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

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N :

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*

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

BRIEF OF AUTHORITIES OF THE PLAINTIFFS
Settlement Approval – Ernst & Young LLP Settlement
(Motion Returnable February 4, 2013)

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

ONTARIO
SUPERIOR COURT OF JUSTICE
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252 A.D.2d 179, 683 N.Y.S.2d 179, 1998 WL 851890, 1998 N.Y. Slip Op. 10942

Carolyn Ackerman et al., Appellants,
v.
Price Waterhouse, Respondent.
Carolyn Ackerman et al., Respondents,
v.
Price Waterhouse, Appellant.
Supreme Court, Appellate Division, First Department, New York

December 1, 1998

CITE TITLE AS: Ackerman v Price Waterhouse

SUMMARY

Appeal, in the first above-entitled action, from orders of the Supreme Court (Ira Gammerman, J.), entered November 15, 1994 and April 22, 1997 in New York County, which, *inter alia*, denied plaintiffs' motion for class certification.

Appeal, in the second above-entitled action, from an order of the Supreme Court (Ira Gammerman, J.), entered April 29, 1997 in New York County, which, to the extent appealed from, denied defendant's motion for summary judgment.

HEADNOTES

Actions--Class Actions--Accountant Malpractice--Conflict of Laws-- Certification of Class of New York Residents Only
(1) Class action certification relating to New York residents only is proper in an action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982. The IAS Court erred in concluding that choice of law issues would render the action unmanageable as to the New York class under CPLR 902 (5) due to the necessity of applying conflicting laws from various jurisdictions both as to substantive claims and defenses as well as Statute of Limitations issues. Since New York is the place of injury where the New York plaintiffs felt the economic injury of the IRS's disallowance of their tax deductions because of defendant's continued use of a repudiated accounting practice known as the Rule of 78's in calculating their accrued interest deductions, this State's interest analysis choice-of-law approach mandates application of New York law, including New York's loss allocation rules, to the tort claims. As to the New York residents' contract causes of action, since defendant's retainer agreement with the general partner to render annual accounting services and to prepare the tax schedules for use by the limited partners in filing their own individual returns was entered into in Pennsylvania and all the tax preparation work was completed in that State, the grouping of contacts choice-of-law analysis would allow the IAS Court to apply either New York or Pennsylvania law, thereby obviating any conflicts of laws problems with regard to either the tort or contract claims.

Actions--Class Actions--Accountant Malpractice--Conflict of Laws--Propriety of Global Class
(2) While class action certification relating to New York residents only is proper in an action against defendant professional accounting firm soundingin ***180** negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-

sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982, class certification for the nonresident limited partners is inappropriate since it has not been sufficiently demonstrated that common questions of substantive law would predominate in the global class action, especially with regard to the accountant malpractice claims and the application of the defenses of comparative negligence and assumption of risk. Moreover, even if the substantive law of a single State could be applied to the tort and contract claims of the global class, there is a strong likelihood that the Statute of Limitations of each plaintiff's State of residence would apply to their claims under New York's "borrowing statute" (CPLR 202). Accordingly, the IAS Court properly determined that certification of the global class would be unmanageable (CPLR 902 [5]) because of the necessity of examining the laws of multiple jurisdictions.

Actions--Class Actions--Accountant Malpractice--Predominance of Common Issues--Presumption of Reliance on Negligent Representations

(3) Class action certification relating to New York residents only is proper in an action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982. The IAS Court erred in concluding that individual issues of reliance predominate over the issues common to all class members as to whether defendant breached its contract to provide professional accounting services and whether defendant was negligent and/or committed malpractice by continuing to use a repudiated accounting practice known as the Rule of 78's in calculating each limited partner's accrued interest deduction and then failing to transmit any warnings of potential adverse tax consequences to the limited partners after the issuance of a 1983 Revenue Ruling which specifically barred the use of the Rule of 78's for accrued interest deductions in cases like the subject limited partnerships. Since, under New York law, a breach of contract action for professional services may be based on an implied promise to exercise due care in performing the services required by the contract, any purported reliance by plaintiffs on actions or representations by defendant would be irrelevant. Furthermore, in view of defendant's express agreement to prepare partnership tax returns, including the tax schedules used by the limited partners in filing their own individual tax returns, reliance upon defendant's negligent misrepresentations may be presumed with respect to the negligence and malpractice causes of action. The causal connection between defendant's alleged malpractice and plaintiffs' injuries may be readily inferred by the contractual relationship between defendant and the limited partners for specified accounting services. The predominance requirement in CPLR 901 requires that common issues predominate over individual ones, not that class members be identical or that individual issues be nonexistent.

