of the Settlement Fund

The final two *Grinnell* factors constitute an inquiry into the settlement fund's range of reasonableness (1) in light of the best possible recovery and (2) to a possible recovery in light of all the attendant risks of litigation. 495 F.2d at 463. Though courts are encouraged to consider the best possible recovery, the range of reasonableness inquiry is tightly bound to the risks of litigation, which have been developed in greater detail above. *See supra* Part II.D.4. As such, the following **[*43]** discussion must be tempered by the Court's earlier finding that continued litigation would proceed with a high degree of risk.

Plaintiffs have not provided a specific estimate of the total damages sustained by the Class, in large part, no doubt, due to the difficulty of distinguishing the decline in share price attributable to fraud from the decline attributable to general market forces. In light of the steep decline during the Class Period and the Settlement's estimated recovery per share, however, it seems clear that Class Members will not recover their entire loss. This consideration alone does not undermine my finding that the $ 2.65 billion Settlement Fund is reasonable in light of the difficulty of establishing damages here. "The settlement amount's ratio to the maximum potential recovery need not be the sole, or even the dominant, consideration when assessing the settlement's fairness." *In re Global Crossing,* 225 F.R.D. at 460-61. Indeed, damages are of such a speculative and contested nature here that the ratio of the settlement amount to a hypothetical maximum recovery would not be dispositive of the Settlement's fairness.

Not only do the parties dispute **[*44]** the amount of damages sustained by the Class, they continue to dispute the very existence of damages. In light of this fundamental disagreement, the $ 2.65 billion Settlement secured by Plaintiffs is all the more impressive. Plaintiffs have secured a substantial, immediate recovery for the Plaintiff Class that ranks among the five largest securities settlements in history (Coffee Decl. P2), and is the second largest settlement ever reached with an issuer of securities. (Heins Decl. P83.) [12] In addition, the Settlement Fund is currently in escrow, earning approximately $ 303,000 a day for the Class. In this sense, the benefit of the Settlement will not only be realized far earlier than a hypothetical post-trial recovery, but dates back to October 7, 2005, when the funds were deposited in the escrow account. The concrete benefits of this Settlement outweigh the possibility of a higher recovery after trial. Under the circumstances of this case, the Settlement Fund is within the range of reasonableness.

12 In the early stages of this litigation, legal experts estimated "a payout of $ 1 billion" in the event of a settlement. (Heins Decl. Ex. 40.) Though this figure represents an estimated settlement amount rather than a full recovery, it provides some indication of the legal community's expectations. The Settlement reached here far exceeds those prognostications.

[*45] After carefully considering the *Grinnell* factors, most of which weigh in favor of the Settlement, I find the substantive terms of the Settlement fair, reasonable, and adequate.

E. Objections

The Court received a handful of objections to the Settlement prior to the deadline. [13] I will address each objection in the context of the aspect of the Settlement that is disputed.

13 Several of the persons objecting to the Settlement also object to Class Counsel's application for attorney's fees. The Court reserves judgment on the issue of attorney's fees at this time and will address the objections to fees in a separate ruling.

1. Stichting's Objection to the Settlement's Handling of the DOJ and SEC Funds

Stichting Pensioenfonds ABP ("Stichting") filed a motion to intervene, objecting to the Settlement's handling of funds set aside by AOLTW subsequent to the Company's settlements with the DOJ and SEC. [14] Stichting's objection to the Settlement's inclusion of the DOJ funds and AOLTW's decision to **[*46]** use its "best efforts" to include the SEC funds are without merit. Because the right of intervention is inessential to my disposition of Stichting's objection, the validity of its intervention is assumed for the purpose of this Opinion. [15]

14 Stichting is a putative Class Member but has chosen to opt out of the instant Settlement, hence the necessity of its motion to intervene. Stichting has filed a separate lawsuit, which is pending in this Court.

15 Stichting's right of intervention is by no means assured under the circumstances of this case. I am particularly troubled by the objector's argument that its intervention in this dispute is timely. Though Stichting filed its motion on the January 9, 2006 deadline for objections, it made no attempt to alert the Court to its objection at the preliminary fairness hearing on September 28, 2004, or at any time prior to January 9, 2006. By the time Stichting objected,

the Settlement Administrator had mailed millions of Notice Packages and hundreds of thousands of putative Class Members had filed claims. If Stichting's requested relief were granted, these costs would be duplicated by a second round of Notice.

Although Stichting waited until the last possible minute to bring their objection to the Court's attention, the exhibits to its motion indicate that Stichting was aware of the content of its objection well before the preliminary fairness hearing. (Kairis Decl. Ex. L; Letter from John C. Kairis to Samuel D. Heins and Peter T. Barbur (Aug. 17, 2005).) At that hearing, the Court heard argument from individuals objecting to certain conditions of the Notice, and, where appropriate, suggested that the Plaintiffs modify their proposal. Stichting's grievance is precisely the type of objection that would have been beneficially brought to the Court's attention at the preliminary fairness hearing. *See* Manual for Complex Litigation (Third) § 30.41, at 265 (2000) ("The court may want to hear not only from counsel but also from named plaintiffs, from other parties, and from attorneys who did not participate in the negotiations.").

[*47] Stichting requests that the Court strike the terms of the Settlement that refer to the DOJ and SEC funds, order that those funds be distributed pro rata to all aggrieved shareholders regardless of their participation in the instant Settlement, and order that a modified Notice and Plan of Allocation be published and distributed. Because the DOJ and SEC funds were established under different conditions and the Settlement handles the funds dissimilarly, each fund will be considered in turn.

i. The DOJ Funds

Prior to the instant Settlement, AOLTW entered into a Deferred Prosecution Agreement with the DOJ (the "DPA"). In accordance with the DPA, AOLTW agreed to pay $ 150 million into a "fund to be established under *its direction and control* to be used for either the settlement of shareholder securities law litigation or for purposes of any compensation fund" related to the transactions underlying the DPA. (Karis Decl. Ex. C; *United States v. America Online, Inc.*, No. 1:04 M 1133, at P9 (E.D. Va. Dec. 14, 2004) (emphasis added).) Stichting argues that the inclusion of the DOJ funds in the Settlement will preclude them from obtaining their pro rata share of the money provided **[*48]** by the DPA, thus unfairly benefiting the Settlement claimants to the detriment of shareholders who have opted out of the Settlement. (Stichting Obj. 23.)

Stichting's objection to the Settlement's inclusion of the DOJ funds is undermined by the DOJ's directions for the distribution of those funds. Under the DPA, the DOJ funds are put under AOLTW's "direction and control" for "the settlement of shareholder securities law litigation." In its discretion, AOLTW has chosen to distribute those funds by means of the primary class action Settlement, benefiting hundreds of thousands of aggrieved shareholders and eliminating the costs associated with a separate distribution mechanism. Stichting's protestations notwithstanding, the DPA does not expressly indicate that the funds must be distributed pro rata to all harmed investors.

Prior to filing their objection, Stichting wrote a letter to the DOJ, submitting their concern to that agency. (Kairis Decl. Ex. M; Letter from John C. Kairis to Paul J. McNulty, Esq., U.S. Dep't of Justice (Dec. 16, 2005).) There is no record of a reply. Without some indication that AOLTW's distribution of the funds is contrary to the Company's agreement with the DOJ, **[*49]** the Court will not disturb an agreement within the jurisdiction of another federal district court by reading conditions absent from the DPA into that agreement.

Stichting has not demonstrated that the Settlement's inclusion of the DOJ funds was improper. Consequently, the Settlement terms including those funds need not be stricken, nor must Plaintiffs distribute a modified Notice and Plan of Allocation on that basis.

ii. The SEC Funds

Following an SEC investigation into AOL's allegedly fraudulent accounting and Time Warner's alleged violation of a cease-and-desist order, AOLTW entered into an agreement with the SEC. Under the terms of a consensual judgment, AOLTW agreed to pay "$ 300 million in civil penalties, which the Commission will request be distributed to harmed investors." (Kairis Decl. Ex. F; SEC Litigation Release No. 2215 (March 21, 2005).)

In all of the materials announcing and describing the Settlement, the parties have referred to a $ 2.65 billion Settlement Fund. The $ 2.65 billion figure does not include the SEC funds. The first mention of the SEC funds is on page six of the sixteen-page Notice. The Notice states that the SEC has not determined how those funds **[*50]** will be distributed, but that AOLTW has requested that the SEC make those funds, or a portion thereof, available for distribution with the Settlement. The settling parties have twice updated the Settlement website to indicate that the SEC has not made a final decision regarding those funds. In short, the Settlement does *not* include the SEC funds. Consequently, the Court will not require the parties to remove wholly aspirational language regarding the mechanism by which those funds may be distributed.

Furthermore, intermittent references to the SEC funds make neither the Notice nor the Plan of Allocation defective. Each of the Notice's references to the SEC funds is accompanied by a disclosure that those funds are not a part of the Settlement, but that AOLTW will make its best efforts to distribute those funds, or a portion thereof, through the class action mechanism. All estimates of per share recovery clearly indicate that the recovery is based on the $ 2.65 billion figure, which does not include the SEC funds. Providing a second set of figures including the SEC funds in the estimated per share recovery would not only be misleading, but potentially inaccurate, because there is **[*51]** no indication of whether the SEC will elect to distribute none of the SEC funds, all of the SEC funds, or a portion thereof, through the Settlement. It cannot be said that the Notice fails to fairly apprise the putative Class Members of the terms of the Settlement. [16] To the contrary, the Notice explains the status of the SEC funds as clearly and simply as possible in light of the SEC's indecision with respect to how those funds will be distributed.

16 *See infra* Part II.E.4 for an elaboration on the relevant standards for settlement notice.

Along these lines, the Plan of Allocation never mentions the amount of money that will be distributed. It merely states that the "Settlement monies will be distributed on a pro rata basis" under the terms of the Plan. (Plan of Allocation 1.) Stichting fails to explain how the Plan of Allocation would need to be altered to incorporate the greater amount of Settlement monies. If the SEC consented to distributing the $ 300 million via the Settlement, that money would simply **[*52]** be added to the $ 2.65 billion Settlement Fund already being distributed. Each claimant's pro rata share would net a greater per share recovery, but the Plan of Allocation itself would not require modification.

In short, references to SEC funds that are not included in the Settlement amount, but that AOLTW will make its "best efforts" to distribute through the class action mechanism do not make the Stipulation of Settlement, Notice, or Plan of Allocation defective. Stichting's objection is overruled.

2. Objections to the Reasonableness of the Settlement

Two individuals filed formal objections to the reasonableness of the Settlement. Margaret M. Keffer ("Keffer") argues that the Settlement provides inadequate compensation for her loss, suggesting instead that a settlement leading to the recovery of one-third of her losses might be adequate. Paul Heyburn ("Heyburn") argues that, considering the serious allegations against Defendants, the estimated recovery per share simply does not provide a substantial benefit. [17]

17 Plaintiffs argue that Heyburn does not have standing to object to the Settlement. Indeed, the transaction records attached to Heyburn's objection indicate that he profited from his AOL investment. (Heyburn Obj. Ex 1.) Consequently, he does not have a claim under the Plan of Allocation, which limits recovery to those shareholders that suffered a loss. Without an injury, Heyburn does not have standing to object. *New York v. Reebok Int'l Ltd.,* 96 F.3d 44, 47 (2d Cir. 1996). Nevertheless, in order to dispel any perceived unreasonableness of the Settlement, I will briefly address Heyburn's concerns regarding the reasonableness of the Settlement and adequacy of representation. *See infra* Part II.E.3.

[*53] Courts routinely approve settlements over conclusory objections. *See, e.g., In re Prudential Sec. Inc., Ltd. P'Ships Litig.,* 1995 U.S. Dist. LEXIS 22103, MDL No. 1005, 1995 WL 798907, at *13 (S.D.N.Y. Nov. 20, 1995); *Saylor v. Bastedo,* 594 F. Supp. 371, 373-74 (S.D.N.Y. 1984). Neither Heyburn's nor Keffer's objection provides a legal or factual basis for the alleged insufficiency of the Settlement, nor do they consider the legal or factual context in which the

Settlement was reached. Consequently, the objectors' unsupported allegations of unreasonableness do not alter my appraisal of the Settlement's fairness.

3. Objection to Lead Plaintiff's Adequacy of Representation

Heyburn also questions the adequacy of representation. He argues that Lead Plaintiff has failed to adequately protect the interests of Class Members by neglecting to analyze whether "certain class members in certain states would fare better than in others" on the basis of state securities laws. (Heyburn Obj. P3.) This objection is without merit.

Heyburn overlooks the provisions of the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA amended the federal securities laws to preempt state **[*54]** securities laws in certain class actions. [18] In relevant part, SLUSA directs that:

> No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal Court by any private party alleging--
>
> (A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or
>
> (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

15 U.S.C. § 78bb(f)(1). [19]

18 As the Supreme Court recently noted, SLUSA amends the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act") "in substantially similar ways." Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, U.S. , 126 S. Ct. 1503, 164 L. Ed. 2d 179, 2006 WL 694137, at *7 n.6 (March 21, 2006). Plaintiffs claims are almost evenly divided between the 1933 Act and the 1934 Act. For ease of reference to the Supreme Court's analysis in *Dabit,* I will quote the amendments to the 1934 Act.

[*55]

19 The analogous provision in the 1933 Act is found at 15 U.S.C. § 77p(b).

Because the instant action is a "covered class action," [20] alleging materially false and misleading statements or omissions of material fact (Second Am. Compl. PP240-432) in connection with the purchase or sale of "covered securit[ies]," [21] claims under state securities laws are preempted. Consequently, Lead Plaintiff had no duty to consider, and in fact was prohibited from considering, state securities laws in the context of this class action. *See Dabit,* 164 L. Ed. 2d 179, 2006 WL 694137, at *9; *see also Lander v. Hartford Life & Annuity Ins. Co.,* 251 F.3d 101, 108-10 (2d Cir. 2001) (reaching the same conclusion in the context of the 1933 Act). As such, Heyburn's objection to the adequacy of Lead Plaintiff's representation is overruled.

20 SLUSA defines a "covered class action" as:

> any single lawsuit in which . . . damages are sought on behalf of more than 50 persons or prospective class members, and questions of law or fact common to those persons or members of the prospective class . . . predominate over any questions affecting only individual persons or members . . . .

15 U.S.C. § 78bb(f)(5)(B). The instant class action clearly falls within this definition.

[*56]

21 "A 'covered security' is one traded nationally and listed on a regulated national exchange." *Dabit,* 164 L. Ed. 2d 179, 2006 WL 694137, at *7 & n.9 (citing 15 U.S.C. §§ 78bb(f)(5)(E) & 77r(b)). Both AOL (prior to the merger) and AOLTW stock traded on the New York Stock Exchange during the Class Period.

4. Objection to the Notice

"The adequacy of a settlement notice in a class action under either the Due Process Clause or the Federal Rules is measured by reasonableness." *Wal-Mart,* 396 F.3d at 113-14 (citations omitted). Reasonableness refers to the understanding of the average class member; "the settlement notice must 'fairly apprise the prospective members of the class of the terms of the proposed settlement and of the options which are open to them in connection with the proceedings.'" *Id.* at 114 (quoting *Weinberger,* 698 F.2d at 70).

Cynthia R. Levin Moulton ("Moulton") objects to the Class Definition contained in the Notice, arguing that it "is defective and fails to satisfy the minimal **[*57]** requirements of due process" because the definition "only includes those security owners 'who were injured thereby,'" and the "class notice provides nothing by way of guidance concerning what it means to be injured thereby." (Moulton Obj. 2.) Moulton proceeds to describe a number of hypothetical situations in which the "injured thereby" definition may be unclear, as when a putative Class Member realizes gains offsetting her losses or has divergent results stemming from the ownership of distinct investment vehicles.

Moulton made an almost identical objection to the *WorldCom* settlement approved in this District just six months ago. In that case, Moulton argued that the class definition, which contained a similar "injured thereby" clause, "might be confusing to a person who had isolated losses but net gains from securities purchased during the Class Period, or who faced divergent results from purchases of different types of securities." *In re WorldCom,* 388 F. Supp. 2d at 340. Judge Cote's well-reasoned analysis of Moulton's objection in that case applies equally here:

> A purchaser of [AOLTW] securities who believed that she had a legally cognizable injury **[*58]** attributable to those purchases would have been on notice that she was included in the Class. It is sufficient that the Class Definition gave putative Class Members who believed they had colorable claims arising from purchases of [AOLTW] securities enough information to alert them that they

needed to opt out of the Class if they wished to pursue their claims separately.

In re WorldCom, 388 F. Supp. 2d at 340-41. Furthermore, the Plan of Allocation provides instructions for the calculation of recovery in many of the allegedly problematic scenarios proposed by Moulton. As in *WorldCom,* Moulton's objection is overruled.

5. Objection to the Plan of Allocation

A plan of allocation is evaluated by the same standards applied to the settlement as a whole: fairness, reasonableness, and adequacy. *See Maley,* 186 F. Supp. 2d at 367 (citations omitted). "An allocation formula need only have a reasonable, rational basis, particularly if recommended by 'experienced and competent' class counsel." *Id.* (citations omitted). Despite the existence of one objection here, the Plan of Allocation readily satisfies these standards.

I have already commented **[*59]** on Lead Plaintiff's Counsel's experience and competency. *See supra* Part II.C. Lead Plaintiff's Counsel prepared the Plan of Allocation in consultation with Scott D. Hakala, Ph.D., CPA ("Hakala"), an economics expert who has prepared court-approved plans of allocation in over a dozen securities settlements across the nation. (Hakala Decl. P1, Jan. 25, 2006.) Hakala designed the Plan of Allocation to provide recovery to damaged investors on a pro rata basis according to their recognized claims of damages. The Plan of Allocation presents clearly defined formulas for calculating claims by reference to a schedule with measures of artificial inflation for all relevant time periods and types of securities. Plans of allocation similarly calculating claims according to inflationary loss have recently been approved as a reasonable approach to the calculation of damages. *See Maley,* 186 F. Supp. 2d at 367; *In re Lucent Techs., Inc., Sec. Litig.,* 307 F. Supp. 2d 633, 649 (D.N.J. 2004).

In his declaration, Hakala explains the methodology used to prepare the Plan of Allocation and asserts that the Plan is "fair and reasonable from an economic perspective." (Hakala **[*60]** Decl. P28.) While the estimates of damages and methodologies used to produce the Plan are necessarily complex due to the various types of securities involved in the AOLTW merger, the Court agrees with Hakala's assessment.

Pat L. Canada ("Canada") objects to the Plan of Allocation to the extent that it provides for the calculation of damages by the first-in/first-out accounting method ("FIFO"), rather than the last-in/first-out method ("LIFO"). Canada argues that courts prefer LIFO and only reluctantly permit the use of FIFO, thus the Plan of Allocation should be modified to calculate damages using LIFO. [22]

22 In addition to their substantive disagreement with Canada's objection, Plaintiffs attack the objection on two procedural grounds. First, they argue that Canada does not have standing, because he did not submit adequate proof of his membership in the Class. Indeed, Canada's non-notarized certification that he purchased 200 shares of AOL stock is not a valid proof of

purchase. Second, they argue that Canada's lawyer, Nicholas M. Fausto, Esq. ("Fausto"), is in the practice of submitting "canned objections," thus the Court should be wary of his objection. On this latter point too, Plaintiffs may be correct.

Much of the language in Fausto's brief attacking the use of FIFO is taken directly from Judge Schiendlin's opinion in *In re Espeed, Inc. Secs. Litig.*, 232 F.R.D. 95 (S.D.N.Y. 2005). Despite the fact that it is the most comprehensive authority from this District supporting his argument, Fausto fails to cite the case, choosing instead to lift whole sentences from that opinion without attribution. *Compare* Canada Obj. 7-8, *with In re eSpeed,* 232 F.R.D. at 101-02 & nn.35-36. None of his arguments are original, nor are they made in the context of the specific factual circumstances of this case. Although I am wary of the Canada objection, I will briefly address the thrust of its argument.

[*61] In the context of a securities class action, FIFO and LIFO refer to methods used for matching purchases and sales of stock during the class period in order to measure a class member's damages. Under FIFO, a class member's damages are calculated by matching her first purchases during the class period with her first sales during the class period. Under LIFO, a class member's damages are calculated by matching the class member's last purchases during the class period with the first sales made during the period. Calculating recovery by means of these different methods can affect the measure of a class members' injury. Depending on the trajectory of a stock's percentage of artificial inflation and the sale of shares during the class period, use of FIFO may result in damages where LIFO would not, and vice versa.

The method used to match purchases and sales when calculating damages in a securities action has only recently been the subject of judicial scrutiny and has more commonly arisen in the context of a court's assignment of lead plaintiff status. In this District, both FIFO and LIFO have been used to calculate the financial stake of movants for lead plaintiff status in securities class **[*62]** actions. *Compare In re Veeco Instruments Inc. Sec. Litig.*, 233 F.R.D. 330, 333 (S.D.N.Y. 2005) (concluding that FIFO is "the appropriate methodology . . . for the purpose of considering the financial stake of the movant for lead plaintiff status"), *with In re eSpeed, Inc. Sec. Litig.*, 232 F.R.D. 95, 100-02 (S.D.N.Y. 2005) (concluding that lead plaintiff movant's "loss as calculated by the [movant] demonstrates why FIFO (as applied by the [movant]) is inferior to LIFO"). Determining the method of analysis is especially important in the context of lead plaintiff selection because prospective lead plaintiffs may manipulate their analysis in order to inflate their measure of damages, giving them an advantage over movants that calculate damages according to a different methodology. [23]

23 The method of analysis was not contested during the selection of lead plaintiff in this case. Without any objection, FIFO was used to calculate the damages in movants' applications for

lead plaintiff. (Crawford Aff. Ex. B, Oct. 15, 2002.) Furthermore, the more than half million claimants to this Settlement have submitted their claims on the basis of the Plan of Allocation as presented here.

[*63] The LIFO/FIFO debate has not arisen in the context of a plan of allocation anywhere in this Circuit, [24] and Canada's conclusory objection fails to raise the slightest inference of how the Plan of Allocation's use of FIFO is unfair here. *Cf. In re eSpeed,* 232 F.R.D. at 101 (finding FIFO unfair in movant's application for lead plaintiff status in light of the movant's specific, manipulative application of FIFO in that case). Nor can Canada explain how the method of analysis would affect his recovery, as he claims to have made only a single purchase of stock and LIFO/FIFO is necessarily concerned with the matching of multiple stock purchases. Here, the Plan of Allocation is careful to limit a claimant's recovery to shares sold at a loss. Moreover, Plaintiff's economic expert affirms that "the overall effect of using the LIFO method instead of FIFO is not significant in this case." (Hakala Decl. P27.) Ultimately, there is no evidence that the method of analysis used in this case would result in an unfair distribution of the Settlement Fund. [25]

24 One court in this District recently approved a Plan of Allocation using LIFO, but did not elaborate on the choice of methodology, nor is their any evidence that the method of analysis was contested in that case. *See SEC v. Bear, Stearns & Co.,* 2005 U.S. Dist. LEXIS 6683, No. 03 Civ. 2937, 2005 WL 217018, at *7 (S.D.N.Y. Jan. 31, 2005). The unelaborated use of LIFO in one case does not compel the use of that method of analysis in all cases. Both Hakala and the Settlement Administrator affirm that FIFO has been used in the great majority of the plans of allocation that they have prepared and administrated in the past. (Hakala Decl. P22; Forrest Decl. P12.)

[*64]

25 This Opinion should not be read as an unconditional endorsement of FIFO as the method for matching purchases and sales for the calculation of damages in securities fraud litigation. Rather, the insignificance of the methodology applied in this case makes it counter-productive to require Plaintiffs to revise the Plan of Allocation and reinitiate the Notice period in order to calculate damages according to LIFO.

In light of overwhelming support for the Plan of Allocation by nearly all of the estimated 600,000 claimants to the Settlement, and the insignificance of the method of matching sales with purchases in the context of this case, I find the Plan of Allocation fair, reasonable, and adequate.

III. Conclusion

For the foregoing reasons, Lead Plaintiff's petition for approval of the Settlement and Plan of

Allocation is granted. A separate opinion establishing attorney's fees and expenses will follow.

SO ORDERED.

SHIRLEY WOHL KRAM

UNITED STATES DISTRICT JUDGE

Dated: New York, New York

April 6, 2006

Ontario Securities Commission
Commission des valeurs mobilières de l'Ontario
P.O. Box 55, 19th Floor
20 Queen Street West
Toronto ON M5H 3S8
CP 55, 19e étage
20, rue queen ouest
Toronto ON M5H 3S8

IN THE MATTER OF THE SECURITIES ACT
R.S.O. 1990, c.S.5, as amended

- and -

IN THE MATTER OF
SINO-FOREST CORPORATION, ALLEN CHAN, ALBERT IP, ALFRED C.T. HUNG, GEORGE HO AND SIMON YEUNG

TEMPORARY O R D E R

(Section 127(1) & (5))

WHEREAS it appears to the Ontario Securities Commission (the "Commission") that:

1. Sino-Forest Corporation ("Sino-Forest") is a publicly traded Canadian company and a "reporting issuer" in Ontario and other provinces, as that term is defined in section 1(1) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act");

2. Allen Chan ("Chan") is Chairman and Chief Executive Officer ("CEO") of Sino-Forest;

3. Albert Ip ("Ip") is the Senior Vice President Development and Operations North–East and South-West China of Sino-Forest;

4. Alfred C.T. Hung ("Hung") is Vice-President Corporate Planning and Banking of Sino-Forest;

5. George Ho ("Ho") is Vice-President Finance of Sino-Forest;

6. Simon Yeung ("Yeung") is Vice President - Operation within the Operation / Project Management group of Sino-Panel (Asia) Inc., a subsidiary of Sino-Forest ("Yeung");

7. Since 2003, Sino-Forest has raised approximately $2.986 billion from public investment and/or debt securities issues including four public offerings between 2004 and 2009 which approximately raised $1.05 billion;

8. Sino-Forest has over 150 subsidiaries, the majority of which are registered in the British Virgin Islands and Peoples Republic of China ("PRC");

9. Sino-Forest's operations are predominately in the PRC and its management has offices in Hong Kong primarily and also in the PRC and Ontario;

10. Staff of the Commission is conducting an investigation into the activities and business of Sino-Forest and its subsidiaries and their management;

11. The Independent Committee of Sino-Forest has also been conducting an investigation into the activities and business of Sino-Forest and its subsidiaries and their management. As a result, Sino-Forest has recently suspended Ho, Hung, and Yeung temporarily and curtailed Ip's duties and responsibilities.

12. Sino-Forest, through its subsidiaries, appears to have engaged in significant non-arm's length transactions which may have been contrary to Ontario securities laws and the public interest;

13. Sino-Forest and certain of its officers and directors appear to have misrepresented some of its revenue and/or exaggerated some of its timber holdings by providing information to the public in documents required to be filed or furnished under Ontario securities laws which may have been false or misleading in a material respect contrary to section 122 or 126.2 of the Act and contrary to the public interest;

14. Sino-Forest and certain of its officers and directors including Chan appear to be engaging or participating in acts, practices or a course of conduct related to its securities which it and/or they know or reasonably ought to know perpetuate a fraud on any person or company contrary to section 126.1 of the Act and contrary to the public interest;

AND WHEREAS, the Commission is of the opinion that the time required to conclude a hearing could be prejudicial to the public interest as set out in section 127(5) of the Act;

AND WHEREAS the Commission considers it to be in the public interest to make this order;

AND WHEREAS by Authorization Order made July 14, 2011, pursuant to subsection 3.5(3) of the Act, each of Howard I. Wetston, James E. A. Turner, Kevin J. Kelly, James D. Carnwath, Mary G. Condon, Paulette L. Kennedy, Vern Krishna, Christopher Portner and Edward P. Kerwin, acting alone, is authorized, to exercise the powers of the Commission under the Act, subject to subsection 3.5(4) of the Act, to make orders under section 17 of the Act.

IT IS HEREBY ORDERED that, pursuant to clause 2 of section 127(1) of the Act that all trading in the securities of Sino-Forest shall cease;

IT IS FURTHER ORDERED that pursuant to clauses 7 and 8 of section 127(1) of the Act that Chan, Ip, Hung, Ho and Yeung resign any and all positions that they hold as a director or officer of Sino-Forest or any other registrant and that they are prohibited from becoming or acting as director or officer of an issuer;

IT IS FURTHER ORDERED that pursuant to clause 2 of section 127(1) of the Act that all trading by Chan, Ip, Hung, Ho and Yeung in securities shall cease;

IT IS FURTHER ORDERED that, pursuant to section 127(6) of the Act that this order shall take effect immediately and shall expire on the fifteenth day after its making unless extended by order of the Commission.

DATED at Toronto this 26th day of August, 2011.

"Howard Wetston"

Howard Wetston, Chair

Indexed as:

Hercules Managements Ltd. v. Ernst & Young

Hercules Managements Ltd., Guardian Finance of Canada Ltd. and Max Freed, appellants (plaintiffs/respondents), and Friendly Family Farms Ltd., Woodvale Enterprises Ltd., Arlington Management Consultants Ltd., Emarjay Holdings Ltd. and David Korn, (plaintiffs);

v.

Ernst & Young and Alexander Cox, respondents (defendants/applicants), and Max Freed, David Korn and Marshall Freed, (third parties), and The Canadian Institute of Chartered Accountants, intervener.

[1997] 2 S.C.R. 165

[1997] S.C.J. No. 51

File No.: 24882.

Supreme Court of Canada

1996: December 6 / 1997: May 22.

Present: La Forest, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR MANITOBA

Negligence -- Negligent misrepresentation -- Auditors' report prepared for company -- Report required by statute -- Individual investors alleging investment losses and losses in value of existing shareholdings incurred because of reliance on audit reports -- Whether auditors owed individual investors a duty of care with respect to the investment losses and the losses in the value of existing shareholdings -- Whether the rule in Foss v. Harbottle affects the appellants' action.

Northguard Acceptance Ltd. ("NGA") and Northguard Holdings Ltd. ("NGH") carried on business lending and investing money on the security of real property mortgages. The appellant Guardian

Finance of Canada Ltd. ("Guardian") was the sole shareholder of NGH and it held non-voting class B shares in NGA. The appellants Hercules Managements Ltd. ("Hercules") and Max Freed were also shareholders in NGA. At all relevant times, ownership in the corporations was separated from management. The respondent Ernst & Young was originally hired by NGA and NGH in 1971 to perform annual audits of their financial statements and to provide audit reports to the companies' shareholders. The partner in charge of the audits for the years 1980 and 1981, Cox, held personal investments in some of the syndicated mortgages administered by NGA and NGH.

In 1984, both NGA and NGH went into receivership. The appellants, and a number of other shareholders or investors in NGA, brought an action against the respondents in 1988 alleging that the audit reports for the years 1980, 1981 and 1982 were negligently prepared and that in reliance on these reports, they suffered various financial losses. They also alleged that a contract existed between themselves and the respondents in which the respondents explicitly undertook to protect the shareholders' individual interests in the audits as distinct from the interests of the corporations themselves.

The respondents brought a motion for summary judgment in the Manitoba Court of Queen's Bench seeking to have the plaintiffs' claims dismissed. The grounds for the motion were (a) that there was no contract between the plaintiffs and the respondents; (b) that the respondents did not owe the individual plaintiffs any duty of care in tort; and (c) that the claims asserted by the plaintiffs could only properly be brought by the corporations themselves and not by the shareholders individually. The motions judge granted the motion with respect to four plaintiffs, including the appellants, and dismissed their actions on the basis that they raised no genuine issues for trial. By agreement, the claims of the remaining plaintiffs were adjourned sine die. An appeal to the Manitoba Court of Appeal was unanimously dismissed with costs.

At issue here are: (1) whether the respondents owe the appellants a duty of care with respect to (a) the investment losses they incurred allegedly as a result of reliance on the 1980-82 audit reports, and (b) the losses in the value of their existing shareholdings they incurred allegedly as a result of reliance on the 1980-82 audit reports; and (2) whether the rule in Foss v. Harbottle (which provides that individual shareholders have no cause of action in law for any wrongs done to the corporation) affects the appellants' action.

Held: The appeal should be dismissed.

Four preliminary matters were addressed before the principal issue. Firstly, the question to be decided on a motion for summary judgment under rule 20 of the Manitoba Court of Queen's Bench Rules is whether there is a genuine issue for trial. Although a defendant who seeks dismissal of an action has an initial burden of showing that the case is one in which the existence of a genuine issue is a proper question for consideration, it is the plaintiff who must then, according to the rule, establish his claim as being one with a real chance of success. Thus, the appellants (who were the plaintiffs-respondents on the motion) bore the burden of establishing that their claim had "a real chance of success". Secondly, no contract existed between the appellant shareholders and the respondents and, in any event, the contract claim was not properly before this Court. Consequently, the appellants' submissions in this regard must fail. Thirdly, the independence requirements set out in s. 155 of the Manitoba Corporations Act do not themselves give rise to a cause of action in negligence. Similarly, breach of those independence requirements could not establish a duty of care in tort. Finally, it was not necessary to inquire into whether the appellants actually relied on the audited reports prepared by the respondents because the finding of an absence of a duty of care rendered the question of actual reliance inconsequential.

The existence of a duty of care in tort is to be determined through an application of the two-part Anns/Kamloops test (Anns v. Merton London Borough Council; Kamloops (City of) v. Nielsen). That approach should be taken here. To create a "pocket" of negligent misrepresentation cases in which the existence of a duty of care is determined differently from other negligence cases would be incorrect. Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of the audit reports, therefore, depends on (a) whether a prima facie duty of care is owed, and (b) whether that duty, if it exists, is negated or limited by policy considerations.

The existence of a relationship of "neighbourhood" or "proximity" distinguishes those circumstances in which the defendant owes a prima facie duty of care to the plaintiff from those where no such duty exists. In the context of a negligent misrepresentation action, deciding whether a prima facie duty of care exists necessitates an investigation into whether the defendant-representor and the plaintiff-representee can be said to be in a relationship of proximity or neighbourhood. The term "proximity" itself is nothing more than a label expressing a result, judgment or conclusion and does not, in and of itself, provide a principled basis on which to make a legal determination.

"Proximity" in negligent misrepresentation cases pertains to some aspect of the relationship of reliance. It inheres when (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation, and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable.

Looking to whether reliance by the plaintiff would be reasonable in determining whether a prima facie duty of care exists (as opposed to looking at reasonable foreseeability alone) is not to abandon the basic tenets underlying the first branch of the Anns/Kamloops test. While specific inquiries into the reasonableness of the plaintiff's expectations are not normally required in the context of physical damage cases (since the law has come to recognize implicitly that plaintiffs are reasonable in expecting that defendants will take reasonable care of their persons and property), such an inquiry is necessary in the negligent misrepresentation context. This is because reliance by a plaintiff on a defendant's representation will not always be reasonable. Only by inquiring into the reasonableness of the plaintiff's reliance will the Anns/Kamloops test be applied consistently in both contexts.

The reasonable foreseeability/reasonable reliance test for determining a prima facie duty of care is somewhat broader than the tests used both in the cases decided before Anns and in those that have rejected the Anns approach. Those cases typically require (a) that the defendant know the identity of either the plaintiff or the class of plaintiffs who will rely on the statement, and (b) that the reliance losses claimed by the plaintiff stem from the particular transaction in respect of which the statement at issue was made. In reality, inquiring into such matters is nothing more than a means by which to circumscribe -- for reasons of policy -- the scope of a representor's potentially infinite liability. In other words, adding further requirements to the duty of care test provides a means by which concerns that are extrinsic to simple justice -- but that are, nevertheless, fundamentally important -- may be taken into account in assessing whether the defendant should be compelled to compensate the plaintiff for losses suffered.

In light of this Court's endorsement of the Anns/Kamloops test, enquiries concerning (a) the defendant's knowledge of the identity of the plaintiff (or of the class of plaintiffs) and (b) the use to which the statements at issue are put may now quite properly be conducted in the second branch of that test when deciding whether policy considerations ought to negate or limit a prima facie duty that has already been found to exist. Criteria that in other cases have been used to define the legal test for the duty of care can now be recognized as policy-based ways by which to curtail liability and they can appropriately be considered under the policy branch of the Anns/Kamloops test.

The fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that the defendant might be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class". While the criteria of reasonable foreseeability and reasonable reliance serve to distinguish cases where a prima facie duty is owed from those where it is not, these criteria can, in certain types of situations, quite easily be satisfied and, absent some means by which to circumscribe the ambit of the duty, the prospect of limitless liability will loom. The general area of auditors' liability is a case in point. Here, the problem of indeterminate liability will often arise because the reasonable foreseeability/reasonable reliance test for ascertaining a prima facie duty of care may be satisfied in many, even if not all, such cases.

While policy concerns surrounding indeterminate liability will serve to negate a prima facie duty of care in many auditors' negligence cases, there may be particular situations where such concerns do not inhere. The specific factual matrix of a given case may render it an "exception" to the general class of cases, in that while considerations of proximity might militate in favour of finding that a duty of care inheres, the typical policy considerations stemming from indeterminate liability do not arise.

This concept can be articulated within the framework of the Anns/Kamloops test. Under this test, factors such as (1) whether the defendant knew the identity of the plaintiff (or the class of plaintiff) and (2) whether the defendant's statements were used for the specific purpose or transaction for which they were made ought properly to be considered in the "policy" branch of the test once the first branch concerning "proximity" has been found to be satisfied. The absence of these factors will normally mean that concerns over indeterminate liability inhere and, therefore, that the prima facie duty of care will be negated. Their presence, however, will mean that worries stemming from indeterminacy should not arise since the scope of liability is sufficiently delimited. In such cases, policy considerations will not override a positive finding on the first branch of the Anns/Kamloops test and a duty of care will quite properly be found to exist.

On the facts of this case, the respondents clearly owed a prima facie duty of care to the appellants. Firstly, the possibility that the appellants would rely on the audited financial statements in conducting their affairs and that they might suffer harm if the reports were negligently prepared must have been reasonably foreseeable to the respondents. Secondly, reliance on the audited statements by the appellant shareholders would, on the facts, be reasonable given both the relationship between the parties and the nature of the statements themselves. The first branch of the Anns/Kamloops test is therefore satisfied.

As regards the second branch of this test, it is clear that the respondents knew the identity of the appellants when they provided the audit reports. In determining whether this case is an "exception" to the generally prevailing policy concerns regarding auditors, the central question is therefore whether the appellants can be said to have used the audit reports for the specific purpose for which they were prepared. The answer will determine whether policy considerations surrounding indeterminate liability ought to negate the prima facie duty of care owed by the respondents.

The respondent auditors' purpose in preparing the reports was to assist the collectivity of shareholders of the audited companies in their task of overseeing management. The respondents did not prepare the audit reports in order to assist the appellants in making personal investment decisions or, indeed, for any purpose other than the standard statutory one. The only purpose for which the reports could have been used so as to give rise to a duty of care on the part of the respondents, therefore, is as a guide for the shareholders, as a group, in supervising or overseeing management.

In light of this finding, the specific claims of the appellants could each be assessed. Those claims were in respect of: (1) moneys injected into NGA and NGH by Hercules and Freed, and (2) the devaluation of existing equity caused by the appellants' alleged inability (a) to oversee personal investments properly, and (b) to supervise the management of the corporations with a view to protecting their personal holdings.

As regards the first claim, the appellants alleged that they relied on the respondents' audit reports for the purpose of making individual investments. Since this was not a purpose for which the reports were prepared, policy concerns surrounding indeterminate liability are not obviated and these claims must fail. Similarly, the first branch of the appellants' second claim must fail since monitoring existing personal investments is likewise not a purpose for which the audited statements were prepared.

With respect to the second branch relating to the devaluation of appellants' equity, the appellants' position may at first seem consistent with the purpose for which the reports were prepared. In reality, however, their claim did not involve the purpose of overseeing management per se. Rather, it ultimately depended on being able to use the auditors' reports for the individual purpose of overseeing their own investments. Thus, the purpose for which the reports were used was not, in fact, consistent with the purpose for which they were prepared. The policy concerns surrounding indeterminate liability accordingly inhered and the prima facie duty of care was negated in respect of this claim as well.

The absence of a duty of care with respect to the appellant's alleged inability to supervise management in order to monitor their individual investments is consistent with the rule in Foss v. Harbottle which provides that individual shareholders have no cause of action for wrongs done to the corporation. When, as a collectivity, shareholders oversee the activities of a corporation through resolutions adopted at shareholder meetings, they assume what may be seen to be a "managerial" role. In this capacity, they cannot properly be understood to be acting simply as individual holders of equity. Rather, their collective decisions are made in respect of the corporation itself. Any duty owed by auditors in respect of this aspect of the shareholders' functions is owed not to shareholders qua individuals, but rather to all shareholders as a group, acting in the interests of the corporation. Since the decisions taken by the collectivity of shareholders are in respect of the corporation's affairs, the shareholders' reliance on negligently prepared audit reports in taking such decisions will result in a wrong to the corporation for which the shareholders cannot, as individuals, recover. A derivative action would have been the proper method of proceeding with respect to this claim.

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Considered: Fidkalo v. Levin (1992), 76 Man. R. (2d) 267; Caparo Industries plc. v. Dickman, [1990] 1 All E.R. 568; Anns v. Merton London Borough Council, [1978] A.C. 728; Kamloops (City of) v. Nielsen, [1984] 2 S.C.R. 2; Canadian National Railway Co. v. Norsk Pacific Steamship Co., [1992] 1 S.C.R. 1021; Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465; Haig v. Bamford, [1977] 1 S.C.R. 466; Ultramares Corp. v. Touche, 174 N.E. 441 (1931); Glanzer v. Shepard, 135 N.E. 275 (1922); referred to: Foss v. Harbottle (1843), 2 Hare 460, 67 E.R. 189; Hercules Management Ltd. v. Clarkson Gordon (1994), 91 Man. R. (2d) 216; R. in right of Canada v. Saskatchewan Wheat Pool, [1983] 1 S.C.R. 205; Queen v. Cognos Inc., [1993] 1 S.C.R. 87; Murphy v. Brentwood District Council, [1991] 1 A.C. 398; Sutherland Shire Council v. Heyman (1985), 60 A.L.R. 1; B.D.C. Ltd. v. Hofstrand Farms Ltd., [1986] 1 S.C.R. 228; London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299; Winnipeg Condominium Corporation No. 36 v. Bird Construction Co., [1995] 1 S.C.R. 85; Edgeworth Construction Ltd. v. N. D. Lea & Associates Ltd., [1993] 3 S.C.R. 206; Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553; Donoghue v. Stevenson, [1932] A.C. 562; Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164; H. Rosenblum (1983), Inc. v. Adler, 461 A.2d 138 (1983); Roman Corp. Ltd. v. Peat Marwick Thorne (1992), 11 O.R. (3d) 248; Roman Corp. v. Peat Marwick Thorne (1993), 12 B.L.R. (2d) 10; Prudential Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354; Goldex Mines Ltd. v. Revill (1974), 7 O.R. (2d) 216.

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Companies Act 1985 (U.K.), 1985, c. 6.
Corporations Act, R.S.M. 1987, c. C225, ss. 149(1), 155(1), (2), (6), 163(1), 232.
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APPEAL from a judgment of the Manitoba Court of Appeal (1995), 102 Man. R. (2d) 241, 93 W.A.C. 241, 125 D.L.R. (4th) 353, 19 B.L.R. (2d) 137, 24 C.C.L.T. (2d) 284, dismissing an appeal from judgment by Dureault J. Appeal dismissed.

Mark M. Schulman, Q.C., and Brian A. Crane, Q.C., for the appellants.
Robert P. Armstrong, Q.C., and Thor J. Hansell, for the respondents.
W. Ian C. Binnie, Q.C., and Geoff R. Hall, for the intervener.

Solicitors for the appellants: Schulman & Schulman, Winnipeg.
Solicitors for the respondents: Aikins, MacAulay, Thorvaldson, Winnipeg.
Solicitors for the intervener: McCarthy, Tétrault, Toronto.

The judgment of the Court was delivered by

1 **LA FOREST J.**:-- This appeal arises by way of motion for summary judgment. It concerns the issue of whether and when accountants who perform an audit of a corporation's financial statements owe a duty of care in tort to shareholders of the corporation who claim to have suffered losses in reliance on the audited statements. It also raises the question of whether certain types of claims against auditors may properly be brought by shareholders as individuals or whether they must be brought by the corporation in the form of a derivative action.

Facts

2 Northguard Acceptance Ltd. ("NGA") and Northguard Holdings Ltd. ("NGH") carried on business lending and investing money on the security of real property mortgages. The appellant Guardian Finance of Canada Ltd. ("Guardian") was the sole shareholder of NGH and it held non-voting class B shares in NGA. The appellants Hercules Managements Ltd. ("Hercules") and Max Freed were also shareholders in NGA. At all relevant times, ownership in the corporations was separated from management. The respondent Ernst & Young (formerly known as Clarkson Gordon) is a firm of chartered accountants that was originally hired by NGA and NGH in 1971 to perform annual audits of their financial statements and to provide audit reports to the companies' shareholders. The partner in charge of the audits for the years 1980 and 1981 is the respondent William Alexander Cox. Mr. Cox held personal investments in some of the syndicated mortgages administered by NGA and NGH.

3 In 1984, both NGA and NGH went into receivership. The appellants, as well as Friendly Family Farms Ltd. ("F.F. Farms"), Woodvale Enterprises Ltd. ("Woodvale"), Arlington Management Consultants Ltd. ("Arlington"), Emarjay Holdings Ltd. ("Emarjay") and David Korn (all of whom were shareholders or investors in NGA) brought an action against the respondents in 1988 alleging that the audit reports for the years 1980, 1981 and 1982 were negligently prepared and that in reliance on these reports, they suffered various financial losses. More specifically, the appellant Hercules sought damages for advances totalling $600,000 which it made to NGA in January and February of 1983, and the appellant Freed sought damages for monies he added to an investment account in NGH in 1982. All the plaintiffs claimed damages in tort for the losses they suffered in the value of their existing shareholdings. In addition to their tort claims, the plaintiffs also alleged that a contract existed between themselves and the respondents in which the respondents explicitly undertook, as of 1978, to protect the shareholders' individual interests in the audits as distinct from the interests of the corporations themselves.

4 After a series of amendments to the initial statement of claim, over 40 days of discovery, and numerous pre-trial conferences and case management sessions, the respondents brought a motion for summary judgment in the Manitoba Court of Queen's Bench seeking to have the plaintiffs' claims dismissed. The grounds for the motion were (a) that there was no contract between the plaintiffs and the respondents; (b) that the respondents did not owe the individual plaintiffs any duty

of care in tort; and (c) that the claims asserted by the plaintiffs could only properly be brought by the corporations themselves and not by the shareholders individually. The motions judge granted the motion with respect to the plaintiffs Hercules, F.F. Farms, Woodvale, Guardian and Freed and dismissed their actions on the basis that they raised no genuine issues for trial. By agreement, the claims of the remaining plaintiffs were adjourned sine die. An appeal to the Manitoba Court of Appeal by Hercules, Guardian and Freed was unanimously dismissed with costs. Leave to appeal to this Court was granted on March 7, 1996 and the appeal was heard on December 6, 1996.

Judicial History

Manitoba Court of Queen's Bench

5 Dureault J. began his reasons by noting that only the claims of Hercules, F.F. Farms, Woodvale, Guardian and Freed had to be addressed since, by agreement, the claims of the other plaintiffs had been adjourned. He then proceeded to set out the appropriate test to be applied in summary judgment motions. Referring to Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules, Reg. 553/88, (which governs summary judgment motions) and citing Fidkalo v. Levin (1992), 76 Man. R. (2d) 267 (C.A.), he explained that while the defendant bears the initial burden of proving that the case is one where the question whether there exists a genuine issue for trial can properly be raised, the plaintiff bears the subsequent burden of establishing that his claim has a real chance of success.

6 After rejecting the claim of the plaintiff F.F. Farms on the ground that it failed from the outset to establish any cause of action, Dureault J. turned to the more substantive issues in the motion. He began by addressing the question whether the plaintiffs qua shareholders may properly bring an action for the devaluation in their shareholdings in NGA and NGH, and held that

> . . . shareholders have no cause of action in law for any wrongs which may have been inflicted upon a corporation. This principle of law is often referred to as "the rule in Foss v. Harbottle". The plaintiff shareholders are trying to get around this principle. At best, if any wrong was done in the conduct of the defendants' audits, it was done to [NGA] and [NGH] and cannot be considered an injury sustained by the shareholders.

Dureault J. found on this basis that the claims of Hercules, Guardian, Woodvale and Freed did not disclose any genuine issue for trial since they ought to have been brought by the corporations and not by the plaintiffs as individual shareholders.

7 The motions judge next addressed the question whether any duty of care in tort was owed by the defendants to the plaintiffs in their capacities as either shareholders or investors in the audited corporations. He noted that

> [g]enerally speaking, the law requires more than foreseeability and reliance.

> Actual knowledge on the part of the accountant/auditor of the limited class that will use and rely on the statements, referred to as the "proximity test", is also required.

Adopting the defendants' submissions on this issue, Dureault J. found that no duty of care was owed the plaintiffs because the audited statements were not prepared specifically for the purpose of assisting them in making investment decisions.

8 Finally, Dureault J. addressed the plaintiffs' claim that their losses stemmed from a breach of contract by the defendants. He recognized that the engagement of the auditors by the corporations is a contractual relationship, but rejected the contention that this relationship can be extended to include the shareholders so as to permit them to bring personal actions against the auditors in the event of breach. Finding that none of the plaintiffs' claims raised a genuine issue for trial, Dureault J. granted the motion with costs.

Manitoba Court of Appeal (1995), 102 Man. R. (2d) 241 (Philp, Lyon and Helper JJ.A.)

9 An appeal was brought to the Manitoba Court of Appeal by Hercules, Guardian and Freed. Helper J.A., writing for the court, began her reasons by finding that the learned motions judge had correctly applied the Fidkalo test for summary judgment motion under Rule 20.03(1) She also distinguished that test from that applicable on a motion to strike pleadings on the ground that, unlike the situation on a motion to strike, a Rule 20 motion requires an examination of the evidence in support of the plaintiff's claim.

10 Turning to the question whether the respondents owed a duty of care in tort to the appellants, Helper J.A. noted the latter's two alternative submissions. The first (at p. 244) was that

> . . . a common law duty of care arose . . . because the respondents knew or ought to have known: i) that the appellants were relying on the audited statements and the services and advice provided by the respondents; ii) the purpose for which the appellants would rely upon the respondents' services and statements; iii) that the appellants did so rely upon those audited statements for investment and other purposes; and iv) that the respondents breached their duties to the appellants thereby causing them a financial loss.

In response to this claim, Helper J.A. explained, the respondents contended that the appellants were simply trying to avoid the rule in Foss v. Harbottle (1843), 2 Hare 460, 67 E.R. 189 (H.L.), by asserting their claims as individual shareholders rather than by way of derivative action. The respondents also argued that they had no knowledge that investments would be made on the basis of the audited statements and that there was no evidence to support the contention that they ought to have known that their reports would be relied upon in this manner. Finally, Helper J.A. noted, the respondents asserted that there was no evidence demonstrating that the appellants had, in fact, relied on the audited statements at issue.

11 In analysing this first main submission, Helper J.A. undertook a thorough review of Caparo Industries plc. v. Dickman, [1990] 1 All E.R. 568, where the House of Lords considered the question of the scope of the duty of care owed by auditors to shareholders and investors. After reviewing the Canadian case law on the matter, she concluded, at p. 248, that

> [t]he appellants were unable to direct this court to any evidence in support of their position which was ignored by the motions judge. Nor am I persuaded that the order dismissing the appellants' claims is contrary to the existing jurisprudence.
>
> The evidence showed that the auditors had prepared the annual reports to comply with their statutory obligations. There was a total absence of evidence to indicate the respondents knew the appellants would rely upon the reports for any specific purpose or that the appellants did rely upon the reports before infusing more capital into their companies. The appellants were content to allow management to continue running the companies despite a drop in profitability reflected in the 1982 audited report and invested more capital in the face of that report. The evidence filed in opposition to the motion did not support the appellants' claim on this issue.

In the view of the Manitoba Court of Appeal, then, the first of the appellants' submissions regarding the existence of a duty of care could not succeed.

12 The appellants' second main submission concerning the existence of a duty of care consisted in an allegation that the respondent auditors contravened the statutory independence requirements set out in s. 155 of the Manitoba Corporations Act, R.S.M. 1987, c. C225, and that this in itself gave rise to a cause of action in the individual shareholders. The relevant portions of s. 155 are as follows:

> 155(1) Subject to subsection (5), a person is disqualified from being an auditor of a corporation if he is not independent of the corporation, all of its affiliates, and the directors or officers of the corporation and its affiliates.

155(2)For the purposes of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if he or his business partner

(i) is a business partner, a director, an officer or an employee of the corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates, or
(ii) beneficially owns or controls, directly or indirectly, a material interest in the securities of the corporation or any of its affiliates, or
(iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

. . .

155(6) The shareholders of a corporation may resolve to appoint as auditor, a person otherwise disqualified under subsections (1) and (2) if the resolution is consented to by all the shareholders including shareholders not otherwise entitled to vote.

Specifically, the appellants alleged that because s. 155(6) of the Act allows a single shareholder to exercise a veto power over the appointment of the auditors, each shareholder also has a right of action against the auditors where damage has been occasioned by a breach of the independence requirement in s. 155(2). Helper J.A. rejected this submission both on the ground that it was unsupported by authority and on the basis that the wording of s. 155 as a whole does not suggest the interpretation urged by the appellants.

13 Finally, Helper J.A. addressed the appellants' contractual claim and held that the respondents' engagement to audit the financial statements of NGA and NGH in accordance with the Act did not give rise to a contractual relationship between them and the appellants. Similarly, she found the appellants could not sue on the contract between the corporations and the respondent Ernst & Young because of the lack of privity. Finding no evidence to support the existence of the requisite contractual relationship, Helper J.A. rejected the appellants' claim in this regard. For all these reasons, the Court of Appeal unanimously dismissed the appeal with costs.

Issues

14 The issues in this case may be stated as follows:

(1) Do the respondents owe the appellants a duty of care with respect to

(a) the investment losses they incurred allegedly as a result of reliance on the 1980-82 audit reports; and
(b) the losses in the value of their existing shareholdings they incurred allegedly as a result of reliance on the 1980-82 audit reports?

(2) Does the rule in Foss v. Harbottle affect the appellants' action?

Analysis

Preliminary Matters

15 Four preliminary matters should be addressed before turning to the principal issues in this appeal. The first concerns the procedure to be followed in a motion for summary judgment brought under Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules. That rule provides as follows:

> 20.03(1) Where the court is satisfied that there is no genuine issue for trial with respect to a claim or defence, the court shall grant summary judgment accordingly.

I would agree with both the Court of Appeal and the motions judge in their endorsement of the procedure set out in Fidkalo, supra, at p. 267, namely:

> The question to be decided on a rule 20 motion is whether there is a genuine issue for trial. Although a defendant who seeks dismissal of an action has an initial burden of showing that the case is one in which the existence of a genuine issue is a proper question for consideration, it is the plaintiff who must then, according to the rule, establish his claim as being one with a real chance of success.

In the instant case, then, the appellants (who were the plaintiffs-respondents on the motion) bore the burden of establishing that their claim had "a real chance of success". They bear the same burden in this Court.

16 The second preliminary matter concerns the appellants' claim that as a result of a meeting in the summer of 1978 between David Korn, Max Freed and the respondent Cox and in light of an engagement letter sent by the respondents to NGA and NGH in 1981, a contract was formed between the shareholders of the audited corporations, on the one hand, and the respondents, on the other. This purported contract ostensibly required the respondents to conduct their audits for the benefit of the shareholders themselves and not merely for the benefit of the corporations. I have reviewed the portions of the record upon which the appellants base this submission and I am unable to find that the requisite elements of contract formation inhere on the facts. In any event, as the respondents pointed out, the appellants' request to amend their pleadings before trial to include a claim for breach of contract was denied by Kennedy J. and no appeal was brought from that decision. (See: Hercules Management Ltd. v. Clarkson Gordon (1994), 91 Man. R. (2d) 216 (Q.B.).) I would find, therefore, that the claim in breach of contract is not properly before this Court and that the appellants' submissions in this regard must fail.

17 Thirdly, the appellants allege that the respondent Cox's investments in certain syndicated mortgages administered by NGA and NGH constituted a breach of the statutory independence requirements set out in s. 155 of the Manitoba Corporations Act and that such a breach either gives rise to a private law cause of action or, alternatively, that it provides an independent basis for finding a duty of care in a tort action. Assuming without deciding that the respondent Cox was in breach of the independence requirements set out in that section, I would agree with Helper J.A. in finding that the section does not, in and of itself, give rise to a cause of action in negligence; see: R. in right of Canada v. Saskatchewan Wheat Pool, [1983] 1 S.C.R. 205. Similarly, I cannot see how breach of the independence requirements could establish a duty of care in tort. This does not mean, of course, that the statutory audit requirements set out in the Manitoba Corporations Act are entirely irrelevant to the appellants' claim. Rather, it simply means that a breach of the independence provisions does not, by itself, give rise either to an independent right of action or to a duty of care.

18 The final preliminary matter concerns whether or not the appellants actually relied on the 1980-82 audited reports prepared by the respondents. More specifically, the appellants allege that the Court of Appeal erred in finding, at p. 248, that

> [t]here was a total absence of evidence to indicate the respondents knew the appellants would rely upon the reports for any specific purpose or that the appellants did rely upon the [1980-82] reports before infusing more capital into their companies. The appellants were content to allow management to continue running the companies despite a drop in profitability reflected in the 1982 audited report and invested capital in the face of that report. The evidence filed in opposition to the motion did not support the appellants' claim on this issue. [Emphasis added.]