Actions--Class Actions--Accountant Malpractice--Typicality of Individual Plaintiff's Claims--Fair Representation of Interests of Class

(4) Class action certification relating to New York residents only is proper in an action against defendant professional accounting firm sounding in ***181** negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982. The IAS Court erred in determining that the claims of the individual plaintiff are not typical of the class she purports to represent because she was an unsophisticated investor. Since the individual plaintiff's claims that she suffered tax losses from defendant's continued use of a repudiated accounting practice known as the Rule of 78's in calculat-

ing each limited partners' accrued interest deduction arose out of the same course of conduct and is based on the same theories as the other class members, they are plainly typical of the entire class. Furthermore, the IAS Court also erred in determining that plaintiff and her counsel will not fairly and adequately represent the interests of the class (CPLR 901 [a] [4]). Plaintiff's counsel has amply demonstrated its experience and skill in class action litigation, and that it will adequately represent the interest of all class members. Lastly, since adjudication of the common issues as to whether defendant's actions constituted negligence, professional malpractice and/or breach of contract would dispose of most if not all of the issues in this case, a class action is the superior method of adjudicating this controversy (CPLR 901 [a] [5]).

Attorney and Client--Financial Sanctions against Attorney--Frivolous Conduct-- Successive Motions for Class Certification in Accountant Malpractice Action

(5) In a proposed class action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982, the IAS Court erred in imposing sanctions on plaintiffs' counsel for filing its third and fourth motions for class certification. The motions were precisely addressed to overcome the impediments identified by the court in its initial denial of class certification. Further, these two motions were made only after crucial evidence had been discovered indicating that defendant's internal policy acknowledged that the accounting practice known as the Rule of 78's should generally not be utilized to calculate accrued interest deductions unless an alternative method justified the deduction. This evidence enhanced plaintiffs' argument that given defendant's clear concealment of a known risk, individual proof of reliance was unnecessary. Consequently, the motions should not be considered “frivolous conduct” under 22 NYCRR 130-1.1 (c).

Compromise and Settlement--Settlement of Claims in Class Action--Effect of Settlement in Federal Action on State Accountant Malpractice Class Action

(6) In a proposed class action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982, plaintiffs' acceptance of a settlement in a related Federal action involving their investment in the limited partnerships does not entitle defendant to a setoff against any recovery by plaintiffs in this action pursuant to General Obligations Law ***182** § 15-108 since plaintiffs' claims in the Federal action related solely to their initial investment, a fraud in the inducement claim, while this action relates solely to defendant's postinvestment actions regarding the continued use of a repudiated accounting practice known as the Rule of 78's in calculating their accrued interest deductions. Under these circumstances, the Federal and State actions did not seek recovery for the same injury, and therefore General Obligations Law § 15-108 is not applicable.

Limitation of Actions--Accountant Malpractice--Applicability of Six-Year Statute of Limitations

(7) In a proposed class action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982,

the six-year Statute of Limitations for contract actions (CPLR 213 [2]) is applicable rather than the three-year limitations period now applicable to all nonmedical malpractice cases. The 1996 amendment to CPLR 214 (6) which clarified that the Statute of Limitations for nonmedical malpractice is three years "regardless of whether the underlying theory is based in contract or tort" is to be given prospective application only and may not be applied retroactively to claims that accrued prior to its enactment.

Limitation of Actions--Accountant Malpractice--Continuous Representation Doctrine

(8) In a proposed class action against defendant professional accounting firm sounding in negligence, breach of contract and accountant malpractice for having rendered allegedly negligent tax advice between 1980 and 1988 to over 1,000 individual limited partners from 38 different States and four foreign countries who invested in a tax-sheltered real estate venture involving the acquisition of shopping centers between 1980 and 1982, the doctrine of continuous representation can be applied to toll the applicable six-year Statute of Limitations. In order for the doctrine to be applicable, the continuous representation must be in connection with the specific matter directly in dispute, and not merely the continuations of a general professional relationship. Plaintiffs provided ample evidence supporting the application of continuous representation, including the repeated use of an improper accounting method and the repeated failure to disclose the risks associated with the same. Continuous representation was further demonstrated by defendant's representations that it was "handling" the IRS audit for the partnerships. Since defendant prepared the tax schedules submitted by the individual partners through 1988 and the complaint was filed in April 1990, the claims would be timely under the six-year contract Statute of Limitations (CPLR 213 [2]) or the three-year limitations period for actions involving injury to property (CPLR 214 [4]).

TOTAL CLIENT SERVICE LIBRARY REFERENCES

Am Jur 2d, Accountants, §§ 20, 29; Attorneys at Law, § 47; Limitation of Actions, §§ 92, 138; Parties, §§ 50, 53, 58, 62, 63, 65, 68, 72, 78, 88.

Carmody-Wait 2d, Limitation of Actions §§ 13:122, 13:266; ***183** Parties §§ 19:227, 19:232, 19:233, 19:248, 19:251, 19:257, 19:264, 19:265; Costs and Sanctions §§ 148:24, 148:41.

McKinney's, CPLR 202, 213 (2); 214 (4), (6); 901 (a) (4), (5); 902 (5); General Obligations Law § 15-108.

22 NYCRR 130-1.1.

NY Jur 2d, Attorneys at Law, § 315; Conflict of Laws, § 38; Limitations and Laches, §§ 93, 123, 206; Malpractice, §§ 6, 16; Parties, §§ 239, 243, 244, 253, 256, 262, 284.