Needless to say, actual reliance is a necessary element of an action in negligent misrepresentation and its absence will mean that the plaintiff cannot succeed in holding the defendant liable for his or her losses; see: Queen v. Cognos Inc., [1993] 1 S.C.R. 87, at p. 110. In light of my disposition on the duty of care issue, however, it is unnecessary to inquire into this matter here -- the absence of a duty of care renders inconsequential the question of actual reliance. Having dealt with all four preliminary matters, then, I can now turn to a discussion of the principal issues in this appeal.

Issue 1: Whether the Respondents owe the Appellants a Duty of Care

(i) Introduction

19 It is now well established in Canadian law that the existence of a duty of care in tort is to be determined through an application of the two-part test first enunciated by Lord Wilberforce in Anns v. Merton London Borough Council, [1978] A.C. 728 (H.L.), at pp. 751-52:

> First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or

> neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter -- in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise. . . .

While the House of Lords rejected the Anns test in Murphy v. Brentwood District Council, [1991] 1 A.C. 398, and in Caparo, supra, at p. 574, per Lord Bridge and at pp. 585-86, per Lord Oliver (citing Brennan J. in Sutherland Shire Council v. Heyman (1985), 60 A.L.R. 1 (H.C.), at pp. 43-44), the basic approach that test embodies has repeatedly been accepted and endorsed by this Court. (See, e.g.: Kamloops (City of) v. Nielsen, [1984] 2 S.C.R. 2; B.D.C. Ltd. v. Hofstrand Farms Ltd., [1986] 1 S.C.R. 228; Canadian National Railway Co. v. Norsk Pacific Steamship Co., [1992] 1 S.C.R. 1021; London Drugs Ltd. v. Kuehne & Nagel International Ltd., [1992] 3 S.C.R. 299; Winnipeg Condominium Corporation No. 36 v. Bird Construction Co., [1995] 1 S.C.R. 85.)

20 In Kamloops, supra, at pp. 10-11, Wilson J. restated Lord Wilberforce's test in the following terms:

> (1) is there a sufficiently close relationship between the parties (the [defendant] and the person who has suffered the damage) so that, in the reasonable contemplation of the [defendant], carelessness on its part might cause damage to that person? If so,
>
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

As will be clear from the cases earlier cited, this two-stage approach has been applied by this Court in the context of various types of negligence actions, including actions involving claims for different forms of economic loss. Indeed, it was implicitly endorsed in the context of an action in negligent misrepresentation in Edgeworth Construction Ltd. v. N. D. Lea & Associates Ltd., [1993] 3 S.C.R. 206, at pp. 218-19. The same approach to defining duties of care in negligent misrepresentation cases has also been taken in other Commonwealth courts. In Scott Group Ltd. v. McFarlane, [1978] 1 N.Z.L.R. 553, for example, a case that dealt specifically with auditors' liability for negligently prepared audit reports, the Anns test was adopted and applied by a majority of the New Zealand Court of Appeal.

21 I see no reason in principle why the same approach should not be taken in the present case. Indeed, to create a "pocket" of negligent misrepresentation cases (to use Professor Stapleton's term) in which the existence of a duty of care is determined differently from other negligence cases would, in my view, be incorrect; see: Jane Stapleton, "Duty of Care and Economic Loss: a Wider

Agenda" (1991), 107 L.Q. Rev. 249. This is not to say, of course, that negligent misrepresentation cases do not involve special considerations stemming from the fact that recovery is allowed for pure economic loss as opposed to physical damage. Rather, it is simply to posit that the same general framework ought to be used in approaching the duty of care question in both types of case. Whether the respondents owe the appellants a duty of care for their allegedly negligent preparation of the 1980-82 audit reports, then, will depend on (a) whether a prima facie duty of care is owed, and (b) whether that duty, if it exists, is negatived or limited by policy considerations. Before analysing the merits of this case, it will be useful to set out in greater detail the principles governing this appeal.

(ii) The Prima Facie Duty of Care

22 The first branch of the Anns/Kamloops test demands an inquiry into whether there is a sufficiently close relationship between the plaintiff and the defendant that in the reasonable contemplation of the latter, carelessness on its part may cause damage to the former. The existence of such a relationship -- which has come to be known as a relationship of "neighbourhood" or "proximity" -- distinguishes those circumstances in which the defendant owes a prima facie duty of care to the plaintiff from those where no such duty exists. In the context of a negligent misrepresentation action, then, deciding whether or not a prima facie duty of care exists necessitates an investigation into whether the defendant-representor and the plaintiff-representee can be said to be in a relationship of proximity or neighbourhood.

23 What constitutes a "relationship of proximity" in the context of negligent misrepresentation actions? In approaching this question, I would begin by reiterating the position I took in Norsk, supra, at pp. 1114-15, that the term "proximity" itself is nothing more than a label expressing a result, judgment or conclusion; it does not, in and of itself, provide a principled basis on which to make a legal determination. This view was also explicitly adopted by Stevenson J. in Norsk, supra, at p. 1178, and McLachlin J. also appears to have accepted it when she wrote, at p. 1151, of that case that "[p]roximity may usefully be viewed, not so much as a test in itself, but as a broad concept which is capable of subsuming different categories of cases involving different factors"; see also: M. H. McHugh, "Neighbourhood, Proximity and Reliance", in P. D. Finn, ed., Essays on Torts (1989), 5, at pp. 36-37; and John G. Fleming, "The Negligent Auditor and Shareholders" (1990), 106 L.Q. Rev. 349, at p. 351, where the author refers to proximity as a "vacuous test". While Norsk, supra, was concerned specifically with whether or not a defendant could be held liable for "contractual relational economic loss" (as I called it, at p. 1037), I am of the view that the same observations with respect to the term "proximity" are applicable in the context of negligent misrepresentation. In order to render "proximity" a useful tool in defining when a duty of care exists in negligent misrepresentation cases, therefore, it is necessary to infuse that term with some meaning. In other words, it is necessary to set out the basis upon which one may properly reach the conclusion that proximity inheres between a representor and a representee.

24 This can be done most clearly as follows. The label "proximity", as it was used by Lord Wilberforce in Anns, supra, was clearly intended to connote that the circumstances of the relationship inhering between the plaintiff and the defendant are of such a nature that the defendant may be said to be under an obligation to be mindful of the plaintiff's legitimate interests in conducting his or her affairs. Indeed, this idea lies at the very heart of the concept of a "duty of care", as articulated most memorably by Lord Atkin in Donoghue v. Stevenson, [1932] A.C. 562, at pp. 580-81. In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable. To use the term employed by my colleague, Iacobucci J., in Cognos, supra, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.

25 I should pause here to explain that, in my view, to look to whether or not reliance by the plaintiff on the defendant's representation would be reasonable in determining whether or not a prima facie duty of care exists in negligent misrepresentation cases as opposed to looking at reasonable foreseeability alone is not, as might first appear, to abandon the basic tenets underlying the first branch of the Anns/Kamloops formula. The purpose behind the Anns/Kamloops test is simply to ensure that enquiries into the existence of a duty of care in negligence cases is conducted in two parts: The first involves discerning whether, in a given situation, a duty of care would be imposed by law; the second demands an investigation into whether the legal duty, if found, ought to be negatived or ousted by policy considerations. In the context of actions based on negligence causing physical damage, determining whether harm to the plaintiff was reasonably foreseeable to the defendant is alone a sufficient criterion for deciding proximity or neighbourhood under the first branch of the Anns/Kamloops test because the law has come to recognize (even if only implicitly) that, absent a voluntary assumption of risk by him or her, it is always reasonable for a plaintiff to expect that a defendant will take reasonable care of the plaintiff's person and property. The duty of care inquiry in such cases, therefore, will always be conducted under the assumption that the plaintiff's expectations of the defendant are reasonable.

26 In negligent misrepresentation actions, however, the plaintiff's claim stems from his or her detrimental reliance on the defendant's (negligent) statement, and it is abundantly clear that reliance on the statement or representation of another will not, in all circumstances, be reasonable. The assumption that always inheres in physical damage cases concerning the reasonableness of the plaintiff's expectations cannot, therefore, be said to inhere in reliance cases. In order to ensure that the same factors are taken into account in determining the existence of a duty of care in both instances, then, the reasonableness of the plaintiff's reliance must be considered in negligent misrepresentation actions. Only by doing so will the first branch of the Kamloops test be applied consistently in both contexts.

27 As should be evident from its very terms, the reasonable foreseeability/reasonable reliance test for determining a prima facie duty of care is somewhat broader than the tests used both in the cases decided before Anns, supra, and in those that have rejected the Anns approach. Rather than stipulating simply that a duty of care will be found in any case where reasonable foreseeability and reasonable reliance inhere, those cases typically require (a) that the defendant know the identity of either the plaintiff or the class of plaintiffs who will rely on the statement, and (b) that the reliance losses claimed by the plaintiff stem from the particular transaction in respect of which the statement at issue was made. This narrower approach to defining the duty can be seen in a number of the more prominent English decisions dealing either with auditors' liability specifically or with liability for negligent misstatements generally. (See, e.g.: Candler v. Crane, Christmas & Co., [1951] 2 K.B. 164 (C.A.), at pp. 181-82 and p. 184, per Denning L.J. (dissenting); Hedley Byrne & Co. v. Heller & Partners Ltd., [1964] A.C. 465; Caparo, supra, per Lord Bridge, at p. 576, and per Lord Oliver, at pp. 589.) It is also evident in the approach taken by this Court in Haig v. Bamford, [1977] 1 S.C.R. 466.

28 While I would not question the conclusions reached in any of these judgments, I am of the view that inquiring into such matters as whether the defendant had knowledge of the plaintiff (or class of plaintiffs) and whether the plaintiff used the statements at issue for the particular transaction for which they were provided is, in reality, nothing more than a means by which to circumscribe -- for reasons of policy -- the scope of a representor's potentially infinite liability. As I have already tried to explain, determining whether "proximity" exists on a given set of facts consists in an attempt to discern whether, as a matter of simple justice, the defendant may be said to have had an obligation to be mindful of the plaintiff's interests in going about his or her business. Requiring, in addition to proximity, that the defendant know the identity of the plaintiff (or class of plaintiffs) and that the plaintiff use the statements in question for the specific purpose for which they were prepared amounts, in my opinion, to a tacit recognition that considerations of basic fairness may sometimes give way to other pressing concerns. Plainly stated, adding further requirements to the duty of care test provides a means by which policy concerns that are extrinsic to simple justice -- but that are, nevertheless, fundamentally important -- may be taken into account in assessing whether the defendant should be compelled to compensate the plaintiff for losses suffered. In other words, these further requirements serve a policy-based limiting function with respect to the ambit of the duty of care in negligent misrepresentation actions.

29 This view is confirmed by the judgments themselves. In Caparo, supra, at p. 576, for example, Lord Bridge refers to the criteria of knowledge of the plaintiff (or class of plaintiffs) and use of the statements for the intended transaction as a " 'limit or control mechanism . . . imposed on the liability of the wrongdoer towards those who have suffered some economic damage in consequence of his negligence'" (emphasis added). Similarly, in Haig, supra, at p. 476, Dickson J. (as he then was) explicitly discusses the policy concern arising from unlimited liability before finding that the statements at issue in Haig were used for the very purpose for which they were prepared and that the appropriate test for a duty of care in the case before him was "actual knowledge of the limited class that will use and rely on the statement". (See also Candler, supra, at p. 183, per Denning L.J.

(dissenting).) Certain scholars have adopted this view of the case law as well. (See, e.g.: Bruce Feldthusen, Economic Negligence (3rd ed. 1994), at pp. 93-100, where the author explains that the approach taken in both Haig, supra, and Caparo, supra, toward defining the duty of care was motivated by underlying policy concerns; see also: Earl A. Cherniak and Kirk F. Stevens, "Two Steps Forward or One Step Back? Anns at the Crossroads in Canada" (1992), 20 C.B.L.J. 164, and Ivan F. Ivankovich, "Accountants and Third-Party Liability -- Back to the Future" (1991), 23 Ottawa L. Rev. 505, at p. 518.)

30 In light of this Court's endorsement of the Anns/Kamloops test, however, enquiries concerning (a) the defendant's knowledge of the identity of the plaintiff (or of the class of plaintiffs) and (b) the use to which the statements at issue are put may now quite properly be conducted in the second branch of that test when deciding whether or not policy considerations ought to negate or limit a prima facie duty that has already been found to exist. In other words, criteria that in other cases have been used to define the legal test for the duty of care can now be recognized for what they really are -- policy-based means by which to curtail liability -- and they can appropriately be considered under the policy branch of the Anns/Kamloops test. To understand exactly how this may be done and how these criteria are pertinent to the case at bar, it will first be useful to set out the prevailing policy concerns in some detail.

(iii) Policy Considerations

31 As Cardozo C.J. explained in Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y.C.A. 1931), at p. 444, the fundamental policy consideration that must be addressed in negligent misrepresentation actions centres around the possibility that the defendant might be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class". This potential problem can be seen quite vividly within the framework of the Anns/Kamloops test. Indeed, while the criteria of reasonable foreseeability and reasonable reliance serve to distinguish cases where a prima facie duty is owed from those where it is not, it is nevertheless true that in certain types of situations these criteria can, quite easily, be satisfied and absent some means by which to circumscribe the ambit of the duty, the prospect of limitless liability will loom.

32 The general area of auditors' liability is a case in point. In modern commercial society, the fact that audit reports will be relied on by many different people (e.g., shareholders, creditors, potential takeover bidders, investors, etc.) for a wide variety of purposes will almost always be reasonably foreseeable to auditors themselves. Similarly, the very nature of audited financial statements -- produced, as they are, by professionals whose reputations (and, thereby, whose livelihoods) are at stake -- will very often mean that any of those people would act wholly reasonably in placing their reliance on such statements in conducting their affairs. These observations are consistent with the following remarks of Dickson J. in Haig, supra, at pp. 475-76, with respect to the accounting profession generally:

> The increasing growth and changing role of corporations in modern society

> has been attended by a new perception of the societal role of the profession of accounting. The day when the accountant served only the owner-manager of a company and was answerable to him alone has passed. The complexities of modern industry combined with the effects of specialization, the impact of taxation, urbanization, the separation of ownership from management, the rise of professional corporate managers, and a host of other factors, have led to marked changes in the role and responsibilities of the accountant, and in the reliance which the public must place upon his work. The financial statements of the corporations upon which he reports can affect the economic interests of the general public as well as of shareholders and potential shareholders.

(See also: Cherniak and Stevens, supra, at pp. 169-70.) In light of these considerations, the reasonable foreseeability/reasonable reliance test for ascertaining a prima facie duty of care may well be satisfied in many (even if not all) negligent misstatement suits against auditors and, consequently, the problem of indeterminate liability will often arise.

33 Certain authors have argued that imposing broad duties of care on auditors would give rise to significant economic and social benefits in so far as the spectre of tort liability would act as an incentive to auditors to produce accurate (i.e., non-negligent) reports. (See, e.g.: Howard B. Wiener, "Common Law Liability of the Certified Public Accountant for Negligent Misrepresentation" (1983), 20 San Diego L. Rev. 233.) I would agree that deterrence of negligent conduct is an important policy consideration with respect to auditors' liability. Nevertheless, I am of the view that, in the final analysis, it is outweighed by the socially undesirable consequences to which the imposition of indeterminate liability on auditors might lead. Indeed, while indeterminate liability is problematic in and of itself inasmuch as it would mean that successful negligence actions against auditors could, at least potentially, be limitless, it is also problematic in light of certain related problems to which it might give rise.

34 Some of the more significant of these problems are thus set out in Brian R. Cheffins, "Auditors' Liability in the House of Lords: A Signal Canadian Courts Should Follow" (1991), 18 C.B.L.J. 118, at pp. 125-27:

> In addition to providing only limited benefits, imposing widely drawn duties of care on auditors would probably generate substantial costs. . . .
>
> One reason [for this] is that auditors would expend more resources trying to protect themselves from liability. For example, insurance premiums would probably rise since insurers would anticipate more frequent claims. Also, auditors would probably incur higher costs since they would try to rely more heavily on exclusion clauses. Hiring lawyers to draft such clauses might be expensive because only the most carefully constructed provisions would be likely

to pass judicial scrutiny. . . .

Finally, auditors' opportunity costs would increase. Whenever members of an accounting firm have to spend time and effort preparing for litigation, they forego revenue generating accounting activity. More trials would mean that this would occur with greater frequency.

. . .

The higher costs auditors would face as a result of broad duties of care could have a widespread impact. For example, the supply of accounting services would probably be reduced since some marginal firms would be driven to the wall. Also, because the market for accounting services is protected by barriers to entry imposed by the profession, the surviving firms would pass [sic] at least some of the increased costs to their clients.

Professor Ivankovich describes similar sources of concern. While he acknowledges certain social benefits to which expansive auditors' liability might conduce, he also recognizes the potential difficulties associated therewith (at pp. 520-21):

. . . [expansive auditors' liability] is also likely to increase the time expended in the performance of accounting services. This will trigger a predictable negative impact on the timeliness of the financial information generated. It is equally likely to increase the cost of professional liability insurance and reduce its availability, and to increase the cost of accounting services which, as a result, may become less generally available. Additionally, it promotes "free ridership" on the part of reliant third parties and decreases their incentive to exercise greater vigilance and care and, as well, presents an increased risk of fraudulent claims.

Even though I do not share the discomfort apparently felt by Professors Cheffins and Ivankovich with respect to using an Anns-type test in the context of negligent misrepresentation actions (See: Cheffins, supra, at pp. 129-31, and Ivankovich, supra, at p. 530), I nevertheless agree with their assessment of the possible consequences to both auditors and the public generally if liability for negligently prepared audit reports were to go unchecked.

35 I should, at this point, explain that I am aware of the arguments put forth by certain scholars and judges to the effect that concerns over indeterminate liability have sometimes been overstated. (See, e.g.: J. Edgar Sexton and John W. Stevens, "Accountants' Legal Responsibilities and Liabilities", in Professional Responsibility in Civil Law and Common Law (Meredith Memorial Lectures, McGill University, 1983-84) (1985), 88, at pp. 101-2; and H. Rosenblum (1983), Inc. v. Adler, 461 A.2d 138 (N.J. 1983), at p. 152, per Schreiber J.) Arguments to this effect rest essentially on the premise that actual liability will be limited in so far as a plaintiff will not be successful unless both negligence and reliance are established in addition to a duty of care. While it is true that damages will not be owing by the defendant unless these other elements of the cause of action are proved, neither the difficulty of proving negligence nor that of proving reliance will preclude a disgruntled plaintiff from bringing an action against an auditor and such actions would, we may assume, be all the more common were the establishment of a duty of care in any given case to amount to nothing more than a mere matter of course. This eventuality could pose serious problems both for auditors, whose legal costs would inevitably swell, and for courts, which, no doubt, would feel the pressure of increased litigation. Thus, the prospect of burgeoning negligence suits raises serious concerns, even if we assume that the arguments positing proof of negligence and reliance as a barrier to liability are correct. In my view, therefore, it makes more sense to circumscribe the ambit of the duty of care than to assume that difficulties in proving negligence and reliance will afford sufficient protection to auditors, since this approach avoids both "indeterminate liability" and "indeterminate litigation".

36 As I have thus far attempted to demonstrate, the possible repercussions of exposing auditors to indeterminate liability are significant. In applying the two-stage Anns/Kamloops test to negligent misrepresentation actions against auditors, therefore, policy considerations reflecting those repercussions should be taken into account. In the general run of auditors' cases, concerns over indeterminate liability will serve to negate a prima facie duty of care. But while such concerns may exist in most such cases, there may be particular situations where they do not. In other words, the specific factual matrix of a given case may render it an "exception" to the general class of cases in that while (as in most auditors' liability cases) considerations of proximity under the first branch of the Anns/Kamloops test might militate in favour of finding that a duty of care inheres, the typical concerns surrounding indeterminate liability do not arise. This needs to be explained.

37 As discussed earlier, looking to factors such as "knowledge of the plaintiff (or an identifiable class of plaintiffs) on the part of the defendant" and "use of the statements at issue for the precise purpose or transaction for which they were prepared" really amounts to an attempt to limit or constrain the scope of the duty of care owed by the defendants. If the purpose of the Anns/Kamloops test is to determine (a) whether or not a prima facie duty of care exists and then (b) whether or not that duty ought to be negated or limited, then factors such as these ought properly to be considered in the second branch of the test once the first branch concerning "proximity" has been found to be satisfied. To my mind, the presence of such factors in a given situation will mean that worries stemming from indeterminacy should not arise, since the scope of potential liability is sufficiently delimited. In other words, in cases where the defendant knows the identity of the plaintiff (or of a class of plaintiffs) and where the defendant's statements are used for the specific purpose or transaction for which they were made, policy considerations surrounding indeterminate liability will not be of any concern since the scope of liability can readily be circumscribed. Consequently, such considerations will not override a positive finding on the first branch of the Anns/Kamloops test and a duty of care may quite properly be found to exist.

38 As I see it, this line of reasoning serves to explain the holding of Cardozo J. (as he then was) in Glanzer v. Shepard, 135 N.E. 275 (N.Y.C.A. 1922) . There, the New York Court of Appeals held that the defendant weigher was liable in damages for having negligently prepared a weight certificate he knew would be given to the plaintiff, who relied upon it for the specific purpose for which it was issued. In reaching his decision, Cardozo J. explicitly noted that the weight certificate was used for the very "end and aim of the transaction" and not for any collateral or unintended purpose (Glanzer, supra, at p. 275). On the facts of Glanzer, supra, then, the scope of the defendant's liability could readily be delimited and indeterminacy, therefore, was not a concern.

39 The same idea serves to explain the rationale underlying the seminal judgment of the House of Lords in Hedley Byrne, supra. While that case did not involve an action against auditors, similar concerns about indeterminate liability were, nonetheless, clearly relevant. On the facts of Hedley Byrne, supra, the defendant bank provided a negligently prepared credit reference in respect of one of its customers to another bank which, to the knowledge of the defendants, passed on the information to the plaintiff for a stipulated purpose. The plaintiff relied on the credit reference for the specific purpose for which it was prepared. The House of Lords found that but for the presence of a disclaimer, the defendants would have been liable to the plaintiff in negligence. While indeterminate liability would have raised some concern to the Lords had the plaintiff not been known to the defendants or had the credit reference been used for a purpose or transaction other than that for which it was actually prepared, no such difficulties about indeterminacy arose on the particular facts of the case.

40 This Court's decision in Haig, supra, can be seen to rest on precisely the same basis. There, the defendant accountants were retained by a Saskatchewan businessman, one Scholler, to prepare audited financial statements of Mr. Scholler's corporation. At the time they were engaged, the accountants were informed by Mr. Scholler that the audited statements would be used for the purpose of attracting a $20,000 investment in the corporation from a limited number of potential investors. The audit was conducted negligently and the plaintiff investor, who was found to have relied on the audited statements in making his investment, suffered a loss. While Dickson J. was clearly cognizant of the potential problem of indeterminacy arising in the context of auditors' liability (at p. 476), he nevertheless found that the defendants owed the plaintiff a duty of care. In my view, his conclusion was eminently sound given that the defendants were informed by Mr. Scholler of the class of persons who would rely on the report and the report was used by the plaintiff for the specific purpose for which it was prepared. Dickson J. himself expressed this idea as follows, at p. 482:

> The case before us is closer to Glanzer than to Ultramares. The very end and aim of the financial statements prepared by the accountants in the present case was to secure additional financing for the company from [a Saskatchewan government agency] and an equity investor; the statements were required primarily for these third parties and only incidentally for use by the company.

On the facts of Haig, then, the auditors were properly found to owe a duty of care because concerns over indeterminate liability did not arise. I would note that this view of the rationale behind Haig, supra, is shared by Professor Feldthusen. (See Feldthusen, supra, at pp. 98-100.)

41 The foregoing analysis should render the following points clear. A prima facie duty of care will arise on the part of a defendant in a negligent misrepresentation action when it can be said (a) that the defendant ought reasonably to have foreseen that the plaintiff would rely on his representation and (b) that reliance by the plaintiff, in the circumstances, would be reasonable. Even though, in the context of auditors' liability cases, such a duty will often (even if not always) be found to exist, the problem of indeterminate liability will frequently result in the duty being negated by the kinds of policy considerations already discussed. Where, however, indeterminate liability can be shown not to be a concern on the facts of a particular case, a duty of care will be found to exist. Having set out the law governing the appellants' claims, I now propose to apply it to the facts of the appeal.

(iv) Application to the Facts

42 In my view, there can be no question that a prima facie duty of care was owed to the appellants by the respondents on the facts of this case. As regards the criterion of reasonable foreseeability, the possibility that the appellants would rely on the audited financial statements in conducting their affairs and that they may suffer harm if the reports were negligently prepared must have been reasonably foreseeable to the respondents. This is confirmed simply by the fact that shareholders generally will often choose to rely on audited financial statements for a wide variety of purposes. It is further confirmed by the fact that under ss. 149(1) and 163(1) of the Manitoba Corporations Act, it is patently clear that audited financial statements are to be placed before the shareholders at the annual general meeting. The relevant portions of those sections read as follows:

> 149(1) The directors of a corporation shall place before the shareholders at every annual meeting
>
> . . .
>
> (b) the report of the auditor, if any; and
>
> . . .
>
> 163(1) An auditor of a corporation shall make the examination that is in his opinion necessary to enable him to report in the prescribed manner on the financial statements required by this Act to be placed before the shareholders, except such financial statements or part thereof as relate to the period referred to in sub-clause 149(1)(a)(ii).

In my view, it would be untenable to argue in the face of these provisions that some form of reliance by shareholders on the audited reports would be unforeseeable.

43 Similarly, I would find that reliance on the audited statements by the appellant shareholders would, on the facts of this case, be reasonable. Professor Feldthusen (at pp. 62-63) sets out five general indicia of reasonable reliance; namely:

(1) The defendant had a direct or indirect financial interest in the transaction in respect of which the representation was made.
(2) The defendant was a professional or someone who possessed special skill, judgment, or knowledge.
(3) The advice or information was provided in the course of the defendant's business.
(4) The information or advice was given deliberately, and not on a social occasion.
(5) The information or advice was given in response to a specific enquiry or request.

While these indicia should not be understood to be a strict "test" of reasonableness, they do help to distinguish those situations where reliance on a statement is reasonable from those where it is not. On the facts here, the first four of these indicia clearly inhere. To my mind, then, this aspect of the prima facie duty is unquestionably satisfied on the facts.

44 Having found a prima facie duty to exist, then, the second branch of the Anns/Kamloops test remains to be considered. It should be clear from my comments above that were auditors such as the respondents held to owe a duty of care to plaintiffs in all cases where the first branch of the Anns/Kamloops test was satisfied, the problem of indeterminate liability would normally arise. It should be equally clear, however, that in certain cases, this problem does not arise because the scope of potential liability can adequately be circumscribed on the facts. An investigation of whether or not indeterminate liability is truly a concern in the present case is, therefore, required.

45 At first blush, it may seem that no problems of indeterminate liability are implicated here and that this case can easily be likened to Glanzer, supra, Hedley Byrne, supra, and Haig, supra. After all, the respondents knew the very identity of all the appellant shareholders who claim to have relied on the audited financial statements through having acted as NGA's and NGH's auditors for nearly 10 years by the time the first of the audit reports at issue in this appeal was prepared. It would seem plausible to argue on this basis that because the identity of the plaintiffs was known to the respondents at the time of preparing the 1980-82 reports, no concerns over indeterminate liability arise.

46 To arrive at this conclusion without further analysis, however, would be to move too quickly. While knowledge of the plaintiff (or of a limited class of plaintiffs) is undoubtedly a significant factor serving to obviate concerns over indeterminate liability, it is not, alone, sufficient to do so. In my discussion of Glanzer, supra, Hedley Byrne, supra, and Haig, supra, I explained that indeterminate liability did not inhere on the specific facts of those cases not only because the defendant knew the identity of the plaintiff (or the class of plaintiffs) who would rely on the statement at issue, but also because the statement itself was used by the plaintiff for precisely the purpose or transaction for which it was prepared. The crucial importance of this additional criterion can clearly be seen when one considers that even if the specific identity or class of potential plaintiffs is known to a defendant, use of the defendant's statement for a purpose or transaction other than that for which it was prepared could still lead to indeterminate liability.

47 For example, if an audit report which was prepared for a corporate client for the express purpose of attracting a $10,000 investment in the corporation from a known class of third parties was instead used as the basis for attracting a $1,000,000 investment or as the basis for inducing one of the members of the class to become a director or officer of the corporation or, again, as the basis for encouraging him or her to enter into some business venture with the corporation itself, it would appear that the auditors would be exposed to a form of indeterminate liability, even if they knew precisely the identity or class of potential plaintiffs to whom their report would be given. With respect to the present case, then, the central question is whether or not the appellants can be said to have used the 1980-82 audit reports for the specific purpose for which they were prepared. The answer to this question will determine whether or not policy considerations surrounding indeterminate liability ought to negate the prima facie duty of care owed by the respondents.

48 What, then, is the purpose for which the respondents' audit statements were prepared? This issue was eloquently discussed by Lord Oliver in Caparo, supra, at p. 583:

> My Lords, the primary purpose of the statutory requirement that a company's accounts shall be audited annually is almost self-evident. . . . The management is confided to a board of directors which operates in a fiduciary capacity and is answerable to and removable by the shareholders who can act, if they act at all, only collectively and only through the medium of a general meeting. Hence the legislative provisions requiring the board annually to give an account of its stewardship to a general meeting of the shareholders. This is the only occasion in each year on which the general body of shareholders is given the opportunity to consider, to criticise and to comment on the conduct by the board of the company's affairs, to vote the directors' recommendation as to dividends, to approve or disapprove the directors' remuneration and, if thought desirable, to remove and replace all or any of the directors. It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing . . . and, second, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided. [Emphasis added.]

Similarly, Farley J. held in Roman Corp. Ltd. v. Peat Marwick Thorne (1992), 11 O.R. (3d) 248 (Gen. Div.), at p. 260 (hereinafter Roman I) that

> as a matter of law the only purpose for which shareholders receive an auditor's report is to provide the shareholders with information for the purpose of overseeing the management and affairs of the corporation and not for the purpose of guiding personal investment decisions or personal speculation with a view to profit.

(See also: Roman Corp. v. Peat Marwick Thorne (1993), 12 B.L.R. (2d) 10 (Ont. Gen. Div.).) Lord Oliver was referring to the relevant provisions of the U.K. Companies Act 1985 (U.K.), 1985, c. 6, in making his pronouncements, and Farley J. rendered his judgment against the backdrop of the statutory audit requirements set out in the Ontario Business Corporations Act, R.S.O. 1990, c. B.16.

49 To my mind, the standard purpose of providing audit reports to the shareholders of a corporation should be regarded no differently under the analogous provisions of the Manitoba Corporations Act. Thus, the directors of a corporation are required to place the auditors' report before the shareholders at the annual meeting in order to permit the shareholders, as a body, to make decisions as to the manner in which they want the corporation to be managed, to assess the performance of the directors and officers, and to decide whether or not they wish to retain the existing management or to have them replaced. On this basis, it may be said that the respondent auditors' purpose in preparing the reports at issue in this case was, precisely, to assist the collectivity of shareholders of the audited companies in their task of overseeing management.

50 The appellants, however, submit that, in addition to this statutorily mandated purpose, the respondents further agreed to perform their audits for the purpose of providing the appellants with information on the basis of which they could make personal investment decisions. They base this claim largely on a conversation that allegedly took place at the 1978 meeting between Mr. Cox, Mr. Freed and Mr. Korn, as well as on certain passages of the engagement letter sent to them by the respondents. I have read the relevant portions of the record on this question and I am unable to accept the appellants' submission. Indeed, on examination for discovery, Mr. Freed discussed the engagement letter of the respondents and stated as follows:

> Q It is this that you say is the document that says, it will speak for itself, but you interpret it to mean that they [the respondents] will look after your interests specifically [sic]? . . .
>
> A I am saying that I took for granted that that was their duty.
>
> Q I see. All right. Was there ever anything in writing specifically that says that is your duty, is to look after my interests, I am away all the time?

A I am not aware.

Q Either, from you, or to you in that respect?

A I am not aware of any.

Q This letter happens to say, "We are always prepared upon instruction to extend our services beyond these required procedures." Did you ever give them any additional instructions?

A No. I never saw them.

Q Nor did you communicate with them in writing, or otherwise? Is that right?

A Not that I recall.

Similarly, the transcript of Mr. Korn's examination for discovery reveals the following exchange:

Q You emphasized [at the 1978 meeting] you say to Mr. Cox that because you were no longer in the management stream or chain, you would be relying more on the audited statements?

A Yes, and that -- well, I wanted a sort of commitment that he understood that he was the shareholders' auditor and I did refer to the fact that he had [a] close personal association with Mr. Morris and he said no, he fully understood, have no fear.

Q Did you consider that to be a change from the normal kind of audit engagement, or were you just emphasizing something that was part of the normal audit engagement?

A I just pointed out the change. As a matter of fact, he already knew about the change.

. . .

Q But my question was whether you considered that to be any kind of alteration from the usual audit engagement process.

A Well, that's what happened. That's the fact that I said it to him and those are the words I said, and however he took it, that's however he took it.

Q But I'm asking you if you considered that to be a change from a normal audit engagement.

A Well, I'm not -- whether that was -- whether those words were some sort of special instructions, those were the words and I guess there will be experts to say what consequences should have flown [sic] from them, and I'm not here as an expert on audit --

Q I'm entitled to know what you consider to be the case.

A Well, I made it clear that he should remember that he's the shareholders' auditor, that Clarkson was the shareholders' auditor, notwithstanding his personal relationship with Murray Morris.

Q Auditors are always the shareholders' auditors, are they not?

A And that's what I -- if they are, they are.

Q And that's in fact what they are always?

A Well, that's good, I'm glad to hear that, glad to hear you say it.

Q Do you agree?

A That the auditors are the shareholders' auditors?

Q Yes.

A I agree precisely.

To my mind, these passages serve to demonstrate that despite the appellants' submissions, the respondents did not, in fact, prepare the audit reports in order to assist the appellants in making personal investment decisions or, indeed, for any purpose other than the standard statutory one. This finding accords with that of Helper J.A. in the Court of Appeal, and nothing in the record before this Court suggests the contrary.

51 It follows from the foregoing discussion that the only purpose for which the 1980-82 reports could have been used in such a manner as to give rise to a duty of care on the part of the respondents is as a guide for the shareholders, as a group, in supervising or overseeing management. In assessing whether this was, in fact, the purpose to which the appellants purport to have put the audited reports, it will be useful to take each of the appellants' claims in turn. First, the appellant Hercules seeks compensation for its $600,000 injection of capital into NGA over January and February of 1983 and the appellant Freed seeks damages commensurate with the amount of money he contributed in 1982 to his investment account in NGH. Secondly, all the appellants seek damages for the losses they suffered in the value of their existing shareholdings.

52 The claims of Hercules and Mr. Freed with respect to their 1982-83 investments can be addressed quickly. The essence of these claims must be that these two appellants relied on the respondents' reports in deciding whether or not to make further investments in the audited corporations. In other words, Hercules and Mr. Freed are claiming to have relied on the audited reports for the purpose of making personal investment decisions. As I have already discussed, this is not a purpose for which the respondents in this case can be said to have prepared their reports. In light of the dissonance between the purpose for which the reports were actually prepared and the purpose for which the appellants assert they were used, then, the claims of Hercules and Mr. Freed with respect to their investment losses are not such that the concerns over indeterminate liability discussed above are obviated; viz., if a duty of care were owed with respect to these investment transactions, there would seem to be no logical reason to preclude a duty of care from arising in circumstances where the statements were used for any other purpose of which the auditors were equally unaware when they prepared and submitted their report. On this basis, therefore, I would find that the prima facie duty that arises respecting this claim is negated by policy considerations and, therefore, that no duty of care is owed by the respondents in this regard.

53 With respect to the claim concerning the loss in value of their existing shareholdings, the appellants make two submissions. First, they claim that they relied on the 1980-82 reports in monitoring the value of their equity and that, owing to the (allegedly) negligent preparation of those reports, they failed to extract it before the financial demise of NGA and NGH. Secondly, and somewhat more subtly, the appellants submit that they each relied on the auditors' reports in overseeing the management of NGA and NGH and that had those reports been accurate, the collapse of the corporations and the consequential loss in the value of their shareholdings could have been avoided.

54 To my mind, the first of these submissions suffers from the same difficulties as those regarding the injection of fresh capital by Hercules and Mr. Freed. Whether the reports were relied upon in assessing the prospect of further investments or in evaluating existing investments, the fact remains that the purpose to which the respondents' reports were put, on this claim, concerned individual or personal investment decisions. Given that the reports were not prepared for that purpose, I find for the same reasons as those earlier set out that policy considerations regarding indeterminate liability inhere here and, consequently, that no duty of care is owed in respect of this claim.

55 As regards the second aspect of the appellants' claim concerning the losses they suffered in the diminution in value of their equity, the analysis becomes somewhat more intricate. The essence of the appellants' submission here is that the shareholders would have supervised management differently had they known of the (alleged) inaccuracies in the 1980-82 reports, and that this difference in management would have averted the demise of the audited corporations and the consequent losses in existing equity suffered by the shareholders. At first glance, it might appear that the appellants' claim implicates a use of the audit reports which is commensurate with the purpose for which the reports were prepared, i.e., overseeing or supervising management. One might argue on this basis that a duty of care should be found to inhere because, in view of this compatibility between actual use and intended purpose, no indeterminacy arises. In my view, however, this line of reasoning suffers from a subtle but fundamental flaw.

56 As I have already explained, the purpose for which the audit reports were prepared in this case was the standard statutory one of allowing shareholders, as a group, to supervise management and to take decisions with respect to matters concerning the proper overall administration of the corporations. In other words, it was, as Lord Oliver and Farley J. found in the cases cited above, to permit the shareholders to exercise their role, as a class, of overseeing the corporations' affairs at their annual general meetings. The purpose of providing the auditors' reports to the appellants, then, may ultimately be said to have been a "collective" one; that is, it was aimed not at protecting the interests of individual shareholders but rather at enabling the shareholders, acting as a group, to safeguard the interests of the corporations themselves. On the appellants' argument, however, the purpose to which the 1980-82 reports were ostensibly put was not that of allowing the shareholders as a class to take decisions in respect of the overall running of the corporation, but rather to allow them, as individuals, to monitor management so as to oversee and protect their own personal investments. Indeed, the nature of the appellants' claims (i.e. personal tort claims) requires that they assert reliance on the auditors' reports qua individual shareholders if they are to recover any personal damages. In so far as it must concern the interests of each individual shareholder, then, the appellants' claim in this regard can really be no different from the other "investment purposes" discussed above, in respect of which the respondents owe no duty of care.

57 This argument is no different as regards the specific case of the appellant Guardian, which is the sole shareholder of NGH. The respondents' purpose in providing the audited reports in respect of NGH was, we must assume, to allow Guardian to oversee management for the better administration of the corporation itself. If Guardian in fact chose to rely on the reports for the ultimate purpose of monitoring its own investment it must, for the policy reasons earlier set out, be found to have done so at its own peril in the same manner as shareholders in NGA. Indeed, to treat Guardian any differently simply because it was a sole shareholder would do violence to the fundamental principle of corporate personality. I would find in respect of both Guardian and the other appellants, therefore, that the prima facie duty of care owed to them by the respondents is negated by policy considerations in that the claims are not such as to bring them within the "exceptional" cases discussed above.

Issue 2:

The Effect of the Rule in Foss v. Harbottle

58 All the participants in this appeal -- the appellants, the respondents, and the intervener -- raised the issue of whether the appellants' claims in respect of the losses they suffered in their existing shareholdings through their alleged inability to oversee management of the corporations ought to have been brought as a derivative action in conformity with the rule in Foss v. Harbottle rather than as a series of individual actions. The issue was also raised and discussed in the courts below. In my opinion, a derivative action -- commenced, as required, by an application under s. 232 of the Manitoba Corporations Act -- would have been the proper method of proceeding with respect to this claim. Indeed, I would regard this simply as a corollary of the idea that the audited reports are provided to the shareholders as a group in order to allow them to take collective (as opposed to individual) decisions. Let me explain.

59 The rule in Foss v. Harbottle provides that individual shareholders have no cause of action in law for any wrongs done to the corporation and that if an action is to be brought in respect of such losses, it must be brought either by the corporation itself (through management) or by way of a derivative action. The legal rationale behind the rule was eloquently set out by the English Court of Appeal in Prudential Assurance Co. v. Newman Industries Ltd. (No. 2), [1982] 1 All E.R. 354, at p. 367, as follows:

> The rule [in Foss v. Harbottle] is the consequence of the fact that a corporation is a separate legal entity. Other consequences are limited liability and limited rights. The company is liable for its contracts and torts; the shareholder has no such liability. The company acquires causes of action for breaches of contract and for torts which damage the company. No cause of action vests in the shareholder. When the shareholder acquires a share he accepts the fact that the value of his investment follows the fortunes of the company and that he can only exercise his influence over the fortunes of the company by the exercise of his voting rights in general meeting. The law confers on him the right to ensure that the company observes the limitations of its memorandum of association and the right to ensure that other shareholders observe the rule, imposed on them by the articles of association. If it is right that the law has conferred or should in certain restricted circumstances confer further rights on a shareholder the scope and consequences of such further rights require careful consideration.

To these lucid comments, I would respectfully add that the rule is also sound from a policy perspective, inasmuch as it avoids the procedural hassle of a multiplicity of actions.

60 The manner in which the rule in Foss v. Harbottle, supra, operates with respect to the appellants' claims can thus be demonstrated. As I have already explained, the appellants allege that

they were prevented from properly overseeing the management of the audited corporations because the respondents' audit reports painted a misleading picture of their financial state. They allege further that had they known the true situation, they would have intervened to avoid the eventuality of the corporations' going into receivership and the consequent loss of their equity. The difficulty with this submission, I have suggested, is that it fails to recognize that in supervising management, the shareholders must be seen to be acting as a body in respect of the corporation's interests rather than as individuals in respect of their own ends. In a manner of speaking, the shareholders assume what may be seen to be a "managerial role" when, as a collectivity, they oversee the activities of the directors and officers through resolutions adopted at shareholder meetings. In this capacity, they cannot properly be understood to be acting simply as individual holders of equity. Rather, their collective decisions are made in respect of the corporation itself. Any duty owed by auditors in respect of this aspect of the shareholders' functions, then, would be owed not to shareholders qua individuals, but rather to all shareholders as a group, acting in the interests of the corporation. And if the decisions taken by the collectivity of shareholders are in respect of the corporation's affairs, then the shareholders' reliance on negligently prepared audit reports in taking such decisions will result in a wrong to the corporation for which the shareholders cannot, as individuals, recover.

61 This line of reasoning finds support in Lord Bridge's comments in Caparo, supra, at p. 580:

> The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy. But in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders . . . will be recouped by a claim against the auditor in the name of the company, not by individual shareholders. [Emphasis added.]

It is also reflected in the decision of Farley J. in Roman I, supra, the facts of which were similar to those of the case at bar. In that case, the plaintiff shareholders brought an action against the defendant auditors alleging, inter alia, that the defendant's audit reports were negligently prepared. That negligence, the shareholders contended, prevented them from properly overseeing management which, in turn, led to the winding up of the corporation and a loss to the shareholders of their equity therein. Farley J. discussed the rule in Foss v. Harbottle and concluded that it operated so as to preclude the shareholders from bringing personal actions based on an alleged inability to supervise the conduct of management.

62 One final point should be made here. Referring to the case of Goldex Mines Ltd. v. Revill (1974), 7 O.R. (2d) 216 (C.A.), the appellants submit that where a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action. Nothing in the foregoing paragraphs should be understood to detract from this principle. In finding that claims in respect of losses stemming from an alleged inability to oversee or supervise management are really derivative and not personal in nature, I have found only that shareholders cannot raise individual claims in respect of a wrong done to the corporation. Indeed, this is the limit of the rule in Foss v. Harbottle. Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder qua individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out.

63 The facts of Haig, supra, provide the basis for an example of where such a claim might arise. Had the investors in that case been shareholders of the corporation, and had a similarly negligent report knowingly been provided to them by the auditors for a specified purpose, a duty of care separate and distinct from any duty owed to the audited corporation would have arisen in their favour, just as one arose in favour of Mr. Haig. While the corporation would have been entitled to claim damages in respect of any losses it might have suffered through reliance on the report (assuming, of course, that the report was also provided for the corporation's use), the shareholders in question would also have been able to seek personal compensation for the losses they suffered qua individuals through their personal reliance and investment. On the facts of this case, however, no claims of this sort can be established.

Conclusion

64 In light of the foregoing, I would find that even though the respondents owed the appellants (qua individual claimants) a prima facie duty of care both with respect to the 1982-83 investments made in NGA and NGH by Hercules and Mr. Freed and with respect to the losses they incurred through the devaluation of their existing shareholdings, such prima facie duties are negated by policy considerations which are not obviated by the facts of the case. Indeed, to come to the opposite conclusion on these facts would be to expose auditors to the possibility of indeterminate liability, since such a finding would imply that auditors owe a duty of care to any known class of potential plaintiffs regardless of the purpose to which they put the auditors' reports. This would amount to an unacceptably broad expansion of the bounds of liability drawn by this Court in Haig, supra. With respect to the claim regarding the appellants' inability to oversee management properly, I would agree with the courts below that it ought to have been brought as a derivative action. On the basis of these considerations, I would find under Rule 20.03(1) of the Manitoba Court of Queen's Bench Rules that the appellants have failed to establish that their claims as alleged would have "a real chance of success".

65 I would dismiss the appeal with costs.

cp/d/hbb/DRS/DRS

Case Name:

McKenna v. Gammon Gold Inc.

Between
Ed J. McKenna, Plaintiff, and
Gammon Gold Inc., Russell Barwick, Colin P. Sutherland, Dale M. Hendrick, Fred George, Frank Conte, Kent Noseworthy, Canek Rangel, Bradley Langille, Alejandro Caraveo, BMO Nesbitt Burns Inc., Scotia Capital Inc. and TD Securities Inc., Defendants
Proceeding under the Class Proceedings Act, 1992

[2010] O.J. No. 1057

88 C.P.C. (6th) 27

2010 CarswellOnt 1460

2010 ONSC 1591

Court File No. 08-0036143600CP

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: December 14-16, 2009.
Judgment: March 16, 2010.

(187 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Common interests and issues -- Definition of class -- Sub-class -- Members of class or sub-class -- Representative plaintiff -- Motion by plaintiff to certify class action allowed in part -- Plaintiff claimed defendants made misrepresentations in connection with sale of securities, which caused decline in share price when true state of affairs disclosed -- Action certified with respect to two claims and certification of third claim adjourned -- Pleading disclosed causes of actions for misrepresentation in prospectus, unjust enrichment, conspiracy and other claims -- Clear connection to Ontario -- Class action preferable procedure -- Proposed plaintiff could fairly and adequately represent class, but there should be sub-class of those who had sold securities and *representative for non-resident class members.*

Motion by the plaintiff to certify a class action. The plaintiff purchased shares in the defendant, Gammon Gold Inc. ("Gammon"), a gold and silver producer. Under a short-form prospected dated April 2007, Gammon made a public offering of 10 million common shares at a price of $20 per share. The plaintiff purchased 1000 shares of Gammon in the public offering. The plaintiff claimed that the defendants made misrepresentations, in public filings and other forms, the effect of which was to overestimate the actual and anticipated production rate at Gammon's Mexican mines and to misrepresent the real state of Gammon's business, which resulted in the inflation of the value of the shares. The plaintiff further claimed that when the true state of affairs was disclosed, in August 2007, the share price declined and he and other investors lost money. Although the plaintiff did not purchase shares on the secondary market, he claimed that certain continuous disclosure documents issued by Gammon between April 2006 and October 2007, and oral statements made by some of Gammon's officers and directors also claimed misrepresentations and, accordingly, he sought to represent all shareholders who acquired Gammon securities, whether under the prospectus or in the secondary market, at any time between April 2006 and August 2007. The plaintiff asserted claims for prospectus misrepresentation, negligent misrepresentation, negligence, reckless misrepresentation, conspiracy unjust enrichment and waiver of tort.

HELD: Motion allowed in part. Action certified with respect to Securities Act claim and unjust enrichment claim, and certification of conspiracy claim was adjourned. The pleading disclosed causes of actions for misrepresentation in the prospectus, negligent misrepresentation, conspiracy, unjust enrichment and waiver of tort. There was clearly a connection between Ontario and the plaintiff's claim as the plaintiff was a resident of Ontario and acquired his shares in Ontario and it was a reasonable assumption that a number of other share purchases were also residents of Ontario. There was on unfairness in subjecting the defendants to Ontario jurisdiction, but it would be unfair to require the plaintiff to pursue his claim elsewhere. Furthermore, it was appropriate to certify a class that included non-residents residents who engaged in a cross-border transaction because in acquiring securities of a Canadian company, they could reasonably expect that their legal rights in relation to that acquisition would be subject to Canadian jurisdiction, however it was not appropriate to include non-residents who purchased securities outside Canada. In addition, it was not appropriate to certify the secondary market claim. A class action was the preferable procedure as it would promote the goals of access to justice, judicial economy and behaviour modification. The proposed plaintiff could fairly and adequately represent the class, had no conflict with the class and was represented by experienced counsel who produced a workable litigation plan, however, there should be a sub-class of those who had sold their securities as well as a representative on behalf of non-resident class members.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 5, s. 5(1), s. 8

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 17.02, Rule 17.02(a), Rule 17.02(f), Rule 17.02(g), Rule 17.02(h), Rule 17.02(o), Rule 17.02(p), Rule 21.01(1)(b), Rule 25.06(8)

Securities Act, S.O. 1990, c. S. 5, s. 130, s. 130(1), s. 130(1)(c), s. 130(7), s. 131, s. 131.1(1), s. 138(b)(i), s. 138.3, s. 138.3(1), s. 138.8, s. 138.8(1), s. 138.13

Securities Exchange Act of 1934,

Counsel:

A. Dimitri Lascaris, Michael J. Peerless and Monique Radlein, for the plaintiff.

Ronald Slaght Q.C. and Nadia Campion, for the defendants BMO Nesbitt Burns Inc., Scotia Capital Inc., and TD Securities Inc.

Paul J. Martin and Laura F. Cooper, for the defendants Gammon Gold Inc., et al.

DECISION ON CERTIFICATION

1 G.R. STRATHY J.:-- This is a motion by the plaintiff, Ed McKenna, to certify a proposed class action pursuant to s. 5(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the "*C.P.A.*"). He claims that the defendants made misrepresentations in connection with the sale of the securities of Gammon Lake Resources Inc., now known as Gammon Gold Inc. ("Gammon"). He seeks to represent all persons (the "Class" or "Class Members") who acquired Gammon's shares between October 10, 2006 and August 10, 2007 (the "Class Period").

2 Gammon is a gold and silver producer. It is a reporting issuer under the *Securities Act,* S.O. 1990, c. S. 5 (the *"Securities Act"*). During the Class Period, Gammon's common shares were traded on the Toronto Stock Exchange (the "TSX"), the AMEX Stock Exchange in the United States (the "AMEX"), and elsewhere.

3 Under a short-form prospectus dated April 19, 2007 (the "Prospectus") Gammon made a public offering of 10 million common shares at a price of $20 per share, for gross proceeds of $200 million. Mr. McKenna purchased 1,000 shares of Gammon in the public offering.

4 Mr. McKenna claims that the value of Gammon's shares was inflated by the defendants' misrepresentations and that when the true state of affairs was disclosed, in early August 2007, the share price declined and he and other investors lost money. While Mr. McKenna did not buy Gammon shares in the secondary market, that is, through the stock exchange, he seeks to represent all shareholders who acquired Gammon securities, whether under the Prospectus or in the secondary market, at any time during the Class Period.

I. <u>Background</u>

5 Gammon is incorporated in Quebec. Its registered office is in Montreal and its head office is in Halifax. Its mining operations are based in Mexico, where it has three operating mines, including its flagship mining property, the Ocampo Project in Chihuahua State ("Ocampo").

6 The individual defendants were senior officers and/or directors of Gammon during some or all of the Class Period. Gammon and these individual defendants will be referred to as the "Gammon Defendants." The remaining defendants, BMO Nesbitt Burns Inc., Scotia Capital Inc. and TD Securities Inc. (the "Underwriters") were members of the syndicate that underwrote the securities offered under the Prospectus. BMO Nesbitt Burns Inc. was the lead underwriter.

7 As a reporting issuer under the *Securities Act,* Gammon was subject to various public disclosure obligations, including the obligation to file reports of any material changes in its financial position with the Ontario Securities Commission, as well as interim and annual consolidated financial statements. It also had an obligation to ensure that the Prospectus provided full and accurate disclosure of all material facts relating to the securities proposed to be issued.

8 The commencement of the Class Period on October 10, 2006 is marked by the date of a press release issued by Gammon in which it was stated, among other things, that Gammon was on track to attain annual production of 400,000 gold equivalent ounces ("GEO") by the end of the 2006 calendar year. The plaintiff claims that this announcement caused the price of Gammon's stock to rise from $11.88 on October 6, 2006 to $12.50 on October 10, 2006, on high trading volumes. Gammon's stock price continued to climb for the balance of October and closed at $14.75 on October 31, 2006, an increase of 18% over the closing price on the last trading day before the commencement of the Class Period.

9 Mr. McKenna claims that the press release contained a misrepresentation, as Gammon was not in fact on track to achieve the stated production rate. He claims that the defendants made additional misrepresentations during the Class Period, in public filings and in other forms, the effect of which was to overestimate the actual and anticipated production rate at Gammon's Mexican mines and to misrepresent the real state of Gammon's business.

10 Mr. McKenna alleges that in the Prospectus, and in Gammon's regulatory disclosure documents during the Class Period, the defendants made the following misrepresentations, among others:

(a) they materially overstated Gammon's GEO production rate at Ocampo and another gold and silver mine;

(b) they falsely stated that Gammon maintained adequate internal disclosure controls and procedures to ensure, among other things, that management did not make unreasonable projections;

(c) they materially understated Gammon's stock option expense for the fiscal years that ended on July 31st in 2004 and 2005, the five month period that ended December 31, 2005, and the fiscal year that ended on December 31, 2006;

(d) they falsely stated that Gammon's financial reports had been prepared in accordance with generally accepted accounting principles;

(e) they unreasonably projected that Gammon would produce 400,000 GEO in 2007, and 480,000 GEO in 2008;

(f) they failed to disclose that a company from which Gammon procured its Mexican labour force was controlled by the brother of Gammon's President and Chairman of the Board, and that Gammon was being overcharged for labour;

(g) they failed to disclose, on a timely basis, that Gammon was experiencing severe equipment failures and other technical difficulties at Ocampo in the first and second quarters of 2007; and

(h) they failed to disclose that Gammon's reported production figures were improperly calculated.

11 The end of the Class Period, August 9, 2007, is the date on which Gammon made certain regulatory filings for the second quarter of 2007. Mr. McKenna alleges that, on that day, and during a conference call with analysts on the following day, Gammon and its officers disclosed for the first time that Gammon was unlikely to meet its 2007 production projection of 400,000 GEO. This disclosure allegedly corrected the misrepresentations that had been made during the Class Period, in the Prospectus, regulatory filings and public statements.

12 The corrective information that was allegedly revealed for the first time on August 9 and 10, 2007 included the following:

(a) Gammon had experienced severe equipment failures at Ocampo in the first and second quarters of 2007;

(b) Gammon's GEO production had fallen by 16% from the first quarter to the second quarter of 2007, making it highly unlikely that Gammon's previous production estimates would be met; and

(c) Gammon had been including zinc precipitate in its GEO production totals, thus causing those production totals to be materially overstated.

13 The plaintiff claims that Gammon's stock price fell as a result of these disclosures. Prior to the release of the information on August 9, 2007 Gammon's shares traded at $11.22 per share. Over the next five trading days, the shares fell to a low of $8.10 per share, a decrease of $3.12, or 28%. Moreover, the share price of $8.10 constituted roughly a 60% decline from the price at which Gammon had sold shares under the Prospectus less than four months earlier.

14 Mr. McKenna alleges that the defendants' misrepresentations caused the shares offered under the Prospectus to be offered at an inflated price, and claims that he, and the other Class Members who purchased Gammon shares under the Prospectus, relied upon those misrepresentations to their detriment.

15 He further alleges that certain continuous disclosure documents issued by Gammon during the Class Period, and oral statements made by some of Gammon's officers and directors also contained misrepresentations. Accordingly, he asserts claims against the Gammon Defendants not only on behalf of primary market purchasers, but also on behalf of persons who acquired Gammon securities in the secondary market, who allegedly relied to their detriment on the misrepresentations and purchased Gammon securities at inflated prices.

16 The Plaintiff asserts various causes of action. His claims against the Gammon Defendants overlap with, but are not the same as, the causes of action asserted against the Underwriters.

17 The Plaintiff asserts against the Gammon Defendants claims on behalf of both primary and secondary market purchasers. On behalf of primary market purchasers, the Plaintiff asserts claims for: (1) prospectus misrepresentation under s. 130 of the *Securities Act*; (2) negligent misrepresentation; (3) negligence; (4) reckless misrepresentation; and (5) conspiracy. On behalf of secondary market purchasers, the Plaintiff asserts all these causes of action against the Gammon Defendants, except for s. 130 of the *Securities Act.*

18 The Plaintiff asserts against the Underwriters claims only on behalf of primary market purchasers. The causes of action asserted are: (1) prospectus misrepresentation under s. 130 of the *Securities Act*; (2) negligence; (3) negligent misrepresentation; (4) unjust enrichment; and (5) waiver of tort.

II. <u>The Issues</u>

19 The primary issue in the motion before me is whether this action should be certified as a class action. The test is set out in s. 5 of the *C.P.A.* and I will discuss and apply it in the course of these reasons. The motion raises two overarching additional issues, which have been problematic in class actions, and which I will briefly explain in order to put the principal issues in context.

20 The first important issue is whether it is appropriate to certify this proceeding as a "global" class action on behalf of all purchasers of Gammon securities during the Class Period, wherever they may be situated. The purchasers of Gammon securities are widely dispersed around the world. The issue raises important questions concerning the court's jurisdiction and the recognition and enforceability of the court's judgment which would, of course, purport to bind all members of the Class who do not opt out. I will discuss this issue when I consider the Class definition under s. 5(1)(b) of the *C.P.A.*

21 The second important issue is whether a plaintiff claiming negligent misrepresentation must

prove that he or she actually *relied* on the alleged misrepresentation and suffered damages as a result. This issue does not arise in connection with the plaintiff's claim for prospectus misrepresentation under s. 130(1) of the *Securities Act,* because that section provides a remedy "without regard to whether the purchaser relied on the misrepresentation." The statute makes it unnecessary for the purchaser under a prospectus to prove that he or she relied on the alleged misrepresentation. The issue is, however, important in the plaintiff's common law claim for negligent misrepresentation, which is advanced as an independent cause of action in relation to the Prospectus, and also in the secondary market claim. If the claim for misrepresentation requires proof of actual reliance, as the defendants assert, then it arguably gives rise to a need to examine whether each purchaser relied upon the alleged misrepresentations and, if so, which ones. The defendants say that these individual issues would make this proceeding unmanageable and unsuitable for certification as a class action. I will examine this question when I discuss the common issue that the plaintiff proposes in relation to the misrepresentation claim.

22 Against this background, I turn to the test for certification.

III. <u>The Test for Certification</u>

23 The requirements of certification of a class action are set out in s. 5 of the *C.P.A.*:

> 5.(1) The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,
>
> (a) the pleadings or the notice of application discloses a cause of action;
> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
> (c) the claims or defences of the class members raise common issues;
> (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
> (e) there is a representative plaintiff or defendant who,
>
> (i) would fairly and adequately represent the interests of the class,
> (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
> (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

24 There must be a cause of action, shared by an identifiable class, from which common issues arise, that can be resolved in a fair, efficient, and manageable way that will advance the proceeding and achieve access to justice, judicial economy, and the modification of behaviour of wrongdoers:

Sauer v. Canada (Attorney General), [2008] O.J. No. 3419 (S.C.J.) at para. 14, leave to appeal to Div. Ct. refused, [2009] O.J. No. 402 (Div. Ct.). The motion is procedural not merits-based. The question is whether the claims can appropriately be prosecuted as a class proceeding: *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158 at paras. 16, 25, 28-29. The plaintiff must show "some basis in fact" for each of the certification requirements, other than the requirement that the pleading disclose a cause of action: *Hollick v. Toronto (City)*, above, at para. 25; *Taub v. Manufacturers Life Insurance Co.* (1998), 40 O.R. (3d) 379 (Gen. Div.), aff'd (1999), 42 O.R. (3d) 576 (Div. Ct.).

25 I will consider each of the s. 5 requirements in order.

(a) <u>Causes of Action Asserted</u>

26 The first criterion for certification is that the pleading must disclose a cause of action. The test in *Hunt v. Carey Canada*, [1990] 2 S.C.R. 959, 1990 CarswellBC 216, which applies to motions under Rule 21.01(1)(b) of the *Rules of Civil Procedure,* R.R.O. 1990, reg. 194, is applicable for this purpose as well. The pleading will be acceptable unless it contains a radical defect or it is "plain and obvious" that it could not succeed: *Anderson v. Wilson* (1999), 44 O.R. (3d) 673 (C.A.) at p. 679, leave to appeal to S.C.C. denied, [1999] S.C.C.A. No. 476; *1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd.* (2002), 62 O.R. (3d) 535 (S.C.J.) at para. 19, leave to appeal granted, 64 O.R. (3d) 42 (Div. Ct.), aff'd (2004), 70 O.R. (3d) 182 (Div. Ct.); *Healey v. Lakeridge Health Corp.*, [2006] O.J. No. 4277 (S.C.J.) at para. 25. No evidence is admissible on this aspect of the motion, and the material facts pleaded are accepted as true, unless patently ridiculous or incapable of proof.

27 The pleading must be read generously to allow for drafting inadequacies and the lack of information available to the plaintiff in the early stages of the action: *Hunt v. Carey Canada Inc.*, above, at 980; *Anderson v. Wilson*, above, at 679. It will be struck only if it is plain, obvious, and beyond reasonable doubt that the plaintiff cannot succeed: *Hollick v. Toronto (City)*, above, at para. 25; *Cloud v. Canada (Attorney General) v. Canada (Attorney General),* above, at para. 41; *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.) at p. 469. Matters of law not fully settled in the jurisprudence must be permitted to proceed: *Ford v. F. Hoffmann-LaRoche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 17(e).

28 The plaintiff asserts multiple causes of action in the Amended Amended Fresh as Amended Statement of Claim (the "Statement of Claim"). These include:

(i) a claim under s. 130 of the *Securities Act* against all defendants in relation to the Prospectus;
(ii) negligent misrepresentation against all defendants;
(iii) reckless misrepresentation against the Gammon Defendants;
(iv) negligence against all defendants;
(v) conspiracy against the Gammon Defendants; and
(vi) unjust enrichment and waiver of tort against the Underwriters.

29 I will now examine whether the pleading discloses each of these causes of action.

(i) Section 130 of the *Securities Act*

30 As noted earlier, s. 130 of the *Securities Act* provides a purchaser of a security under a prospectus with a remedy for misrepresentation, regardless of whether the purchaser relied on the misrepresentation. The remedy is available against the issuer and underwriters of the security as well as directors of the issuer and others who have signed the prospectus or have allowed their reports or statements to be used in the prospectus. The remedy is significant in the context of a class action, because it dispenses with the requirement that each class member prove that he or she relied on the misrepresentation, a requirement that frequently makes misrepresentation claims unsuitable for certification.

31 Section 130 provides:

> (1) Where a prospectus together with any amendment to the prospectus, contains a misrepresentation, a purchaser who purchases a security offered by the prospectus during the period of distribution has, *without regard to whether the purchaser relied on the misrepresentation*, a right of action for damages against,
>
> (a) the issuer or a selling security holder on whose behalf the distribution was made;
> (b) each underwriter of the securities who is required to sign the certificate required by section 59;
> (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed;
> (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and
> (e) every person or company who signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d),
>
> or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter, in which case the purchaser shall have not right of action for damages against such person, company or underwriter [emphasis added].

32 A "misrepresentation" is defined as an untrue statement of material fact or an omission to state

a material fact that is required to be stated or that is necessary to make a statement not misleading. A "material fact" is a fact that would reasonably be expected to have a significant effect on the market price of the securities.

33 The defendants do not dispute that the plaintiff could have a valid cause of action under s. 130 of the *Securities Act.* They say, however, that the claim is time-barred by s. 138(b)(i), which provides that no such action shall be commenced more than "180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action." This assertion is based on a pleading that on May 10, 2007 Gammon issued and filed with the securities regulators a quarterly report that disclosed a first quarter loss of over US$10 million and other information that, collectively, was a partially corrective disclosure of the previous misrepresentations. This resulted in a significant negative impact on Gammon's share price on May 11 and 14, 2007, the trading days following this disclosure.

34 The defendants say that a large proportion of Gammon shareholders would have acquired actual knowledge of these facts and that *all* of Gammon's shareholders ought reasonably to have known of the fact at that time. The Gammon Defendants therefore say that the limitation period began to run on May 14, 2007, and expired on November 10, 2007, approximately three months before the commencement of this action. They say that the statutory misrepresentation claim of every Class Member is barred by the expiry of the limitation period.

35 In addition, the Underwriters rely on statements made by Mr. McKenna on his cross-examination to the effect that he formed the belief in May or June of 2007 that Scotia Capital had failed to conduct adequate due diligence in connection with the public offering. They say that Mr. McKenna knew or ought to have known of the alleged misrepresentations as of that date and that his claim is time-barred for that reason as well. They also say that, for this reason, he is not a suitable representative plaintiff on behalf of Prospectus purchasers.

36 Prior to the hearing of the certification motion, counsel for the Underwriters sought leave to bring a motion for, among other things, summary judgment dismissing the plaintiff's s. 130 *Securities Act* claim on the ground that it was time-barred. I refused the request on several grounds. In particular, I was not satisfied that hearing the motion prior to certification would promote litigation efficiency: *McKenna v. Gammon Gold Inc.*, [2009] O.J. No. 5151.

37 There is no doubt that a putative class action can be dismissed, even prior to certification, where the claim of the proposed representative plaintiff is time-barred on the face of the pleading: *Stone v. Wellington County Board of Education* (1999), 120 O.A.C. 296, [1999] O.J. No. 1298 (C.A.); *Farquar v. Liberty Mutual Insurance Co.* (2004), 43 C.P.C. (5th) 361, [2004] O.J. No. 148 (S.C.J.). I note that in both these cases, however, while the motion was brought prior to certification, the defendants had delivered statements of defence pleading the limitations issue.

38 Where the resolution of the limitations issue depends on a factual inquiry, such as when a plaintiff knew or ought to have known of the facts constituting the action, the issue should not be resolved at certification: *Serhan (Trustee of) v. Johnson & Johnson* (2006), 85 O.R. (3d) 665, [2006] O.J. No. 2421 (Div. Ct.) at paras. 140-145. Accordingly, it is not plain and obvious in this case that the claims of the class generally, or of Mr. McKenna personally, are statute barred due to limitations.

39 If the defendants consider that the limitation period is an issue that can be resolved on a common basis, they may move to have it added as a common issue. Alternatively, the defendants may bring a motion for summary judgment on this issue, if so advised, at a future date. If necessary and appropriate, the plaintiff may move to add another representative plaintiff.

40 It is pleaded that Mr. Langille resigned as a director of Gammon on or about April 3, 2007, a date before the Prospectus was filed. The remedy under s. 130(1)(c) of the *Securities Act* only applies to persons who were directors at the time the prospectus was filed. It is plain and obvious on the face of the pleading that the claim against Mr. Langille cannot succeed and it should be dismissed.

(ii) Negligent Misrepresentation

41 The plaintiff pleads a cause of action in negligent misrepresentation against both the Gammon Defendants and the Underwriters. He pleads that the Gammon Defendants intended that the Class Members would rely on the misrepresentations, which they did to their detriment by purchasing Gammon securities at inflated prices under the Prospectus and in the secondary market. He also pleads that the plaintiff "directly or indirectly" relied upon the misrepresentations. He makes similar allegations against the Underwriters in connection with the Prospectus.

42 The requirements of a claim for negligent misrepresentation were summarized by the Supreme Court of Canada in the leading case of *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87, [1993] S.C.J. No. 3 ("*Cognos*") at para. 33:

> ... (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making said misrepresentation; (4) *the representee must have relied, in a reasonable manner*, on said negligent misrepresentation; and (5) *the reliance must have been detrimental* to the representee in the sense that damages resulted. [emphasis added]

43 The plaintiff has properly pleaded the essential ingredients of negligent misrepresentation. As I will explain later in these reasons, I do not accept the "non-reliance theory of misrepresentation" advanced by plaintiff's counsel and set out as follows in his factum:

> ... Canadian and other common law Courts have increasingly recognized that, in appropriate circumstances, reliance per se is not an essential element of a

> common law misrepresentation claim. ... If causation can be established by some means other than reliance, then the plaintiff can state a valid cause of action.

44 In my respectful view, for reasons I will explain under the common issues analysis, this is not the law of Canada. While reliance can be established by inference, it remains a necessary ingredient of the cause of action of negligent misrepresentation.

(iii) Reckless Misrepresentation

45 The Statement of Claim includes a heading before para. 202 entitled "Reckless Misrepresentation, Negligence and Negligent Misrepresentation of the Gammon Defendants." The plaintiff pleads that those defendants owed a duty to the Class to disseminate accurate information, that the information disseminated by the defendants, including the Prospectus, contained misrepresentations, that the defendants knew that the misrepresentations were false and that the plaintiff and investors would rely on them, which they did to their detriment by purchasing Gammon's securities. Apart from the heading itself, there is no pleading that the Gammon Defendants acted recklessly or not caring whether the representations were true or false.

46 Reckless misrepresentation is not itself a cause of action: *Hurst v. PriceWaterhouseCoopers (PWC) LLP, Canada*, [2009] O.J. No. 1415 (S.C.J.). A pleading of "reckless misrepresentation" may be regarded as being, in substance, a pleading of fraudulent misrepresentation, if the necessary elements of that cause of action are pleaded. Some claims have been allowed to proceed on that basis: *Canadian Imperial Bank of Commerce v. Deloitte & Touche* (2003), 33 C.P.C. (5th) 127, [2003] O.J. No. 2069 (Div. Ct.); *Silver v. Imax Corp.* [2009] O.J. No. 5585 ("*Silver v. Imax - Certification*") at paras. 76-80; *McCann v. CP Ships*, [2009] O.J. No. 5182 (S.C.J.) at paras. 39-43.

47 A pleading of fraudulent misrepresentation requires that there be: (a) a false representation of fact; (b) made with knowledge of its falsehood or recklessly, without belief in its truth; (c) with the intention that it should be acted upon by the plaintiff; and (d) actually inducing the plaintiff to act on it to his or her detriment: *Parna v. G & S Properties Ltd.* [1971] S.C.R. 306, (1970), 15 D.L.R. (3d) 336.

48 In *Mondor v. Fisherman* (2002), 22 C.P.C. (5th) 346, [2002] O.J. No. 1855, Cumming J. permitted a claim to proceed in a class action where the plaintiff alleged that the defendants were "willfully blind" and that they were reckless in their negligent misrepresentation, "not caring whether it was true or false." There is no such pleading in this case. Apart from the request in para. 3(e) of the statement of claim for a declaration that the misrepresentations were made recklessly, and the heading before para. 202, there is no pleading of recklessness or willful blindness and certainly no pleading of fraud.

49 The rule remains that fraud is a serious allegation and it must be pleaded with particularity: see Rule 25.06(8) of the *Rules of Civil Procedure,* R.R.O. 1990, reg. 194; *Lo Faso v. Ferracuti*, [2009] O.J. No. 4568 (S.C.J.). Pleadings of fraud may raise issues for insurers and regulators and they have, of course, serious costs consequences if not made out. When it comes to fraud, a plaintiff is required to fish or cut bait. A defendant is entitled to know if fraud is being alleged and a plaintiff cannot hide behind ambiguous pleadings to avoid the consequences of an unsuccessful pleading of fraud.

50 While the authorities to which I have referred indicate that some measure of flexibility will be permitted in allowing a claim for reckless misrepresentation to proceed where it is in substance a pleading of fraudulent misrepresentation, counsel for the plaintiff did not suggest that a claim for fraud is being made. The pleading in this case does not contain the necessary elements of fraudulent misrepresentation and therefore does not disclose a cause of action.

(iv) Negligence

51 The statement of claim alleges that the Underwriters owed a duty to the Class, at common law and under the *Securities Act*, to ensure that the Prospectus provided full, true and plain disclosure of material facts and that the Underwriters failed to exercise appropriate diligence in connection with the Prospectus. In the course of the submissions, reference was made to the decision of Van Rensburg J. in *Silver v. Imax - Certification,* above, at paras. 81-88, in which it was held that a similar pleading was in substance a claim for negligent misrepresentation without the element of reliance and the claim was not certified; see also *Deep v. M.D. Management* (2007), 35 B.L.R. (4th) 86, [2007] O.J. No. 2392 (S.C.J.).

52 Plaintiff's counsel acknowledged that the claim for negligence was really subsumed by the negligent misrepresentation claim and said that it would be abandoned. Counsel for the plaintiff requested leave to amend but was unable to identify any basis or theory on which a claim for negligence could be asserted. For this reason, I do not propose to grant leave at this time.

(v) Conspiracy

53 The plaintiff pleads that:

* the Gammon Defendants "wrongfully, unlawfully, maliciously and lacking *bona fides*" agreed to conceal from investors material facts relating to Gammon's mining operations and stock options practices;
* the predominant purpose of some but not all of the Gammon Defendants was to inflate the price of Gammon's shares and increase the value of their own holdings;
* various acts were carried out allegedly in furtherance of the conspiracy, including misstating, distorting or withholding material facts;
* the conspiracy was unlawful because the Gammon Defendants knowingly and intentionally committed those acts when they knew that there was no reasonable assurance that their misrepresentations were accurate, and in so doing they violated the *Securities Act*, the United States *Securities*

Exchange Act of 1934, and the reporting requirement of the TSX and AMEX; and

* the conspiracy was directed towards the plaintiff and other Class Members and the Gammon Defendants knew in the circumstances that it would, and it did in fact, cause loss to the plaintiff and the other Class Members.

54 A pleading of conspiracy must include particulars of: (1) the parties and their relationship; (2) an agreement to conspire; (3) the precise purpose or objects of the alleged conspiracy; (4) the overt acts that are alleged to have been done by each of the conspirators; and (5) the injury and particulars of the special damages suffered by reason of the conspiracy: see Perell J. in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, (2008), 89 O.R. (3d) 252, [2008] O.J. No. 833 at para. 90 ("*Quizno's - S.C.J.*"), rev'd on other grounds (2009), 96 O.R. (3d) 252, [2009] O.J. No. 1874 (Div. Ct.)("*Quizno's - Div. Ct.*"), referring to *Aristocrat Restaurants Ltd. v. Ontario*, [2003] O.J. No. 5331 (S.C.J.); *Normart Management Ltd. v. West Hill Redevelopment Co.* (1998), 37 O.R. (3d) 97 (C.A.); *D.G. Jewelry Inc. v. Cyberdiam Canada Ltd.*, [2002] O.J. No. 1465 (S.C.J.); *Cineplex Corporation v. Viking Rideau Corporation* (1985), 28 B.L.R. 212, [1985] O.J. No. 304 (Ont. H.C.J.).

55 In *Silver v. Imax - Certification*, Van Rensburg J. referred to the requirements of a pleading of conspiracy as set out in the leading case of *Normart Management Limited v. West Hill Redevelopment Company Limited et al.,* above, at p. 98:

> [T]he statement of claim should describe who the several parties are and their relationship with each other. It should allege the agreement between the defendants to conspire, and state precisely what the purpose or what were the objects of the alleged conspiracy, and it must then proceed to set forth, with clarity and precision, the overt acts which are alleged to have been done by each of the alleged conspirators in pursuance and in furtherance of the conspiracy; and lastly, it must allege the injury and damage occasioned to the plaintiff thereby.

56 The pleading of conspiracy in this case is very similar to (and in some instances tracks word-by-word), the pleading in *Silver v. Imax - Certification*, in which the plaintiffs were represented by the same counsel. Some of the objections made by the defendants to the pleading in that case are similar to the objections made here.

57 The defendants say that the pleading in this case is deficient because it lacks particularity with respect to the overt acts committed by each conspirator, the alleged agreement between the parties, when the agreement was entered into and what its terms were. They say there is a duty to plead the cause of action with particularity: *OZ Merchandising Inc. v. Canadian Professional Soccer League Inc.*, [2006] O.J. No. 2882 (S.C.J.) at para. 14, 24-25; *Noldin v. Prince*, [1999] O.J. No. 2148, 1999 CanLII 37350 (C.A.) at paras. 3-5; *Research Capital Corporation v. Skyservice Airlines Inc.*, [2008] O.J. No. 2526, 2008 CanLII 30703 (S.C.J.) at paras. 48, 50 varied on other grounds 2009 ONCA 418.

58 They also say that the pleading is deficient because it fails to particularize the damage or injury allegedly caused by the conspiracy: *Aristocrat Restaurants Ltd. v. Ontario*, [2004] O.J. No. 5164 (S.C.J.) at para. 41. The pleading of special damage is an indispensable element of a legally sufficient conspiracy pleading, absent which the claim should be struck: *Robinson v. Medtronic Inc.*, [2009] O.J. No. 4366 (S.C.J.) at paras. 107, 111; *Apotex Inc. v. Plantey USA Inc.*, [2005] O.J. No. 1860 (S.C.J.) at paras. 61-63.

59 The defendants also say, as was asserted in *Silver v. Imax - Certification*, that the claim for conspiracy must fail because the alleged conspirators are Gammon and its officers and directors. Since a corporation must necessarily act through its directing minds, the actions of those individuals, in reaching an agreement on a course of action within the scope of their responsibilities, cannot give rise to an actionable conspiracy: *Normart Management Ltd. v. West Hill Redevelopment Co.*, above; *Craik v. Aetna Life Insurance Co. of Canada*, [1995] O.J. No. 3286 (Gen. Div.) at para. 23, aff'd [1996] O.J. No. 2377 (C.A.); *Accord Business Credit Inc. v. Bank of Nova Scotia*, [1997] O.J. No. 2562 (Gen. Div.) at para. 34.

60 In *Silver v. Imax - Certification*, Van Rensburg J. referred to the decision of the Court of Appeal in *Normart Management Limited v. West Hill Redevelopment Company Limited et al.*, above, at para. 92:

> It is well established that the directing minds of corporations cannot be held civilly liable for the actions of the corporations they contract and direct *unless there is some conduct on the part of those directing minds that is either tortious in itself or exhibits a separate identify or interest from that or the corporations* such as to make the acts or conduct complained of those of the directing minds [emphasis added].

61 She found that that the conspiracy claim was properly pleaded, at paras. 94-96:

> In the present case, while the plaintiffs have alleged that the acts or omissions alleged in the Claim were authorized, ordered and done by the Individual Defendants while engaged in the management, direction, control and transaction of its business affairs and are therefore acts and omissions for which IMAX is vicariously liable (paras. 85 and 86), the plaintiffs have also alleged that the actions of the Individual Defendants are independently tortious and that such defendants are personally liable (para. 87).
>
> The allegations against the Individual Defendants in the Claim include the assertion that they were acting "wrongfully, unlawfully, maliciously and lacking bona fides" (para. 52) and that they were motivated to increase the value of their own holdings in IMAX (para. 53(e)).

> The Claim pleads all of the necessary elements of the cause of action of conspiracy. There are allegations in the Claim that may, if true, give rise to personal liability on the part of the Individual Defendants. Their conduct is at issue both as agents for the Corporation and in their personal capacities. It is not therefore plain and obvious that the conspiracy claim is deficient, and accordingly such claim will not be struck.

62 The defendants say that the plaintiff has not appropriately pleaded simple motive conspiracy -- i.e., that the predominant purpose of the defendants' conduct, whether or not the conduct is unlawful in itself, was to cause injury to the plaintiff: *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452, 1983 CarswellBC 812. The defendants say that the pleading fails to assert a predominant purpose to injure. The defendants say that the plaintiffs must plead that the Gammon Defendants committed one or more unlawful acts in furtherance of the alleged conspiracy: *Starkman v. Canada (Attorney General)*, [2000] O.J. No. 3764 (S.C.J.) at para. 11; *Apotex Inc. v. Plantey USA Inc.*, above, at paras. 58-59.

63 The plaintiff says that he has pleaded both simple motive conspiracy and unlawful means conspiracy in the alternative. The pleading of the latter is that the defendant's conduct was unlawful, was directed at the plaintiff, and the defendant knew or ought to have known that injury to the plaintiff would result: *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, above, at paras. 33-34; *Hunt v. Carey Canada Inc.*, at paras. 42-43. The plaintiff says that there is a proper pleading of unlawful means conspiracy because he alleges that the Gammon Defendants' conduct in making the misrepresentations and manipulating the Gammon stock options was unlawful, that it was directed at the public and in particular the plaintiff and the Class and in the circumstances the Gammon Defendants knew or ought to have known that injury to the Plaintiff and the other Class Members would result.

64 In this case, as in *Silver v. Imax - Certification*, the facts pleaded amount to an assertion that the individual defendants were acting not only for Gammon's benefit, but also for their own benefit, and to that extent, to the detriment of Gammon. Specifically, the individual defendants are alleged to have enriched themselves by manipulating the grant dates of Gammon stock options, thereby enabling themselves to exercise options, to the detriment of Gammon, at impermissibly low prices. It is not plain and obvious that the conspiracy claim must fail. The tort of conspiracy has been properly pleaded. The pleadings allege that the Gammon Defendants:

(a) reached an agreement;
(b) with a common intention (to inflate the share price);
(c) to commit acts that were either unlawful (under the *Securities Act* and other statutes) and likely to cause injury to the class members, or had the predominant purpose of causing injury to the class members; and
(d) thereby caused damage to be suffered by the class members.

65 Moreover, the plaintiff has provided sufficient particulars of the overt acts (the misrepresentations) that were allegedly undertaken in furtherance of this conspiracy. The plaintiff has pleaded facts to establish that the conduct of the defendant directors and officers of Gammon was either tortious in itself, or exhibited a separate interest from that of the corporation. Lastly, the plaintiff has pleaded facts to ground the vicarious liability of the corporation for the acts of the defendant directors and officers. These factual assertions, if proven, would entitle the plaintiff to relief against the Gammon Defendants under the tort of conspiracy: *Canada Cement Lafarge Ltd. v. British Columbia Lightweight Aggregate Ltd.,* above; see also, G.H.L. Fridman, *The Law of Torts in Canada,* 2nd ed. (Toronto: Carswell, 2002) at pp. 765-772 and *Normart Management Ltd. v. West Hill Redevelopment Co.,* above.

66 It is, however, fundamental to a proper pleading of conspiracy that the plaintiff must allege damages that are separate and distinct from the damages suffered from the underlying tort itself. In *Quizno's - S.C.J.*, Perell J. found that the pleading lacked particulars in this regard. As he did not certify the action, which was allowed to continue as an ordinary action, he ordered the plaintiff to provide particulars of the special damages. He stated that, had he certified the action, he would not have ordered particulars beyond those sustained by the representative plaintiff. Special damages suffered by the class would be an individual issue. In *Quizno's - Div. Ct.,* the decision of Perell J. was reversed and the action certified as a class action.

67 In *McCann v. CP Ships Ltd.* above, Rady J. found that there was no pleading of special damages in relation to the conspiracy claim which were distinct from those flowing from the pleading of negligence or negligent misrepresentation. She granted leave to amend to provide particulars of the special damages.

68 I propose to follow the course adopted by my colleagues and to order the plaintiff to provide particulars of the special damages suffered by the representative plaintiff.

(vi) Unjust Enrichment and Waiver of Tort

69 The plaintiff pleads that the Underwriters have been unjustly enriched at the expense of the Class Members and that there is no juristic reason for the enrichment. He also pleads, in the alternative to a claim for damages, that Class Members are entitled to waive the tort claim and instead "elect to claim payment of the underwriting commissions generated by the Underwriters as a result of their failure of diligence and care." The plaintiff relies upon *Garland v. Consumers Gas Co.,* [2004] 1 S.C.R. 629, [2004] S.C.J. No. 21, and says that the pleading contains the necessary allegations of (a) enrichment of the defendant; (b) a corresponding deprivation of the plaintiff; and (c) an absence of juristic reason for the enrichment. The Underwriters acknowledge that the claims are adequately pleaded and I agree.

Summary with respect to cause of action requirement

70 In summary, I conclude that the pleading, as it now stands, discloses the following causes of

action:

(a) the statutory cause of action for misrepresentation in the Prospectus, under s. 130 of the *Securities Act,* as against all defendants;
(b) a cause of action in negligent misrepresentation under the Prospectus and in the secondary market;
(c) a cause of action against all defendants for conspiracy, but particulars of the special damages suffered by the representative plaintiff must be provided; and
(d) a claim against the Underwriters for unjust enrichment and waiver of tort in connection with the Prospectus.

Other Claims

71 For the sake of good order, I will comment briefly on two additional "claims" that were the subject of submissions.

72 First, the statement of claim pleads that the plaintiff "intends promptly to deliver a notice of motion seeking leave under s. 138.8(1) of the [*Securities Act*] to amend this statement of claim to plead the causes of action [for misrepresentation in the secondary market] set out in s. 138.3 of the [*Securities Act*]."

73 Section 138.3 of the *Securities Act*, contained in Part XXIII.1 entitled "Civil Liability for Secondary Market Disclosure," gives shareholders of a reporting issuer a statutory cause of action for misrepresentation in relation to the secondary market "without regard to whether the person or company relied on the misrepresentation." The remedy is available against the issuer, directors, certain officers and others. Certain defences and limits of liability are also available or applicable. Section 138.8 stipulates that no action may be commenced under s. 138.3 unless leave is granted by the court on being satisfied that the action is brought in good faith and that there is a "reasonable possibility" that the action will be resolved at trial in favour of the plaintiff. The origins of the section were considered by Lax J. in *Ainslie v. CV Technologies Inc.* (2008), 93 O.R. (3d) 200, [2008] O.J. No. 4891. The statutory remedy was recently discussed and leave granted to commence a s. 138.3 claim in a separate decision issued by Van Rensburg J. in the *Imax* case: *Silver v. Imax Corp.,* [2009] O.J. No. 5573 (*"Silver v. Imax - s. 138"*).

74 Unlike the plaintiff in *Silver v. Imax - s. 138*, and notwithstanding the statement in his pleading, Mr. McKenna has not sought leave under s. 138.8.

75 While s. 138.3 does not preclude a common law action for negligent misrepresentation, a right that is preserved by s. 138.13, the "deemed reliance" provision in s. 138.3 is unavailable to Mr. McKenna. Hence the debate in this case about the need to establish reliance in a claim for common law misrepresentation and about the suitability of reliance as a common issue, which I shall discuss shortly.

76 The second point is that the statement of claim contains allegations that the Gammon Defendants "manipulated" the dates of stock options granted to insiders and misstated Gammon's stock option expense in the Prospectus and other filings. The pleading states, at para. 198, that as a result of these manipulations, the financial statements of Gammon, which were incorporated by reference into the Prospectus, understated Gammon's stock option expense. Para. 204 states that the Gammon Defendants selected option exercise prices that were below market ("in the money" options), issued options while they were in possession of positive information and signed financial statements that they knew understated Gammon's stock option expense. There is no separate claim for damages in respect of the stock options.

77 The Gammon Defendants say that the true nature of the stock option pleading relates to wrongs committed by Gammon's officers and directors against the corporation itself and, as such, it is a derivative claim that the plaintiff has no standing to assert. They say it offends the rule in *Foss v. Harbottle* (1843), 2 Hare 460, 67 E.R. 189. The fact that the claim is made in a proposed class action does not overcome the rule: *Everest Canadian Properties Ltd. v. Mallmann* (2008), 46 B.L.R. (4th) 198, [2008] B.C.J. No. 1258 (C.A.).

78 The defendants also say that the plaintiff has failed to plead any "corrective disclosure" in relation to the stock options that could possibly have had an effect on the value of Gammon's shares. Thus, the plaintiff has failed to plead that he suffered detriment as a result of the alleged manipulation of stock options, a necessary ingredient of the misrepresentation claim at common law and under s. 130.

79 Mr. McKenna admits that a derivative claim would be unsustainable. He says, however, that he is not seeking to recover the harm he indirectly suffered as a result of Gammon receiving less consideration for its shares than it would have received, but for the manipulation of the option dates. He says that his pleading simply means that Gammon's net income was understated as a result of the improper pricing of the stock options and Gammon falsely represented that the financial statements accurately represented its financial picture.

80 I accept the submission of the plaintiff that the pleading of the stock options is not asserted as a cause of action and it is simply a part of the misrepresentation claim, to the effect that the price of Gammon's shares was improperly inflated as a result of the mis-statement of its stock option expense.

(b) <u>The Proposed Class</u>

81 The description of the Class is broad:

> All persons, [other than certain excluded persons related to the parties] who acquired securities of [Gammon] during the period from the opening of trading on October 10, 2006 to the close of trading on August 10, 2007 (the "Class Period"), whether over a stock exchange, or pursuant to a prospectus, or

otherwise ...

82 The purpose of the class definition is set out in the oft-cited case of *Bywater v. T.T.C.*, [1998] O.J. No. 4913, 27 C.P.C. (4th) 172 (Gen. Div.) at para. 10:

> (a) it identifies the persons who have a potential claim against the defendant;
> (b) it defines the parameters of the lawsuit so as to identify those persons bound by the result of the action; and
> (c) it describes who is entitled to notice.

83 The class definition must not contain merit-based elements: *Markson v. MBNA Canada Bank* (2007), 85 O.R. (3d) 321 (C.A.) at para. 19, rev'g (2005), 78 O.R. (3d) 39 (Div. Ct.), which aff'd (2004), 71 O.R. (3d) 741, (S.C.J.), leave to appeal to S.C.C. ref'd, [2007] S.C.C.A. No. 346; *Ragoonanan v. Imperial Tobacco Canada Ltd.* (2005), 78 O.R. (3d) 98 (S.C.J.), leave to appeal ref'd [2008] O.J. No. 1644 (Div. Ct.). There must be a rational relationship between the class, the causes of action, and the common issues, and the class must not be unnecessarily broad or over-inclusive: *Pearson v. Inco Ltd.* (2006), 78 O.R. (3d) 641 (C.A.) at para. 57, leave to appeal refused, [2006] S.C.C.A. No. 1, rev'g [2004] O.J. No. 317 (Div. Ct.), which had aff'd [2002] O.J. No. 2764 (S.C.J.).

84 The class description in this case, simple though it may appear to be, gives rise to a number of issues. First, as I noted earlier, the Class has no geographic boundaries and includes individuals and institutions, anywhere in the world, who purchased securities of Gammon during the Class Period. This raises a jurisdictional issue. Second, the Class includes persons who sold their securities before the end of the Class Period (the so-called "early sellers"), and therefore before the alleged misrepresentations were corrected. Third, the Class includes persons who received all, some or none of the alleged misrepresentations and who relied upon some, all or none of them. The defendants say that the class description is flawed for all these reasons, which I shall discuss in turn.

(i) <u>The Jurisdiction Issue</u>

A. <u>Introduction</u>

85 The issue is whether the Class should include persons outside the jurisdiction. There are really two issues here. The first is whether the court has jurisdiction over all or some of the defendants in this action. This is the "jurisdiction simpliciter" issue that can arise in every action. The second issue, unique to class actions, is whether the court should extend its jurisdiction to adjudicate on the claims of class members outside the jurisdiction who do not opt out of the class action. The resolution of these issues involves different, but related, considerations.

86 I will begin by setting out the positions of the parties and will then review the authorities and explain my conclusions.

87 The plaintiff submits that "an international class is appropriate" and notes that Ontario courts have certified actions encompassing class members who were resident in other provinces and countries: *Ford v. F. Hoffman-La Roche Ltd.* (2005), 74 O.R. (3d) 758, 2005 CarswellOnt 1095 (S.C.J.), at para. 31; *Nantais v. Telectronics Proprietary (Canada) Ltd.* (1995), 25 O.R. (3d) 331, 1995 CarswellOnt 994 (Gen. Div.) at para. 4 and 83; *Robertson v. The Thomson Corp.* (1999), 43 O.R. (3d) 161, 1999 CarswellOnt 301 (Gen. Div.); *Mondor v. Fisherman* (2002), 22 C.P.C. (5th) 346, 2002 CarswellOnt 1601 (S.C.J.) at para. 12. In *Mandeville v. Manufacturers Life Insurance Co.*, [2002] O.J. No. 5387 (S.C.J.) Nordheimer J. certified a worldwide class.

88 The plaintiff also refers to the decision of Sharpe J.A. in *Currie v. McDonald's Restaurants Canada Ltd.* (2005), 74 O.R. (3d) 321 (C.A.) ("*Currie*") at para. 15, to the effect that "there are strong policy reasons favouring the fair and efficient resolution of interprovincial and international class action litigation." While this is of course true, there are equally strong policy reasons, discussed in that decision, why the court must not act beyond its jurisdictional competence. I will discuss this decision below.

89 The Gammon Defendants submit that the courts of a province can only exercise jurisdiction over a person and determine their legal rights on the basis of:

(a) presence within the territory,
(b) submission or attornment to the jurisdiction, or
(c) a "real and substantial connection" between the province and the matters at issue.

In the case of non-resident Class Members, they submit that the third factor is the only one in play.

B. <u>"Real and Substantial Connection": *Muscutt* and *Van Breda*</u>

90 In determining whether there is a real and substantial connection with the action, sufficient to base jurisdiction over a defendant, the courts in recent years have applied the "*Muscutt*" test: *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (C.A.); see also *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.* (2003), 66 O.R. (3d) 112 (S.C.J.) at para. 16. This the test was recently simplified and reformulated by the Court of Appeal in *Van Breda v. Village Resorts Ltd.*, 2010 ONCA 84, [2010] O.J. No. 402 ("*Van Breda*"). The test remains "real and substantial connection," but the analytical process has been simplified.

91 In *Van Breda*, the Court of Appeal stated that the application of the test requires the court to consider whether the case falls within one of the connections or categories in sub-rule 17.02 of the *Rules of Civil Procedure* (other than sub-rule (h), "damage sustained in Ontario" and sub-rule (o), "necessary and proper party"). If so, jurisdiction over the defendant will be presumed to exist (para. 72 of *Van Breda*).

92 The core aspects of the real and substantial connection test will be the first two *Muscutt* factors - - the connection of the plaintiff's claim to the forum and the connection of the defendant to the forum. In assessing the latter, the primary focus will be on things done by the defendant within the jurisdiction (para. 89 of *Van Breda*). This will not always require that the defendant carry on physical activity within the jurisdiction; if the defendant can reasonably foresee that its actions will cause harm in the forum it may be appropriate for the court to take jurisdiction.

93 Under *Van Breda*, the principles of order and fairness will remain linked to the question of real and substantial connection (para. 98). This is not simply a matter of tallying the contacts between the jurisdiction and the plaintiff on the one hand and the defendant on the other. It requires, however, that the interests of both parties be considered and balanced. The Court of Appeal said that *Muscutt* factors 3 and 4 (unfairness to the defendant in assuming jurisdiction and unfairness to the plaintiff in not assuming jurisdiction) should be collapsed and considered together, and they should "serve as an analytic tool to assess the relevance, qualify and strength of those connections, whether they amount to a real and substantial connection, and whether assuming jurisdiction accords with the principles of order and fairness" (at para. 98).

94 The Court of Appeal in *Van Breda* instructs us that the other *Muscutt* factors (the involvement of other parties to the suit, the court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis, whether the case is interprovincial or international in nature, and comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere) will also serve as analytic tools to assist the court in assessing the significance of the connections between the forum, the claim and the defendant, and will remain relevant to the existence of a real and substantial connection.

95 Sharpe J.A. summarized the reformulated test, including the approach to be taken to *forum non conveniens*, at para. 109 of *Van Breda:*

> To summarize the preceding discussion, in my view, the *Muscutt* test should be clarified and reformulated as follows:
>
> * First, the court should determine whether the claim falls under rule 17.02 (excepting subrules (h) and (o)) to determine whether a real and substantial connection with Ontario is presumed to exist. The presence or absence of a presumption will frame the second stage of the analysis. If one of the connections identified in rule 17.02 (excepting subrules (h) and (o)) is made out, the defendant bears the burden of showing that a real and substantial connection does not exist. If one of those connections is not made out, the burden falls on the plaintiff to demonstrate that, in the particular circumstances of the case, the real and substantial connection test is met
> * At the second stage, the core of the analysis rests upon the connection between Ontario and the plaintiff's claim and the defendant, respectively.

* The remaining considerations should not be treated as independent factors having more or less equal weight when determining whether there is a real and substantial connection but as general legal principles that bear upon the analysis.
* Consideration of the fairness of assuming or refusing jurisdiction is a necessary tool in assessing the strengths of the connections between the forum and the plaintiff's claim and the defendant. However, fairness is not a free-standing factor capable of trumping weak connections, subject only to the forum of necessity exception.
* Consideration of jurisdiction *simpliciter* and the real and substantial connection test should not anticipate, incorporate or replicate consideration of the matters that pertain to *forum non conveniens* test.
* The involvement of other parties to the suit is only relevant in cases where that is asserted as a possible connecting factor and in relation to avoiding a multiplicity of proceedings under *forum non conveniens.*
* The willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis is as an overarching principle that disciplines the exercise of jurisdiction against extra-provincial defendants. This principle provides perspective and is intended to prevent a judicial tendency to overreach to assume jurisdiction when the plaintiff is an Ontario resident. If the court would not be prepared to recognize and enforce an extra-provincial judgment against an Ontario defendant rendered on the same jurisdictional basis, it should not assume jurisdiction against the extra-provincial defendant.
* Whether the case is interprovincial or international in nature, and comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere are relevant considerations, not as independent factors having more or less equal weight with the others, but as general principles of private international law that bear upon the interpretation and application of the real and substantial connection test.
* The factors to be considered for jurisdiction *simpliciter* are different and distinct from those to be considered for *forum non conveniens*. The *forum non conveniens* factors have no bearing on real and substantial connection and, therefore, should only be considered after it has been determined that there is a real and substantial connection and that jurisdiction *simpliciter* has been established.
* Where there is no other forum in which the plaintiff can reasonably seek relief, there is a residual discretion to assume jurisdiction.

C. Jurisdiction in Class Actions -- *Currie*

96 While the *Van Breda* test applies to the determination of the court's jurisdiction in both the usual form of action and a class action, the defendants say that the test for the exercise of the court's jurisdiction is modified where the issue is the court's jurisdiction not over a non-resident defendant, but over a non-resident class member or what the defendants describe as a "passive, absentee plaintiff." The defendants say that in such cases, the further issue is the connection between the forum and the foreign class members and any unfairness to such persons if the court declines jurisdiction: *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.*, above, at paras. 24-25.

97 In this case, the defendants say, there is no connection between Ontario and the non-resident members of the Class. Gammon is incorporated in Quebec, based in Nova Scotia and has its mining operations in Mexico. They say that the only connections between the claims in this action and Ontario are the filing of the Prospectus with the Ontario Securities Commission and the distribution of various public statements of Gammon in accordance with Ontario securities law.

98 The defendants say that the court must also consider whether a judgment of this court will be recognized and enforced in courts outside Ontario and, most important from their perspective, whether a judgment will be considered to be binding against non-resident shareholders and given preclusive effect in their "home" jurisdictions. In the absence of a real and substantial connection between Ontario and the claims of purchasers of Gammon shares in New York or Manitoba, for example, would the courts of those jurisdictions treat an Ontario judgment as precluding an action in their jurisdictions? See: *Canada Post Corp. v. Lépine*, [2009] 1 S.C.R. 549; *Englund v. Pfizer Canada Inc.*, [2006] S.J. No. 9 (Q.B.); *Currie*, above. If not, then the defendants run the risk that Class Members who have not opted out may be free to take a second bite at the defendant in their "home" jurisdictions if they are dissatisfied with the result in this action.

99 The defendants also raise the question of what law governs the claims of non-residents. While the provincial securities statutes may be relatively uniform (and the plaintiff says they are, but has not pleaded the law of other provinces) and while the court has jurisdiction to apply foreign law, the diversity of applicable laws could make the action unmanageable. The defendants submit that persons who purchased Gammon shares outside Ontario, have no cause of action under s. 130 of the *Securities Act*: *Pearson v. Boliden Ltd.* (2002), 222 D.L.R. (4th) 453 (B.C.C.A.) at paras. 64-66. See also *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.*, above, at paras. 37-38.

100 Lastly, the defendants submit that there is no real and substantial connection in this case between Ontario and shareholders outside Canada. They rely on the observations of Rady J. in *McCann v. CP Ships Ltd.,* at para. 83:

> It is difficult to understand the basis on which an Ontario court could or should take jurisdiction over the class members as proposed. Where is the real and substantial connection between, for example, the Ontario Court and a French citizen residing in France who purchased securities over the TSE? It strikes me as judicial hubris to conclude that an Ontario court would have jurisdiction in those

circumstances.

101 In reply, the plaintiff says that notwithstanding these comments, the class certified by Rady J. was not limited to prospectus purchasers. As well, in *Kerr v. Danier Leather*, [2004] O.J. No. 1916, 2004 CarswellOnt 6608 (S.C.J.), at para. 351, rev'd on other grounds (2005), 77 O.R. (3d) 321, 2005 CarswellOnt 7296 (C.A.), a prospectus misrepresentation case, Cumming J. certified a national class. In *Pearson v. Boliden* itself, the British Columbia Court of Appeal created sub-classes for non-residents.

102 The plaintiff says that, at a minimum, in view of the similarities of the provincial and territorial securities statutes, there should be a single pan-Canadian class.

103 This brings me to the decision of the Court of Appeal in *Currie*. In that case, the Court of Appeal addressed the issue of enforcement of a foreign class action judgment in Ontario. The Court of Appeal refused to give preclusive effect to a judgment in Illinois, implementing a settlement of a class action suit, which purported to bind Canadian and other international class members who had not opted out.

104 The Court of Appeal held that before enforcing a foreign class action judgment, it is necessary to consider whether the foreign court had an appropriate basis for assuming jurisdiction and whether the rights of Ontario residents were adequately protected.

105 Sharpe J.A., who gave the judgment of the Court, noted that class actions have unique features, one of which is the involvement of the "unnamed, non-resident class plaintiff" who, unlike the plaintiff in a typical lawsuit, does not come to Ontario asking for access to our courts and thereby attorning to the court's jurisdiction. He suggested that a court considering the enforcement of a foreign class action judgment must look to the real and substantial connection test and the principles of order and fairness from the perspective of the party against whom enforcement is sought. One aspect of this analysis would be to examine whether it would be reasonable for that party to expect that its rights would be determined by the foreign court. He gave the example of an Ontario resident who engages in a cross-border transaction, such as buying goods from a foreign mail order merchant or purchasing securities over a foreign stock exchange - that person might reasonably expect that claims in relation to those transactions could be litigated in the foreign jurisdiction. Where there is no such contact between the plaintiff and the foreign jurisdiction, the court must nonetheless look to whether there is a "real and substantial connection" between the subject matter of the class action litigation and the foreign jurisdiction. In the case before the Court of Appeal, McDonald's had its head office in Illinois and the allegedly wrongful act occurred in the United States. Sharpe J.A. referred to the observations of Cumming J. in *Wilson v. Servier Canada Inc.*, (2000), 50 O.R. (3d) 219, [2000] O.J. No. 3392 (S.C.J.) at para. 83, that Ontario courts have certified national class actions "if there is a real and substantial connection between the subject-matter of the action and Ontario" in the expectation that "other jurisdictions on the basis of comity should recognize the Ontario judgment" (at para. 22).

106 Another aspect of the analysis would be to examine whether the procedures adopted in the "foreign" jurisdiction were "sufficiently attentive to the rights and interests of the unnamed non-resident class members. Respect for procedural rights, including the adequacy of representation, the adequacy of notice and the right to opt out, could fortify the connection with [the foreign] jurisdiction and alleviate concerns regarding unfairness" (at para. 25). In the context of the case before him, Sharpe J.A. stated, at para. 25:

> Given the substantial connection between the alleged wrong and Illinois, and given the small stake of each individual class member, it seems to me that the principles of order and fairness could be satisfied if the interests of the non-resident class members were adequately represented and if it were clearly brought home to them that their rights could be affected in the foreign proceedings if they failed to take appropriate steps to be removed from those proceedings.

107 He concluded, at para. 30 that a three part test should apply to the recognition of a foreign class action judgment:

> In my view, provided (a) there is a real and substantial connection linking the cause of action to the foreign jurisdiction, (b) the rights of non-resident class members are adequately represented, and (c) non-resident class members are accorded procedural fairness including adequate notice, it may be appropriate to attach jurisdictional consequences to an unnamed plaintiff's failure to opt out. In those circumstances, failure to opt out may be regarded as a form of passive attornment sufficient to support the jurisdiction of the foreign court. I would add two qualifications: First, as stated by LaForest J. in *Hunt v. T & N plc.*, above at p. 325, "the exact limits of what constitutes a reasonable assumption of jurisdiction" cannot be rigidly defined and "no test can perhaps ever be rigidly applied" as "no court has ever been able to anticipate" all possibilities. Second, it may be easier to justify the assumption of jurisdiction in interprovincial cases than in international cases: see *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 at paras. 95-100 (C.A.).

108 Although *Currie* involved the enforcement in Ontario of a judgment in a foreign class action, the mirror image of the principles stated by the Court of Appeal are applicable to the exercise of jurisdiction by this court in a class action that seeks to include class members outside the jurisdiction. It must be asked whether the assumption of jurisdiction would satisfy the real and substantial connection test and the principles of order and fairness. This is an issue of whether it is appropriate to assume jurisdiction over the legal rights of an individual who has neither attorned nor agreed to this Court's jurisdiction. In considering this issue from the perspective of the non-resident class member, it is appropriate to ask, as did Sharpe J.A., whether the non-resident has done something that would give rise to a reasonable expectation that legal claims arising out of the activity could be litigated in the jurisdiction. The court should also ask whether it would be reasonable from the perspective of the defendant that class action litigation in the jurisdiction should finally dispose of claims of non-resident class members.

109 This will not be the end of the analysis, as Sharpe J.A. pointed out at paras. 23-25 of *Currie*. The principles of order and fairness require that, even if there is a substantial connection between the wrong and the jurisdiction and the plaintiff might have expected that his or her legal rights would be resolved in the jurisdiction, the procedures adopted must ensure that the rights of absent class members are adequately protected. This calls for consideration of appropriate representation for such class members, appropriate notice and an informed and meaningful opportunity to opt out.

110 The relevant authorities were reviewed by Van Rensburg J. in *Silver v. Imax - Certification*, who noted that presence of non-resident class members could raise issues of applicable law but concluded that those issues need not be resolved at the certification stage. She found that there was a real and substantial connection with Ontario. Imax had its head office in Ontario, it was a reporting issuer under the *Securities Act* and its shares were traded on the TSX. The alleged misrepresentation was made in Ontario and the conduct of some of the defendants was alleged to have taken place in Ontario.

D. <u>Application of jurisdictional tests in this case</u>

111 In this case, dealing first with the s. 130 *Securities Act* claim, which is against all defendants, it seems to me that there is clearly a presumption of a real and substantial connection under a number of heads within Rule 17.02 of the *Rules of Civil Procedure*: the plaintiff claims in respect of personal property in Ontario, his shares (17.02(a)); it is a claim in respect of a contract made in Ontario to acquire his shares (17.02(f)); and a tort -- misrepresentation, committed in Ontario (17.02(g)); and is against a person resident or carrying on business in Ontario, at least in connection with the Underwriters and likely in relation to Gammon by virtue of its listing its shares on the TSX and entering into the underwriting agreement in Ontario (17.02(p)).

112 At the second stage of the *Van Breda* test, there is clearly a connection between Ontario and the plaintiff's claim. Mr. McKenna is a resident of Toronto and acquired his shares in Gammon in Ontario. It is a reasonable assumption that a number of the purchasers under the Prospectus were also residents of Ontario and acquired their shares in a similar fashion. There are also a number of connections between Gammon, the Underwriters and Ontario:

(a) Gammon's shares were traded on the TSX and the evidence suggests that the volume of trading was substantially higher on the TSX than on the AMEX;
(b) Gammon was a reporting issuer in Ontario;
(c) the Underwriters have offices in Ontario, carry on business in Ontario, are registered as dealers under the *Securities Act* and are members of the TSX;
(d) the underwriting agreement was made in Ontario, was expressly subject to

Ontario law and called for closing of the offering in Ontario;

(e) the prospectus was filed with the Ontario Securities Commission; and

(f) one of the directors of Gammon, Mr., Hendrick, was resident in Ontario;

113 The activities of Gammon and the individual defendants in concluding the underwriting agreement in Ontario, filing the Prospectus with the OSC and listing Gammon's share on the TSX are clearly substantial connections with Ontario. Gammon and its officers and directors could reasonably expect that in closing the underwriting in Ontario and issuing the Prospectus through underwriters based in Ontario, their rights, and the rights of purchasers under the Prospectus, would be determined by the courts of Ontario, subject to appropriate safeguards to ensure that the court's judgment would be given preclusive effect in the case of non-resident purchasers. There is no unfairness in subjecting the defendants to Ontario jurisdiction. It would be unfair to require Mr. McKenna to pursue his claim in another province, such as Nova Scotia or Quebec, which have technical connections to Gammon, but no real or substantial connection with Mr. McKenna or the issues in this case.

114 The real and substantial connection test does not require a finding that Ontario has *the most* real and substantial connection. As the cause of action is for prospectus misrepresentation, however, Ontario's connection with the claim as a whole is greater than any other jurisdiction and is both *real* and *substantial.* Having come to Ontario for the purposes of making and closing the public offering, and having listed the shares on the TSX, it seems to me that Gammon can reasonably be taken to have submitted itself to Ontario jurisdiction for the purposes of the determination of its rights and liabilities under the Prospectus.

115 The second issue is whether the principles of order and fairness support the extension of the court's jurisdiction to require class members out of the jurisdiction to either opt out or be bound by the result. Following the example given by Sharpe J.A., in *Currie,* where non-resident class members have engaged in a cross-border transaction, acquiring securities of a Canadian company, in Canada, through a Canadian underwriter, they can reasonably expect that their legal rights in relation to that acquisition would be subject to Canadian jurisdiction and, in this case, a jurisdiction with a real and substantial connection to the defendants and the issues. The same could reasonably be said of Class Members in other provinces. For this reason, subject to appropriate safeguards with respect to representation and notice, it is appropriate to certify a class that would include non-residents who made purchases from the underwriters in Canada and under the Prospectus.

116 It is not appropriate to include within the Class those persons who purchased securities from the Underwriters or their agents outside Canada. The acquisition of those securities in a jurisdiction outside Canada would not give rise to a reasonable expectation that the acquiror's rights would be determined by a court in Canada.

117 Like Van Rensburg J. in *Silver v. Imax - Certification,* I do not find it necessary at this stage to make a determination of the law applicable to the claims of non-resident members of the class who purchased their securities from underwriters in other provinces. Given the similarity between s. 130 of the *Securities Act* and the securities laws of other provinces of Canada, this may not be an issue with respect to Class Members from other provinces. I will require the appointment of a separate representative for Class Members located outside Canada who purchased their shares in Canada. In the event either party wishes to plead foreign law with respect to the rights of Class Members outside Ontario, the issue can be addressed at a later date.

118 As will become apparent, I do not consider it appropriate to certify the secondary market claim. Had I done so, I would have limited the Class to those who acquired their shares on the TSX, who, for the reasons set out above, could reasonably contemplate that their rights would be determined by the courts of the jurisdiction where the shares were acquired.

(ii) The early sellers

119 Counsel for the Gammon Defendants submits that in a "true" securities misrepresentation action, the investors suffer losses because they have purchased shares which have an artificially inflated value as a result of misrepresentations *and* because they continue to hold the shares until the truth is revealed and the share price drops. Counsel submits that the Class must be limited to those investors who held the shares on the date of the "revelation" of the true state of affairs, because anyone who sold before that date benefited from the inflated share price. Any loss suffered by an "early seller" must have been due to circumstances other than the alleged misrepresentation. Counsel relies on *Pearson v. Boliden Ltd.* (2002), 222 D.L.R. (4th) 453 (B.C.C.A.) at paras. 92-93 and *Carom v. Bre-X Minerals Ltd.* (1999), 46 O.R. (3d) 315 (Div. Ct.) at paras. 21-23, var'd on other grounds (2000), 51 O.R. (3d) 236 (C.A.); see also *Kerr v. Danier Leather Ltd.* (2004), 46 B.L.R. (3d) 167 (Ont. S.C.J.) at para. 345, rev'd on other grounds (2007), 36 B.L.R. (4th) 95 (S.C.C.).

120 Subsection 130(7) of the *Securities Act* provides that in an action for damages pursuant to ss. (1), the defendant is not liable for all or any portion of such damages that the defendant proves do not represent the depreciation in value of the security as a result of the misrepresentation relied upon. This provision is similar to the corresponding provision in the take-over bid remedy contained in s. 131 and to which I referred in *Allen v. Aspen Group Resources,* [2009] O.J. No. 5213 at paras. 106-125. I stated in that case at para. 122:

> Given this onus, and the complex legal and factual issues that will probably be involved in the resolution of value, depreciation and date of measurement, I prefer to follow the approach taken by Cumming J. in *Danier Leather*, rather than to prejudge those issues by excluding particular members of the class at this time. As Cumming J. noted, and as the subsequent trial before Lederman J. demonstrated, the *C.P.A.* is sufficiently flexible to address these issues in an efficient manner.

121 I accept that, as a general rule and on the authority of the cases referred to by counsel for the

Gammon Defendants, it may be appropriate to exclude "early sellers" because no damages are suffered until the misrepresentation is disclosed -- shareholders who dispose of their securities before this date cannot suffer a loss as a result of the misrepresentation. In *Allen v. Aspen,* where shares in the acquiring company were exchanged for shares in the aquiree, it was alleged that the transfer ratio was skewed because of misrepresentations affecting the value of the acquiror's shares. I concluded that it was preferable to leave this issue for trial.

122 This case, as well, is an exception to the general rule. As I noted earlier, in asserting that Mr. McKenna's claim was time barred, the Gammon Defendants said that there had been partially corrective disclosure as early as May 10, when Gammon's public filing disclosed a US$10 million first quarter loss. This was slightly over three weeks after the Prospectus was issued. Representations of various kinds continued to be made for the remainder of the Class Period. It would be arbitrary at this stage to conclude that "early sellers" could not have suffered a loss as a result of the alleged misrepresentations in the Prospectus and the onus of proving this should be on the defendants at trial.

(iii) <u>Is the Class overly broad?</u>

123 The defendants submitted on the certification motion that the proposed Class was unmanageably broad, because it covered a long time period during which different misrepresentations, in various formats, were made to a wide-ranging group of shareholders. For the reasons that I will discuss in the next section, the proposed common issues arising from the negligent misrepresentation claim are not appropriate for certification and I do not propose to certify a class for the secondary market misrepresentation claim.

(c) <u>Common Issues</u>

124 The resolution of common issues lies at the heart of a class proceeding by avoiding duplication of fact-finding or legal analysis and promoting access to justice, judicial efficiency and behavior modification: *Western Canadian Shopping Centres Inc. v. Dutton* (2001), 201 D.L.R. (4th) 385 (S.C.C.) at para. 39, *Hollick v. Toronto (City),* above, at para. 18, *Fresco v. Canadian Imperial Bank of Commerce,* [2009] O.J. No. 2531 at para. 51.

125 In *Singer v. Schering-Plough Canada Inc.,* [2010] O.J. No. 113 at para. 140, I set out a number of principles, identified in the authorities, that are applicable to the common issues analysis:

> <u>A</u>: The underlying foundation of a common issue is whether its resolution will avoid duplication of fact-finding or legal analysis: *Western Canadian Shopping Centres Inc. v. Dutton*, above, at para. 39.
>
> <u>B</u>: The common issue criterion is not a high legal hurdle, and an issue can be a common issue even if it makes up a very limited aspect of the liability question

and even though many individual issues remain to be decided after its resolution: *Cloud v. Canada (Attorney General)*, above, at para. 53.

C: There must be a basis in the evidence before the court to establish the existence of common issues: *Dumoulin v. Ontario*, [2005] O.J. No. 3961 (S.C.J.) at para. 25; *Fresco v. Canadian Imperial Bank of Commerce,* above, at para. 21. As Cullity J. stated in *Dumoulin v. Ontario*, at para. 27, the plaintiff is required to establish "a sufficient evidential basis for the existence of the common issues" in the sense that there is some factual basis for the claims made by the plaintiff and to which the common issues relate.

D: In considering whether there are common issues, the court must have in mind the proposed identifiable class. There must be a rational relationship between the class identified by the Plaintiff and the proposed common issues: *Cloud v. Canada (Attorney General)*, above at para. 48.

E: The proposed common issue must be a substantial ingredient of each class member's claim and its resolution must be necessary to the resolution of that claim: *Hollick v. Toronto (City),* above, at para. 18.

F: A common issue need not dispose of the litigation; it is sufficient if it is an issue of fact or law common to all claims and its resolution will advance the litigation for (or against) the class: *Harrington v. Dow Corning Corp.*, [1996] B.C.J. No. 734, 48 C.P.C. (3d) 28 (S.C.), aff'd 2000 BCCA 605, [2000] B.C.J. No. 2237, leave to appeal to S.C.C. ref'd [2001] S.C.C.A. No. 21.

G: With regard to the common issues, "success for one member must mean success for all. All members of the class must benefit from the successful prosecution of the action, although not necessarily to the same extent." That is, the answer to a question raised by a common issue for the plaintiff must be capable of extrapolation, in the same manner, to each member of the class: *Western Canadian Shopping Centres Inc. v. Dutton*, above, at para. 40, *Ernewein v. General Motors of Canada Ltd.*, [2005] B.C.J. No. 2370, above, at para. 32; *Merck Frosst Canada Ltd. v. Wuttunee*, 2009 SKCA 43, [2009] S.J. No. 179 (C.A.), at paras. 145-146 and 160.

H: A common issue cannot be dependent upon individual findings of fact that have to be made with respect to each individual claimant: *Williams v. Mutual Life Assurance Co. of Canada* (2000), 51 O.R. (3d) 54, [2000] O.J. No. 3821 (S.C.J.) at para. 39, aff'd [2001] O.J. No. 4952, 17 C.P.C. (5th) 103 (Div. Ct.), aff'd [2003] O.J. No. 1160 and 1161 (C.A.); *Fehringer v. Sun Media Corp.*, [2002] O.J. No. 4110, 27 C.P.C. (5th) 155, (S.C.J.), aff'd [2003] O.J. No. 3918, 39 C.P.C. (5th) 151 (Div. Ct.).

I: Where questions relating to causation or damages are proposed as common issues, the plaintiff must demonstrate (with supporting evidence) that there is a workable methodology for determining such issues on a class-wide basis: *Chadha v. Bayer Inc.*, [2003] O.J. No. 27, 2003 CanLII 35843 (C.A.) at para. 52, leave to appeal dismissed [2003] S.C.C.A. No. 106, and *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, 2008 BCSC 575, [2008] B.C.J. No. 831 (S.C.) at para. 139.

J: Common issues should not be framed in overly broad terms: "It would not serve the ends of either fairness or efficiency to certify an action on the basis of issues that are common only when stated in the most general terms. Inevitably such an action would ultimately break down into individual proceedings. That the suit had initially been certified as a class action could only make the proceeding less fair and less efficient": *Rumley v. British Columbia,* [2001] 3 S.C.R. 184, [2001] S.C.J. No. 39 at para. 29.

126 I might have added a further proposition:

K. An issue is not "common" simply because the same question arises in connection with the claim of each class member, if that issue can only be resolved by inquiry into the circumstances of each individual claim: *Nadolny v. Peel (Region),* [2009] O.J. No. 4006 (S.C.J.) at para. 50; *Fresco v. Canadian Imperial Bank of Commerce,* [2009] O.J. No. 2531 at para. 51.

127 The plaintiff raises eighteen common issues, but condenses them as follows:

(a) whether the Defendants owed a duty to the Class Members to ensure that Gammon's Class Period disclosure documents (including the Prospectus) and their public oral statements did not contain a misrepresentation;
(b) whether the Gammon disclosure documents issued, or the public oral statements made by the Defendants, during the Class Period contained one or more misrepresentations;
(c) whether the Defendants made those misrepresentations negligently;
(d) whether a Class Member must demonstrate, at common law, that she relied

in whole or in part upon the misrepresentations in order to have a claim against the Defendants;

(e) whether the Gammon Defendants, or some of them, conspired one with the other, and/or with persons unknown, to deceive the Class Members for the purpose of maintaining and increasing the price of Gammon's securities;

(f) whether the Underwriters were unjustly enriched by their failure to perform their duties to the Class Members; and

(g) whether any of the Gammon Defendants ought to pay punitive damages.

128 The plaintiff says that these common issues are a substantial part of the claims of Class Members and that their resolution does not require an examination of individual circumstances and will advance the claim of each Class Member. I will begin by dealing with the first four groups of common issues, which deal with the misrepresentation claims.

<u>(i) Misrepresentation as a common issue</u>

129 The pleading of common law misrepresentation, in relation to both the Prospectus and the secondary market claim, asserts that the plaintiff and Class Members relied to their detriment on the misrepresentations "by purchasing Gammon securities pursuant to the Prospectus and/or in the secondary market at inflated prices." Mr. McKenna also pleads that he and other Class Members "directly or indirectly relied" on the defendants' misrepresentations.

130 The plaintiff has attempted to finesse the thorny issue of reliance in a misrepresentation class action by making reliance a common issue. He proposes the following common issue in relation to the misrepresentation claim:

> (9) ... must a Class Member demonstrate that she relied in whole or in part upon the misrepresentations in order to have a claim against the Underwriters?

131 Under the heading "Damages", the plaintiff asks:

> (13) To the extent that Class Members must demonstrate that they relied upon the Defendants' misrepresentations in order to have a claim against the Defendants, what is the procedure whereby the Class Members must demonstrate their individual reliance?

132 I have noted earlier the leading decision of the Supreme Court of Canada in *Cognos* in which it was stated at para. 33 that one of the requirements of the tort of negligent misrepresentation is that "the representee must have relied, in a reasonable manner, on said negligent misrepresentation." The important role of reliance in both the proximity and causation analyses is highlighted by Allen M. Linden and Bruce Feldthusen, *Canadian Tort Law* (8th ed.), (Toronto: LexisNexis, 2006) at p. 446:

> Finally, misrepresentations do not injure anyone directly. The plaintiff must take

> some action in reliance on the statement before any harm occurs. This gives the plaintiff opportunities for self-protection not available in most physical injury situations. The reasonableness of the plaintiff's reliance is central to the duty-of-care analysis; critical to the issue of causation in fact; and also relevant to the question of contributory negligence.

133 Words are at the root of the action for misrepresentation. Like the tree that falls in the forest and is heard by no one, unless the words reach someone's eyes or ears, they result in no action and they cause no damage. Reasonable reliance plays a role in the proximity analysis by defining the scope of what the defendant can reasonably foresee. It also plays a role in the damages analysis by establishing causation. The role of reliance as an essential ingredient of a claim for negligent misrepresentation has been repeatedly affirmed by the highest authority: *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1. In *Hercules Management Ltd. v. Ernst & Young,* [1997] 2 S.C.R. 165, [1997] S.C.J. No. 51, La Forest J., giving the judgment of the Supreme Court of Canada, stated at para. 24:

> In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable. To use the term employed by my colleague, Iacobucci J., in Cognos, supra, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.

134 The Ontario Court of Appeal has confirmed the reliance requirement in two recent cases: *Abarquez v. Ontario* (2009), 95 O.R. (3d) 414, [2009] O.J. No. 1814 (C.A.); *White v. Colliers Macaulay Nicholls Inc.* (2009), 95 O.R. (3d) 680, [2009] O.J. No. 2188 (C.A.). In the latter case, Blair J.A. adopted the *Cognos* test, but noted, at para. 25, that in addition the plaintiff must prove that the misrepresentation was *material* in the sense that it would be likely to influence the conduct of the plaintiff or likely to operate on the plaintiff's judgment. He also confirmed, at para. 36, that for a representation to be actionable, damages must result from relying on it, referring to the fifth requirement in the *Cognos* test.

135 It has been generally accepted that the cause of action in negligent misrepresentation requires proof that the plaintiff relied on the misrepresentation. It is for this reason that courts have usually concluded that negligent misrepresentation claims give rise to such individual inquiries as to reliance that they are unsuitable for certification: *Mouhteros v. DeVry Canada Inc.*, [1998] O.J. No. 2786 (Gen. Div) at para. 30; *Abdool v. Anaheim Management Ltd. et al* (1995), 21 O.R. (3d) 453 (Div. Ct.) at para. 129; *Sherman v. Drabinsky* (1990), 74 O.R. (2d) 596 (H.C.J.), aff'd [1994] O.J. No. 4419 (C.A.); Moyes *v. Fortune Financial Corp.* (2002), 61 O.R. (3d) 770 (S.C.J.), aff'd (2003), 67 O.R. (3d) 795 (Div. Ct.); *Controltech Engineering Inc. v. Ontario Hydro*, [1998] O.J. No. 5350 (Gen. Div.) at para. 16; *Rosedale Motors Inc. v. Petro-Canada Inc.* (1998), 31 C.P.C. (4th) 340, [1998] O.J. No. 5461 (Gen. Div.) at para. 27; *Williams v. Mutual Life Assurance Co. of Canada* (2003), 226 D.L.R. (4th) 112 (Ont. C.A.) at para. 48; *Nadolny v. Peel (Region),* [2009] O.J. No. 4006 (S.C.J.) at para. 93; *Matoni v. C.B.S. Interactive Multimedia Inc.,* [2008] O.J. No. 197 (S.C.J.); *McKay v. CDI Career Development Institutes Ltd.* (1999), 30 C.P.C. (4th) 101, [1999] B.C.J. No. 561 (S.C.) at paras. 39-42; *Olar v. Laurentian University* (2004), 6 C.P.C. (6th) 276, [2004] O.J. No. 3716 (Div. Ct.) at paras. 25-26; *Samos Investments Inc. v. Pattison,* 2001 BCSC 1790, 22 B.L.R. (3d) 46 (S.C.) aff'd 2003 BCCA 87, 30 B.L.R. (3d) 177 (C.A.); *Huras v. COM DEV Ltd.,* [1999] O.J. No. 2560, 36 C.P.C. (4th) 31 (S.C.J.) at para. 19.

136 Issues of reasonable reliance have usually been considered to be individual issues that are not capable of being resolved on a common basis: *Lacroix v. Canada Mortgage and Housing Corp.*, [2009] O.J. No. 316, 68 C.P.C. (6th) 111 (S.C.J.) at para. 97; *Lawrence v. Atlas Cold Storage Holding Inc.* (2006), 34 C.P.C. (6th) 41, [2006] O.J. No. 3748 (S.C.J.), at paras. 91-93; *Carom v. Bre-X Minerals Ltd.* (2000), 51 O.R. (3d) 236 (C.A.) at para. 57; *Serhan (Estate Trustee) v. Johnson & Johnson* (2004), 72 O.R. (3d) 296 (S.C.J.) at paras. 57-60.

137 Exceptions may be made where there is a single representation made to all members of the class or there are a limited number of representations that have a common import: see, for example, *Hickey-Button v. Loyalist College of Applies Arts & Technology*, (2006), 211 O.A.C. 301, [2006] O.J. No. 2393.

138 In *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780, [1998] O.J. No. 4496 (Gen. Div.), Winkler J., as he then was, referred to *Cognos* and *Hercules Management Ltd. v. Ernst & Young* as well as *Parna v. G. & S. Properties Ltd.*, above, in support of the need to prove reliance in negligent misrepresentation cases. He rejected the proposition that proof of reliance could be supplanted by a "fraud-on-the-market" theory, which has found favour in the United States, based on the proposition that in an efficient securities market the market price of the securities reflects the misrepresentations. He concluded, at para. 40:

> The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of *actual reliance* in either tort. In the context of the torts of

> fraudulent and negligent misrepresentation a presumption of the nature advocated for by the plaintiffs does not exist in Canadian common law. Indeed, to import such a presumption would amount to a redefinition of the torts themselves [emphasis added].

139 The plaintiff relies upon what his counsel described in argument as the "non-reliance theory of misrepresentation" in support of the proposition that, contrary to the authorities set out above, the plaintiff is not required to establish that he or she relied upon the representation.

140 The submission is based, at least in part, on the two recent class action decisions of this court in which similar arguments, made by the same plaintiff's counsel, have been adopted. In the first case, *McCann v. CP Ships*, above, Rady J, after considering a number of authorities to which I shall refer shortly, concluded, at para. 59, that "the case law is in a state of evolution and the court, in certain circumstances, is prepared to relax the otherwise strict requirement to establish individual reliance." She concluded that the plaintiff should be given an opportunity to demonstrate at trial why individual reliance is not necessary and, if it is necessary, class members should be given an opportunity to prove it as a common issue. In the second case, *Silver v. Imax - Certification*, similar arguments were made and the same authorities were considered. Van Rensburg J. concluded that it was not necessary to determine, at the certification stage, whether a plaintiff was required to prove direct reliance and that the issue could be left for argument at trial.

141 In this case, the plaintiff cites many of the authorities that were referred to by Rady J. in *McCann v. C.P. Ships* in support of the proposition that Canadian and common law courts have recognized that reliance *per se* is not an essential element of a common law misrepresentation claim and that the plaintiff need simply establish that the impugned statements *caused* the plaintiff to sustain damage. The plaintiff's counsel says "If causation can be established by some means other than reliance, then the plaintiff can state a valid cause of action."

142 In my respectful view, some of the authorities referred to by the plaintiff are not cases of negligent misrepresentation -- as Van Rensburg J. pointed out at para. 73 of *Silver v. Imax - Certification*, they are cases of negligence or negligent mis-statement where the mis-statement had been made to someone other than the plaintiff, but the plaintiff suffered damages as a result.

143 Thus, in *Haskett v. Equifax Canada Inc.* (2003), 63 O.R. (3d) 577 (C.A.), leave to appeal to S.C.C. dismissed, [2003] S.C.C.A. No. 208, the plaintiff in a proposed class action sued two credit reporting agencies claiming that their negligence in the preparation of credit reports damaged his ability to obtain credit. The claim was based in negligence, not in negligent misrepresentation. Reliance by the plaintiff was not an issue because the reports were made to other parties, not to the plaintiff. The third party recipient relied, however, on the misrepresentation. In *Spring v. Guardian Assurance plc*, [1994] 3 All E.R. 129 (H.L.), the issue involved the liability of an employer to an employee for negligently prepared letters of reference. Again, the plaintiff was not the immediate recipient of the mis-statement. In Lowe *v. Guarantee Co. of North America* (2005), 80 O.R. (3d)

222 (C.A.), the plaintiff sued medical assessors, alleging that they were negligent in their preparation of evaluations for accident benefit insurers. In this case, again, the plaintiff's reliance was not an issue because the statements complained of were made to third parties, not to the plaintiff. The causes of action are properly described as negligence or negligent mis-statement, not negligent misrepresentation.

144 In *Collette v. Great Pacific Management Co.* (2004), 26 B.C.L.R. (4th) 252, [2004] B.C.J. No. 381 (C.A.), leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 174, the plaintiff's claim was against a financial advisor for failing to undertake appropriate due diligence before offering investments for sale. The claim was expressed as a breach of duty in providing professional services and was framed in both contract and tort. It was alleged that, in providing their services, the defendants had a duty to screen out poor investments before offering them to their clients and that, but for their negligence in failing to do so, the plaintiff and other class members would not have purchased the investment. If the investments had not passed the defendants' flawed due diligence inquiry, they would not have been made available to their clients: the class members.

145 It was argued by the defendants that the investors could not succeed without proof of their individual reliance on representations by the defendants that they had carried out due diligence. Mackenzie J.A., giving the judgment of the British Columbia Court of Appeal stated at paras. 33 and 34:

> The respondents submit that the investors cannot succeed without proof of reliance on the misrepresentation by each investor individually, particularly with respect to the claims, for negligent misrepresentation. The chambers judge concluded that proof of reliance was required for the claims in tort but not in contract.
>
> The reason for insistence on reliance is to establish causation. If causation can be established otherwise, then reliance is not required: see *Henderson*, [1995] 2 A.C. 145, supra, per Lord Goff at 776, and *Yorkshire Trust Co. v. Empire Acceptance Corp. Ltd.* (1986), 24 D.L.R. (4th) 140 at 145-47, 69 B.C.L.R. 357 at 354-55, 22 E.T.R. 96 (S.C.) per McLachlin J. Here if the mortgage units had not passed the due diligence test they would not have been offered for sale by the respondents to any clients. *Causation is therefore established between a breach of due diligence duty and the investors' loss, independently of proof of individual reliance. In my view, proof of reliance does not present an obstacle to the appellant's case as framed. The appellant's case adequately links a breach of duty causally to the investors' losses.* [emphasis added]

146 The words in italics indicate that the Court of Appeal was not deciding that reliance is not an essential ingredient of the tort of negligent misrepresentation. It was simply saying that the claim could be established in negligence as breach of a duty to conduct due diligence; but for that breach, the units would not have been offered for sale and the plaintiffs would not have suffered damages. The claim was framed as a breach of duty in both negligence and contract, not as an action in negligent misrepresentation. In the case before me, the plaintiff puts this aspect of his case in negligent misrepresentation.

147 The plaintiff also relies on *Yorkshire Trust Co. v. Empire Acceptance Corp. Ltd.* (1986), 24 D.L.R. (4th) 140, [1986] B.C.J. No. 3254 (S.C.), which was referred to by both Rady J. and Van Rensburg J. In that case, a company, Empire, invested in mortgages for the benefit of its clients. Once a mortgage was arranged, it was assigned to the clients, but Empire continued to manage the mortgage investment. Empire obtained a mortgage for some of its clients on the strength of an appraisal that showed there was sufficient equity in the property. The appraisal proved to be wrong and the investors ended up with nothing. Empire sued the negligent appraiser on the ground that it had a duty to its clients and recovered a judgment. In the meantime, Empire went into receivership and its general creditors claimed an interest in the funds that had been recovered as a result of the judgment. The investors claimed that the funds were held on constructive trust for them.

148 McLachlin J., as she then was, found that the funds had been held by Empire, and hence were held by the receiver, on a constructive trust for the investors. It was argued by the receiver that the investors suffered no detriment because they had no cause of action against the appraiser as they themselves had not relied on the appraisal. It was in this context that McLachlin J. considered authorities that had found a representor liable to persons other than the representee whom he or she knew or ought to have known would have been affected by their mistake. After reviewing the role of reliance in negligent misrepresentation, and observing that it had a diminished role in restricting the class of plaintiffs and in establishing a causal link between the statement and the plaintiff's loss, she observed, at paras. 19-21:

> It is my view that in the appropriate case, where proximity and the necessary causal connection between the negligence and the loss can be established apart from reliance, recovery may be had for a negligent statement without reliance, whether on the basis of simple negligence or an extension of the doctrine propounded by *Hedley Byrne, [1964] A.C. 465, supra. ...*
>
> This case, like the *Ministry of Housing v. Sharp*, [1970] 2 Q.B. 223, and *Whittingham v. Crease & Co.*, [1978] B.C.J. No. 1229, cases, does not follow the usual pattern of actions for negligent misrepresentation: the investors did not rely on the appraisal in the sense of considering it and acting on the strength of it. However, their loss was caused by the negligent appraisal just as effectively as they had done so. The agreement between the investors and Empire stipulated that an appraisal of the property had been obtained. Their money was invested on the basis that there was sufficient equity in the property to secure the mortgage.

> Had the appraisal been done properly, it would have shown insufficient equity in the property to secure a second mortgage; Empire would never have granted a second mortgage; and Empire could not then have assigned any such mortgage to the investors. Because the appraisal was negligently performed, the investors placed their money in a property which did not provide sufficient security and lost it. It might be argued that this is a form of reliance. At very least, both foreseeability of the loss and a causal connection between the negligent appraisal and the investors' loss are established.
>
> ... I conclude that the investors had a cause of action against the appraisers.

149 This decision can be regarded as consistent with the authorities referred to earlier, in which a negligent mis-statement caused damage to someone other than the representee and formed a basis for a claim for damages for negligence. It was referred to in *Collette v. Great Pacific Management Co.,* above, and like that case was fundamentally an action in negligence. In the case before me, as I have noted, the plaintiff puts his claim squarely in negligent misrepresentation. In the case of the secondary market claim, he says that Class Members relied on the misrepresentations to their detriment by purchasing Gammon securities at inflated prices. He pleads that he "directly or indirectly" relied on the misrepresentations in the Prospectus -- unlike the plaintiffs in the foregoing cases, Mr. McKenna and the Class Members are the representees and he claims that they have suffered damages as a result of misrepresentations made to them.

150 The plaintiff also relies on *Eaton v. HMS Financial Inc.,* 2008 ABQB 631, 64 C.P.C. (6th) 295, in which a class of investors alleged that they had been induced to invest in a fraudulent investment. They sued not only the principals of the scheme but lawyers, financial institutions and others who played incidental roles in their losses. Some of the financial institutions argued that the claims against them for negligent misrepresentation would require individual assessments of the reliance issue. The plaintiffs argued that a direct causal link between the fraudulent scheme and the investors' losses could be established by means other than reliance. Rooke J. declined to decide the issue, leaving it to the judge at the common issues trial to determine the extent to which individual reliance needed to be analyzed.

151 I accept the proposition that in a case of misrepresentation proof of reliance can be made by inference, as opposed to direct evidence. The point was made by Cumming J. in *Mondor v. Fisherman,* (2001), 15 C.P.R. (4th) 289, [2001] O.J. No. 4620 (S.C.J.), in which he noted, at para. 61 that the "fraud on the market" theory has been expressly rejected in Canada and he noted the observation of Winkler J. in *Carom v. Bre-Ex Minerals Ltd.*, referred to above, to the effect that the ingredients of negligent misrepresentation are well known. Cumming J. held, however, that whether or not someone actually relied on a misrepresentation can be inferred from all the circumstances: see *Kripps v. Touche Ross & Co.,* [1997] B.C.J. No. 968, 89 B.C.A.C. 288 at para 101; *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 at 547 (C.A.).

152 Similar observations were made by Hoy J. in *Lawrence v. Atlas Cold Storage Holding Inc.*, above, at paras. 88-93 in which she considered a motion to strike negligent misrepresentation claims in a proposed class action in which claims were made under s. 130 of the *Securities Act*, as well as on the basis of negligent misrepresentation and fraudulent misrepresentation. Hoy J. concluded, referring to *NBD Bank, Canada* v. *Dofasco Inc.*, above, and *Mondor v. Fisherman*, above, that the claim should not be struck because the plaintiff might be able to satisfy the trial judge that in all the circumstances actual reliance on the alleged misrepresentation could be inferred. She observed, however, at para. 93, that the issue could impact the appropriateness of misrepresentation as a common issue:

> This need to determine reliance, as a matter of fact, with respect to each member of the class, as opposed to being able to rely on a class-wide presumption of reliance on publicly distributed information as a matter of law [i.e., under s. 130 of the *Securities Act*], will of course significantly impact on certain issues in certification.

153 The action was ultimately settled, and certified without opposition: [2009] O.J. No. 4271 and for that reason the common issues were not discussed in detail.

154 In some cases examination of the surrounding circumstances may be a preferable means of determining reliance rather than the self-serving statement of the plaintiff saying "I relied on it." This does not mean, however, that reliance can be inferred on a class-wide basis. The need to examine the individual circumstances of each shareholder would, as Hoy J. suggested, make certification of the claim problematic.

155 The need for proof of reliance in misrepresentation claims was once again confirmed by the Court of Appeal in *Boulanger v. Johnson & Johnson Corp.* (2003), 174 O.A.C. 44, [2003] O.J. No. 2218. In that case, the plaintiff brought a proposed class action in connection with the marketing and sale of a prescription drug called Prepulsid. The plaintiff claimed, among other things, that the manufacturer's filings with Health Canada were negligently prepared and failed to disclose important information. The Court of Appeal agreed, at para. 11, with the motion judge that the pleading of negligent misrepresentation could not be sustained because of the lack of reliance by consumers on the statements in the regulatory filings:

> The motions judge also concluded that these pleadings could not be sustained on the basis of negligent misrepresentation. Again I agree. It is clear that in Canada, *actual reliance is a necessary element of an action in negligent misrepresentation and its absence will mean that the action cannot succeed.* See *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. Here there is absolutely no assertion of reliance by the appellant (or by anyone on her behalf) on the representations of the respondents to Health Canada. Indeed there is no pleading of reliance on the fact of regulatory approval. *This complete*

> *absence of reliance is fatal to a negligent misrepresentation claim.* Thus these paragraphs of the statement of claim cannot be said to disclose a reasonable cause of action based on misrepresentation [emphasis added].

156 The Court concluded, however, at para. 14, that a claim could be made out in either negligence or negligent misstatement:

> The appellant's allegation is that the standard of care required of the respondents includes taking reasonable care in the filings they made to obtain regulatory approval and that without that approval, Prepulsid would not have been available to harm the appellant. These filings are pleaded as an aspect of the respondents' conduct which caused the appellant harm and which fell below the standard required of a reasonable drug manufacturer. They are one of the ways in which the appellant says the respondents were negligent. Framed this way, I cannot say that it is plain and obvious that such a claim will fail. Indeed the claim could appropriately be viewed as one of negligent misstatement. See *Haskett v. Equifax Canada Inc.*, [2003] O.J. No. 771 (C.A.), leave to appeal to S.C.C. requested.

157 In *McCann v. CP Ships*, Rady J. concluded, at paras. 59-60, that the law on the issue of reliance is in a state of evolution and that in some cases the courts have been prepared to relax the requirement. She adopted the language of Rooke, J. in *Eaton v. HMS Financial Inc.*, above, to the effect that it was too early to determine whether individual reliance is necessary and the plaintiff should be given an opportunity to demonstrate at trial why individual reliance is not necessary. In addition, she found that if reliance is a necessary prerequisite to recovery, class members should have an opportunity to prove it as an individual issue.

158 In *Silver v. Imax (Certification)*, Van Rensburg J. expressed doubt about the plaintiff's theory that reliance is not a necessary ingredient of misrepresentation in light of the decision of the Supreme Court of Canada in *Cognos.* She found it unnecessary to rule on this issue for the purposes of certification, stating that the pleading disclosed a cause of action in negligent misrepresentation, notwithstanding the absence of a pleading of direct individual reliance, and that if the plaintiffs were not able to prove reliance it would remain open for them to argue at trial that reliance is not required.

159 With deference to my colleagues who have come to a different conclusion, I accept the submission of counsel for the defendants that there is authority, binding on me, that makes proof of reliance a necessary requirement of a negligent misrepresentation claim. This is why the legislature has seen fit to relieve the investing public of this onerous requirement in the primary market through s. 130(1) and s. 131.1(1), which contain "deemed reliance provisions," and in the secondary market by a similar provision in s. 138.3(1) of the *Securities Act.* The right to pursue the latter claim is subject to the plaintiff passing the initial hurdle in obtaining leave under s. 138.8 by showing that the action is brought in good faith and has a reasonable prospect of success.

160 I conclude that the need to prove reliance as a necessary element of negligent misrepresentation, and the inability to establish reliance as a common issue, makes the common law misrepresentation claims, in both the secondary and primary markets, fundamentally unsuitable for certification. In this case, multiple misrepresentations are alleged throughout the ten month Class Period, in press releases, regulatory filings, conference calls, annual reports and a multitude of other written and oral forms. The alleged misrepresentations relate to a variety of complaints, not simply the level of gold production. The plaintiff complains of undisclosed equipment failures, contracts with insiders, stock option expenses, non-compliant financial statements and inadequate disclosure controls. Individual inquiries would have to be made into what alleged misrepresentations were made to each class member and whether he or she relied upon any of those representations. As was stated by Winkler J. in *Mouhteros v. DeVry Canada Inc.,* above, at para. 30:

> Assuming that the misrepresentation issues identified above were capable of a common resolution, such resolution would be but the beginning, and not the end of the litigation. With respect to the claim for misrepresentation in tort, the plaintiff must prove reasonable reliance on a misrepresentation negligently made. Reliance is an essential element of the tort. The question of reliance must be determined based on the experience of each individual student, and will involve such evidentiary issues as to how the student heard about DeVry, whether the student saw any of the advertisements and if so, which ones, what written representations were made to the student prior to enrolment, whether the student met with an admissions officer, and whether the student relied on some or all of these in deciding to enrol in DeVry. The inquiry will not end there, however. If the class members are able to demonstrate reliance, they must show that they relied to their detriment. Damages will require individual assessment.

161 There is no basis on which reliance could be resolved as a common issue. The need to determine the issue individually would give rise to a multitude of questions in each case concerning the representations communicated to a particular investor, the experience and sophistication of the investor, other information or recommendations made to the investor and whether there was a causal connection between the misrepresentation(s) and the acquisition of the security. The inability to determine the defendants' liability without individual inquiries as to reliance makes the proceeding unsuitable for certification in relation to the negligent misrepresentation claim.

162 For these reasons, to the extent that the proposed common issues identified above as (a), (b), (c) and (d) relate to the claim for negligent misrepresentation at common law, as opposed to the s. 130 claim, they are unsuitable for certification. To the extent that they (or specifically enumerated common issues) relate to the claims for negligence or "reckless misrepresentation", they will not be certified for the reasons set out under the cause of action analysis.

163 This conclusion does not prevent the plaintiff from bringing a properly-structured claim for misrepresentation in the secondary market under s. 138.3(1) provided its requirements are met. The plaintiff is entitled to pursue the claim for misrepresentation under the Prospectus, under s. 130 of the *Securities Act* and common issues dealing with that claim will be certified.

(ii) Conspiracy common issues

164 I will defer certification of the common issues relating to conspiracy until the plaintiff delivers particulars of the special damages alleged to have been suffered by the representative plaintiff, and any further motions by the defendants in relation to that pleading.

(iii) Unjust enrichment

165 The underwriters do not dispute that the cause of action in unjust enrichment raises common issues that are appropriate for certification. Those common issues will be certified.

(iv) Damages

166 The plaintiff's summary of the common issues, set out above, does not list damages as a common issue, presumably because the quantum of damages would be an individual issue. The list of common issues in the notice of motion, however, includes the question: "If the Defendants are liable to the Class Members, what is the price at which Gammon's shares would have traded had the Defendants made no representations?" It seems to me, that in the context of the s. 130 claim, the appropriate common issue is, to use the statutory language, "What was the depreciation in value, if any, of the Gammon shares as a result of the misrepresentations in the Prospectus." In light of s. 130(7) of the *Securities Act*, the defendants would have the onus of proving that the depreciation in value of the shares was not due to the misrepresentation. It seems to me that this issue could be determined on a common basis. I leave it to counsel to consider whether there should be a common issue certified with respect to damages and, if so, to bring the appropriate motion.

(v) Punitive damages

167 The defendants assert that the claim for punitive damages is not appropriate for certification because punitive damages should be awarded where the compensatory damages fail to achieve the goals of retribution, deterrence and denunciation: *Whiten v. Pilot Insurance Co.* (2002), 209 D.L.R. (4th) 257, [2002] 1 S.C.R. 595 ("*Whiten*") at para. 94. They say that this determination can only be made after the determination of individual entitlement to damages.

168 The defendants refer to *Robinson v. Medtronic Inc.*, [2009] O.J. No. 4366 (S.C.J.) in which Perell J. undertook an extensive review of the case law concerning certification of claims for punitive damages in class proceedings. While noting that such claims have been certified in a number of cases, Perell J. held that punitive damages will not be categorically certifiable as a common issue (at para. 166). Instead, the determination of whether a punitive damages claim is appropriate will depend on whether it has "the commonality necessary for a common issue" (at para. 166). Referring to Justice Binnie's judgment in *Whiten*, above, Perell J. held (at para. 170) that the

assessment of punitive damages at a common issues trial will require an appreciation of:

(a) the degree of misconduct;
(b) the amount of harm caused;
(c) the availability of other remedies;
(d) the quantification of compensatory damages; and
(e) the adequacy of compensatory damages to achieve the objectives of retribution, deterrence, and denunciation.

169 The certification of punitive damages as a common issue will only be appropriate where the common issues judge will be in a position to assess these factors. Applying this test to the case before him, Perell J. held (at para. 172) that:

> ... the common issues associated with negligence and with conspiracy ... will <u>not</u> be dispositive of Medtronic's liability because proof of causation and proof of damages will depend on individual trials that will follow the common issues trial. Whether Medtronic caused any harm and the amount of it will not be known until the individual issues are determined. [emphasis in original]

In the case before him, punitive damages could not be assessed by the common issues judge before determination of the individual issues.

170 Applying Justice Perell's test to the case presently before me, I find that the requirements for the certification of punitive damages as a common issue have been met. The nature of the present securities class action, as opposed to the product liability action before Perell J., makes the degree of misconduct, causation, harm, and the quantification of compensatory damages determinable by the common issues judge. There is no need for individual proof of loss to enable a common issues judge to assess punitive damages.

(d) <u>Preferable Procedure</u>

171 For a class proceeding to be the preferable procedure for the resolution of the claims of the class, it must represent a fair, efficient, and manageable procedure that is preferable to any alternative method of resolving the claims: *Cloud v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401 (C.A.) at paras. 73-75, leave to appeal to S.C.C. ref'd, [2005] S.C.C.A. No. 50.

172 The preferability inquiry should be conducted through the lens of the three principal advantages of a class proceeding: judicial economy, access to justice and behaviour modification: "Preferable" is to be construed broadly and is meant to capture the concepts of whether the class proceeding would be a fair, efficient and manageable method of advancing the claim and whether a class proceeding would be preferable to any other means of resolving the dispute.

173 The preferability determination must be made by looking at the importance of the common issues in relation to the claims as a whole: *Markson v. MBNA Canada Bank,* 2007 ONCA 334, 85 O.R. (3d) 321 at para. 69, leave to appeal dismissed [2007] S.C.C.A. No. 346. In considering the preferable procedure criterion, the court should consider:

(a) the nature of the proposed common issue;
(b) the individual issues which would remain after determination of the common issue;
(c) the factors listed in the *C.P.A.*;
(d) the complexity and manageability of the proposed action as a whole;
(e) alternative procedures for dealing with the claims asserted;
(f) the extent to which certification furthers the objectives underlying the *C.P.A.*; and
(g) the rights of the plaintiff(s) and defendant(s): *Chadha v. Bayer Inc.* (2001), 54 O.R. (3d) 520 (Div. Ct.) at para. 16, aff'd (2003), 63 O.R. (3d) 22 (C.A.), leave to appeal to S.C.C. ref'd, [2003] S.C.C.A. No. 106.

174 A class action is unquestionably the preferable procedure for the claim under s. 130(1) of the *Securities Act.* The remedy is tailor-made for a class action: see *Allen v. Aspen Group Resources Corp.*, above, at paras. 138-144; John J. Chapman, "Class Proceedings for Prospectus Misrepresentations" (1994), 73 *Can. Bar Rev.* 492. *Allen v. Aspen* was a claim under s. 131(1) of the *Securities Act* in connection with an offering memorandum in a take-over bid, but the principles are the same.

175 I can think of no more preferable procedure for the claims against the underwriters for unjust enrichment or against the Gammon Defendants for conspiracy. In both cases, a class action would promote the goals of access to justice, judicial economy and behavior modification. No alternatives were suggested.

176 The Gammon defendants submit that a class action under section 138.1 of the *Securities Act* would be the preferable procedure for the claim for negligent misrepresentation in the secondary market.

177 As discussed earlier, that section provides a statutory cause of action for misrepresentation against a "responsible issuer," its directors and against officers who authorized, permitted or acquiesced in the release of a document containing a misrepresentation. The Gammon Defendants say that s. 138.1 is the preferable procedure because the "deemed reliance" provision overcomes the intractable problem of proving reliance in a class action alleging common law misrepresentation. The say that the procedure is fair to both parties since it contains a reasonable threshold for leave that simply requires the plaintiff to show that the action has been brought in good faith and that there is a reasonable possibility that the action will be resolved in the plaintiff's favour. Moreover, while there are certain liability caps available to the defendants in the s. 138.1 action, there are certain benefits to plaintiffs. The availability of a fair efficient and manageable remedy under that

Part, which has definite advantages over a common law action (albeit subject to some limitations), give some reassurance that access to justice and behavior modification can be achieved, notwithstanding that the common law claims have not been certified.

178 As I have found that the secondary market claim is not appropriate for certification, I do not propose to consider the preferability issue in relation to that claim.

(e) Representative Plaintiff

179 In order to certify this action as a class proceeding, there must be a representative plaintiff who would fairly and adequately represent the interests of the class, who does not have a conflict on the common issues with other members of the class, and who has produced a workable litigation plan.

180 Mr. McKenna acquired Gammon securities during the Class Period. He sold 900 shares in March of 2008 but continues to hold 100 shares. He claims that he can fairly and adequately represent the class, that he has no conflict with the Class and that he is represented by experienced counsel who have produced a workable litigation plan on his behalf. The defendants say that Mr. McKenna is hopelessly inadequate as a representative plaintiff for a variety of reasons, many of which are not applicable as a result of my conclusion that the secondary market and negligent misrepresentation claims will not be certified.

181 I have addressed the complaint that Mr. McKenna's claim is time-barred, which was one of the reasons the defendants said he was an unsuitable plaintiff.

182 The defendants say that Mr. McKenna is an inappropriate representative for the institutional shareholder of Gammon, who have the most at stake, little interest in pursuing claims and "different perspectives or objectives." The causes of action asserted by Mr. McKenna and the institutional investors are identical and they have no conflict on the common issues. It is not uncommon for members of a class to have different perspectives on the claim and for some members to be unenthusiastic about the claim. If the institutional investors have no interest in the claim, or see it as detrimental to their interests, they can opt out of the action. If they do not wish to opt out, but consider that their interests are not adequately represented by Mr. McKenna, they may move for the appointment of a separate representative. To the extent they see the claim as unfounded and ill-conceived, they can support Gammon's defence.

183 The defendants say that there is also a conflict between Mr. McKenna and investors who no longer hold Gammon securities and those (including the institutional investors) who will continue to hold them until the time of trial. They suggests that the effect of this is that current shareholders would effectively be suing themselves and that any judgment Gammon is required to pay to former and current shareholders will dilute the value of the shares held by the continuing shareholders. It seems to me that this concern arises in any s. 130 claim where the class will include former as well as current shareholders. It is not a reason to refuse to certify the claim. While there may be different theories of damages applicable to shareholders who have retained their shares, as opposed to those who have sold them, this does not mean that there will be an inevitable conflict of interest. I respectfully agree with the approach taken by Cumming J. in *Kerr v. Danier Leather Inc.,* [2001] O.J. No. 4000, 14 C.P.C. 292 (S.C.J.) at para. 67, that the issue can be dealt with by the creation of a subclass, with a separate representative plaintiff, should that prove necessary.

184 For the reasons set out above with respect to non-residents, it is my view that there should be a representative on behalf of non-resident Class Members. The plaintiff may make an application to propose a representative of this group and to propose a sub-class or classes if necessary.

IV. <u>Conclusion</u>

185 In the result, this action will be certified as a class proceeding with respect to the cause of action against all defendants under s. 130 of the *Securities Act* and the additional claim for unjust enrichment against the Underwriters. The motion for certification of the conspiracy claim is adjourned pending the delivery of particulars of the special damages alleged to have been sustained by the representative plaintiff.

186 The Class definition in relation to the claim under s. 130 of the *Securities Act* and the claim for unjust enrichment will be limited to those who acquired their shares through the Underwriters in Canada.

187 Counsel shall prepare an order incorporating my conclusions and in compliance with s. 8 of the *C.P.A.* If additional issues arise, they can be addressed in a case conference. The parties may make written submissions as to costs, to be filed within 30 days, in accordance with a schedule to be agreed upon between counsel.

G.R. STRATHY J.

cp/e/qlrxg/qljxr/qlced/qlaxw/qljyw/qlhcs

Case Name:

Sharma v. Timminco Ltd.

Between
Ravinder Kumar Sharma, Plaintiff (Respondent), and Timminco Limited, Photon Consulting LLC, Rogol Energy Consulting LLC, Michael Rogol, Dr. Heinz Schimmelbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, Mickey M. Yaksich and John P. Walsh, Defendants (Appellants)
PROCEEDINGS UNDER the Class Proceedings Act, 1992

[2012] O.J. No. 719

2012 ONCA 107

289 O.A.C. 19

109 O.R. (3d) 569

345 D.L.R. (4th) 94

211 A.C.W.S. (3d) 788

19 C.P.C. (7th) 1

2012 CarswellOnt 1904

Dockets: C53624, C53642 and C53644

Ontario Court of Appeal
Toronto, Ontario

S.T. Goudge, R.P. Armstrong and S.E. Lang JJ.A.

Heard: November 2, 2011.
Judgment: February 16, 2012.

(30 paras.)

Civil litigation -- Limitation of actions -- Extension, interruption, suspension and inapplicability -- Appeal by defendants from order declaring that limitation period applicable to cause of action for misrepresentation in s. 138.3 of Ontario Securities Act was suspended by s. 28(1) of Class Proceedings Act before leave to bring misrepresentation claim was obtained allowed -- For a s. 138.3 cause of action to be asserted in a class proceeding, so as to trigger suspension provision in s. 28(1), leave had to be granted -- Since respondent had not obtained leave, s. 28(1) had not been activated.

Securities regulation -- Legislation -- Interpretation -- Appeal by defendants from order declaring that limitation period applicable to cause of action for misrepresentation in s. 138.3 of Ontario Securities Act was suspended by s. 28(1) of Class Proceedings Act before leave to bring misrepresentation claim was obtained allowed -- For a s. 138.3 cause of action to be asserted in a class proceeding, so as to trigger suspension provision in s. 28(1), leave had to be granted -- Since respondent had not obtained leave, s. 28(1) had not been activated.

Appeal by the defendants from an order declaring that the limitation period applicable to the statutory cause of action for misrepresentation in the Ontario Securities Act was suspended by s. 28(1) of the Class Proceedings Act. In 2009 the respondent commenced a proposed class action alleging misrepresentations by the appellants that adversely affected the value of shares of Timminco Limited in the secondary market. These misrepresentations were alleged to have commenced in March 2008 and continued until November 2008. The respondent sued for negligence and negligent misrepresentation and sought leave to assert the statutory cause of action for misrepresentation provided by s. 138.3 of the Ontario Securities Act. The three-year limitation period under the Act had expired before the respondent sought leave. The motions judge held that the limitation period in s. 138.14 was suspended pursuant to s. 28 of the Class Proceedings Act, effective as of the date of the issuance of the statement of claim. He held that to require that leave be granted before s. 28 applied would have defeated its purpose. He therefore concluded that because the class proceeding commenced by the respondent for common law negligence and negligent misrepresentation mentioned the s. 138.3 cause of action, the limitation period applicable to it was suspended.

HELD: Appeal allowed. The respondent's mention in his class proceeding of his intention to seek leave was not enough to activate s. 28 of the Class Proceedings Act so as to suspend the limitation period applicable to the s. 138.3 cause of action. Giving the suspension provision in s. 28(1) of the Class Proceedings Act its ordinary meaning, the s. 138.3 cause of action could not be said to be asserted in the respondent's class proceeding because no leave had been granted. The purpose of s. 28(1) did not require that the limitation period applicable to this cause of action be suspended pending the outcome of this class proceeding, since that action could not give class members access to justice for that claim as no leave to assert it had been granted.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 28, s. 28(1)

Ontario Securities Act, R.S.O. 1990, c. S.5, s. 138.3, s. 138.8(1), s. 138.14

Appeal From:

On appeal from the order of Justice Paul M. Perell of the Superior Court of Justice, dated March 31, 2011, with reasons reported at 2011 ONSC 8024.

Counsel:

Alan L.W. D'Silva, Daniel S. Murdoch and Lesley Mercer, for the appellants Timminco Limited, Dr. Heinz Schimmelbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield and Mickey M. Yaksich.

Paul Le Vay and Brendan Van Niejenhuis, for the appellant Photon Consulting LLC.

Derek J. Bell, for the appellant John P. Walsh.

Michael C. Spencer, Won J. Kim and Victoria Paris, for the respondent.

[Editor's note: A corrigendum was released by the Court March 28, 2012; the corrections have been made to the text and the corrigendum is appended to this document.]

The judgment of the Court was delivered by

1 S.T. GOUDGE J.A.:-- The issue raised by this appeal is whether s. 28 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the *CPA*) can operate to suspend the limitation period applicable to the statutory cause of action for misrepresentation provided by s. 138.3 of Part XXIII.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5 (the *OSA*) before an action under that part is commenced.

2 At first instance the motion judge answered that question affirmatively. For the reasons that follow, I have come to the opposite conclusion and I would therefore allow the appeal.

3 The essential facts are easily stated. On May 14, 2009 the respondent commenced a proposed class action alleging misrepresentations by the appellants that adversely affected the value of shares of Timminco Limited in the secondary market. These misrepresentations are alleged to have commenced on March 17, 2008 and continued until November 11, 2008.

4 The respondent's statement of claim alleges two common law causes of action, negligence and negligent misrepresentation. It also indicates that the respondent will seek an order granting leave to assert the statutory cause of action for misrepresentation provided by s. 138.3 of Part XXIII.1 of the *OSA*.

5 By the end of February 2011, the respondent had not yet sought that leave and, as a result, was faced with a possible limitation issue. Part XXIII.1 imposes a limitation period of three years from the misrepresentation for the commencement of an action under this Part. It also provides that such an action can be commenced only with leave.

6 Faced with this, the respondent moved for an order declaring that this limitation period is suspended pursuant to s. 28 of the *CPA*. The result was the order that is now appealed.

7 The relevant statutory provisions in the *OSA* are found in Part XXIII.1 of the legislation, which was proclaimed in effect on December 31, 2005. Part XXIII.1 provides for statutory civil liability where misrepresentations are made that adversely affect the value of securities purchased in the secondary market (as opposed to purchases from an issuer in a primary distribution). Enacted after much careful study, this Part provided the counterpart to Part XXIII, which, for some time, has provided a statutory cause of action for misrepresentation to purchasers of securities in the primary market.

8 In Part XXIII.1, section 138.3 provides a statutory cause of action against an issuer and those acting on its behalf for misrepresentation to persons who acquire the issuer's securities in the secondary market.

9 Section 138.8(1) provides that an action under s. 138.3 may not be commenced without leave of the court. This differs from Part XXIII, which does not require leave for commencement of an action. Section 138.8(1) reads as follows:

> **Leave to proceed**
>
> 138.8 (1) No action may be commenced under section 138.3 without leave of the court granted upon motion with notice to each defendant. The court shall grant leave only where it is satisfied that,
>
> (a) the action is being brought in good faith; and
> (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

10 Section 138.14 provides that an action under s. 138.3 must be commenced within three years of the misrepresentation:

> **Limitation period**
>
> 138.14 No action shall be commenced under section 138.3,
>
> (a) in the case of misrepresentation in a document, later than the earlier of,

(i) three years after the date on which the document containing the misrepresentation was first released, and
(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation;

(b) in the case of a misrepresentation in a public oral statement, later than the earlier of,

(i) three years after the date on which the public oral statement containing the misrepresentation was made, and
(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in another province or territory of Canada in respect of the same misrepresentation; and

(c) in the case of a failure to make timely disclosure, later than the earlier of,

(i) three years after the date on which the requisite disclosure was required to be made, and
(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in another province or territory of Canada in respect of the same failure to make timely disclosure.

11 The relevant provision of the CPA is s. 28(1). It provides for the suspension of the limitation period applicable to a cause of action asserted in a class proceeding, and for the circumstances under which it resumes running:

Limitations

28. (1) Subject to subsection (2), any limitation period applicable to a cause of action asserted in a class proceeding is suspended in favour of a class member on the commencement of the class proceeding and resumes running against the class member when,

(a) the member opts out of the class proceeding;
(b) an amendment that has the effect of excluding the member from the class is made to the certification order;
(c) a decertification order is made under section 10;
(d) the class proceeding is dismissed without an adjudication on the merits;
(e) the class proceeding is abandoned or discontinued with the approval of the court; or
(f) the class proceeding is settled with the approval of the court, unless the settlement provides otherwise.

12 The motion judge granted the respondent's motion. His order declares that the limitation period in s. 138.14 of the *OSA* is suspended pursuant to s. 28 of the *CPA,* effective as of the date of the issuance of the statement of claim on May 14, 2009.

13 At para. 50 of his reasons, the motion judge held that s. 28 of the *CPA* applies to "any limitation period applicable to a cause of action" and that this includes a cause of action under Part XXIII.1 of the *OSA*. He saw no justification for s. 28 to operate for Part XXIII causes of action, but not for Part XXIII.1 causes of action just because of the leave requirement for the latter. He pointed to s. 28 speaking of a cause of action being "asserted" and concluded that this did not depend on the commencement of litigation. Rather, in his view, s. 28 requires only that a cause of action be mentioned in an already commenced class proceeding for the limitation period applicable to it to be suspended. He held that to require that leave be granted before s. 28 of the *CPA* applied would defeat its purpose.

14 He therefore concluded that because the class proceeding commenced by the respondent for common law negligence and negligent misrepresentation mentioned the s. 138.3 cause of action, the limitation period applicable to it was suspended.

ANALYSIS

15 It is not disputed that there has been no leave granted pursuant to s. 138.8 of the *OSA*, that the respondent's class proceeding is not an action commenced under s. 138.3, and that leave is required to add the s. 138.3 cause of action to the respondent's class proceeding. The question is whether the respondent's mention in his class proceeding of his intention to seek leave is enough to activate s. 28 of the *CPA*, so as to suspend the limitation period applicable to the s. 138.3 cause of action. Is it enough to be able to say that this cause of action has been asserted in the respondent's class proceeding?

16 The suspension provision in s. 28(1) of the *CPA* provides that "any limitation period applicable to a cause of action asserted in a class proceeding is suspended in favour of a class member on the commencement of the class proceeding". These words must be read in their grammatical and ordinary sense, in the full context of the scheme of the *CPA*, its object and the intention of the legislature. See: *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2

S.C.R. 559, at para. 26.

17 *The Canadian Oxford Dictionary*, 2d ed., defines "assert" as "make or enforce a claim to (*assert one's rights*)". *Black's Law Dictionary* defines "assert" as "to invoke or enforce (a legal right)": see Henry C. Black, *Black's Law Dictionary*, 8th ed. (St. Paul: Thomson West, 2004). By contrast, *The Canadian Oxford Dictionary* defines "mention" as "refer to or remark on incidentally". *Black's Law Dictionary* does not include the word. Clearly, "assert" is a significantly more forceful concept.

18 Without leave having been granted, a s. 138.3 cause of action cannot be enforced. It cannot be invoked as a legal right. Section 138.14 says as much. Thus, giving the suspension provision in s. 28(1) of the *CPA* its ordinary meaning, the s. 138.3 cause of action cannot be said to be asserted in the respondent's class proceeding since no leave has been granted.

19 The respondent argues that it is significant that s. 28(1) requires not that a cause of action be "commenced", but only that it be "asserted". However, this choice of language is entirely appropriate. A cause of action is not commenced. That is a concept applicable not to a cause of action but to the litigation in which it is asserted.

20 Thus, in my view as applied to the s. 138.3 cause of action, the grammatical and ordinary meaning of the s. 28(1) suspension provision is that without leave being granted the cause of action cannot be said to be asserted in a class proceeding.

21 Indeed, the mention of the s. 138.3 cause of action in the respondent's statement of claim appears to reflect this view, namely that leave is required before this cause of action can be asserted in the respondent's class proceeding.

22 Paragraph 117 of the statement of claim reads as follows:

> PART XXIII.1 OF THE SECURITIES ACT
>
> 117. The Plaintiff intends to deliver a notice of motion seeking, among other things, an Order permitting the Plaintiff to assert the statutory causes of action particularized in Part XXIII.1 of the Securities Act, and if granted, to amend this Statement of Claim to plead these causes of action.

23 The statutory context of the suspension provision in s. 28(1) of the CPA provides additional support for this interpretation. The balance of the subsection lists the various circumstances that cause the suspended limitation period to resume running. They do not include any reference to the leave motion required to add the s. 138.3 cause of action to the respondent's class proceeding. If mention of the intention to seek leave were enough to trigger the suspension of the applicable limitation period, surely the failure to proceed with the leave motion or the denial of leave would be

included as circumstances causing its resumption. Assume, for instance, that having pleaded his intention to seek leave, the respondent decides not to do so. The consequence of his argument would mean that since the statutory cause of action is mentioned in his pleading, the limitation period applicable to it is suspended and remains so even though the class proceeding could never be the vehicle to vindicate the class members' rights under Part XXIII.1. That cannot have been the legislature's intention.

24 It is also clear that the interpretation I propose is consistent with the purpose of s. 28(1) of the *CPA*. In *Coulson v. Citigroup Global Markets Canada Inc.*, 2010 ONSC 1596, at para. 49, Perell J. described this purpose to be to protect class members from the operation of limitation periods without the need to themselves pursue individual actions in order to avoid being out of time until it has been determined whether they can get access to justice through the class proceeding. That purpose was approved in this court in *Coulson v. Citigroup Global Markets Canada Inc.*, 2012 ONCA 108. In the context of this case, the respondent's class proceeding gives class members no possibility of access to justice for their s. 138.3 causes of action because no leave to assert it has been granted. The purpose of s. 28(1) of the *CPA* does not therefore require that the limitation period applicable to these causes of action be suspended pending the outcome of this class proceeding, since that action cannot give class members access to justice for their claims.

25 Indeed, the respondent's proposal would reflect a different purpose that cannot have been intended by the legislature. It would suspend the applicable limitation period for the s. 138.3 cause of action on the mere mention of that cause of action. This is a benefit that would not come to the respondent if he were suing in an individual capacity and did the same thing. It cannot have been the purpose of s. 28(1) of the *CPA* to put the class plaintiff in a better position than he would have been had he commenced an individual action.

26 The purpose of s. 138.14 of the *OSA* is also served by the interpretation of s. 28(1) of the *CPA* that I have described. Section 138.14 was clearly designed to ensure that secondary market claims be proceeded with dispatch. That requires the necessary leave motion to be brought expeditiously. To suspend that limitation period with no guarantee that the s. 138.3 cause of action, including the prerequisite leave motion, will be proceeded with expeditiously is inconsistent with that purpose.

27 Finally, the interpretation I have given for s. 28(1) of the *CPA* does not make it inapplicable to a s. 138.3 cause of action under Part XXIII.1 of the *OSA*. It simply requires that leave be granted before that happens. The fact that by comparison no leave is required for s. 28(1) to apply to Part XXIII causes of action is simply a reflection of the legislative policy to require leave for secondary market causes of action but not for their primary market counterparts.

28 In summary, I conclude for a s. 138.3 cause of action to be asserted in a class proceeding, so as to trigger the suspension provision in s. 28(1) of the *CPA*, leave must be granted. Since the respondent has not obtained leave, s. 28(1) has not been activated.

29 I would therefore allow the appeal and dismiss the respondent's motion for an order declaring that the limitation period in s. 138.14 of the *OSA* is suspended.

30 As we indicated during argument, the parties may make written submissions of no more than eight pages addressing costs here and below. These are to be filed within 30 days of the release of these reasons.

S.T. GOUDGE J.A.
R.P. ARMSTRONG J.A.:-- I agree.
S.E. LANG J.A.:-- I agree.

* * * * *

Corrigendum
Released: March 28, 2012

There were two other appeals that should have been referenced on the judgment at the time of release. The court file numbers that were inadvertently missed were C53642 and C53644.

cp/e/qlacx/qljxr/qlbdp/qljxh/qlmll/qljxh/qlhcs/qlhcs/qlgpr

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED, AND IN THE MATTER OF A PLAN OF COMPRISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Commercial Court File No.: CV-12-9667-00CL

The Trustees of the Labourer's Pension Fund of Central and Eastern Canada, et al.

Plaintiffs

and

Sino-Forest Corporation, et al.

Defendants

Superior Court File No: CV-10-414302

ONTARIO
SUPERIOR COURT OF JUSTICE
Commercial List
Proceeding under the *Class Proceedings Act, 1992*
Proceeding commenced at Toronto

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