ANNOTATION REFERENCES

See ALR Index under Accountants; Attorney or Assistance of Attorney; Class Actions; Compromise and Settlement; Frivolous Actions; Limitation of Actions.

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OPINION OF THE COURT

Mazzarelli, J.

In these consolidated appeals,[FN1] important issues are raised involving the liability of professional accountants for allegedly negligent tax advice rendered to the individual limited partners of 54 co-

sponsored limited partnerships. Among the issues to be resolved are whether the IAS Court properly denied the Ackerman plaintiffs' four separate motions for class action certification, whether defendant Price Waterhouse is entitled to summary judgment based upon the plaintiffs' inability to ***184** demonstrate reliance on defendant's alleged misrepresentations, or because the claims are barred by the Statute of Limitations, and whether a settlement in a related Federal action entitles Price Waterhouse to a setoff of the damages obtained by the plaintiffs in that settlement. As detailed below, in Appeal No. 61788, we affirm the IAS Court's denial of the Ackerman plaintiffs' second motion for class certification for the reasons stated by that court. In Appeal No. 61789, we modify to the extent of granting the Ackerman plaintiffs' third motion for class certification relating to New York residents only and vacating the imposition of sanctions against counsel for the Ackerman plaintiffs. In Appeal No. 61790, we affirm the order of the IAS Court granting Price Waterhouse's motion for summary judgment only to the extent of limiting the damages recoverable.

FN1 The consolidated appeals initially included orders appealed in a related action (*Ravitch v Back, Wax, Streisfeld & Schreiber,* NY County index No. 26807/91), and a third-party action (*Back, Wax, Streisfeld & Schreiber v Price Waterhouse,* NY County index No. 2165/92). Each of the parties to these actions submitted briefs on appeal. Subsequently, however, this Court has been advised that both actions have been settled. Stipulations of discontinuance have been forwarded to the Court, and the noticed appeals have been withdrawn. Accordingly, we address only the issues raised in the action entitled *Ackerman v Price Waterhouse* (NY County index No. 15639/90).

I.

FACTS

The Ackerman plaintiffs are individuals from 38 different States and four foreign nations who invested in tax shelter limited partnerships between 1980 and 1982. The limited partnerships were formed to acquire K-Mart shopping centers throughout the United States. All of the 54 limited partnerships were sponsored by the same entity, Commercial Properties Group, Inc. (CPG). From 1980-1989, CPG engaged defendant Price Waterhouse (PW) to render annual accounting services and to prepare the limited partnerships' Schedules K-1, which report each limited partner's pro rata share of income and expenses.[FN2] PW transmitted these returns and schedules to CPG each year, and was aware that the documents would be transferred to the individual limited partners "for filing" with their Federal and State income tax returns.

FN2 The returns are known as "U.S. Partnership Return of Income" and are filed by each limited partner with their individual returns, since the partnership itself does not pay income taxes.

It is undisputed that between 1980 and 1988, PW utilized an accounting practice known as the Rule of 78's in calculating each limited partner's accrued interest deduction on their Schedules K-1. The Rule of 78's is an accounting practice that allocates greater interest deductions to the earlier years of the debt. CPG informed potential investors, by way of the offering materials, that the general partners intended to employ the Rule of 78's in calculating the accrued interest deduction, and that the IRS might disapprove such method, possibly resulting in an audit and the loss of tax benefits.***185**

In 1983, the IRS issued Revenue Ruling 83-84 which specifically barred the use of the Rule of 78's in cases where the resulting deduction exceeded the true economic accrual of interest. Plaintiffs allege that after Revenue Ruling 83-84 was issued, PW discontinued the use of the Rule of 78's in calculat-

ing the accrued interest deductions for other clients, but continued to utilize it for the CPG partnerships.

In response to Revenue Ruling 83-84, PW adopted internal policy guidelines prohibiting the use of the Rule of 78's for accrued interest deductions unless (1) an alternative, acceptable method justified the deduction, or (2) an opinion letter of tax counsel was obtained stating that it was "more likely than not" that the practice would be upheld if challenged by the IRS. In December 1983, PW was furnished, at its own request, with a letter from tax counsel stating that it was "more likely than not" that the CPG limited partners would prevail if the IRS challenged the use of the Rule of 78's with respect to transactions, such as this one, which *predated* Revenue Ruling 83-84. Tax counsel further gave its opinion that based on its analysis of current IRS policy and prior revenue rulings, "the Commissioner cannot properly assert that [Revenue Ruling] 83-84 has retroactive effect." In its 1984 transmittal letter to the limited partners accompanying the Schedules K-1, PW summarized tax counsel's opinions regarding the revenue ruling and stated that it had relied on such opinion in preparing the partnership tax returns. However, PW's transmittal letter omitted much of the detail in counsel's opinion letter, including the warning that the IRS had explicit statutory authority to determine whether a Revenue Ruling "shall be applied without retroactive effect" (Internal Revenue Code [26 USC] § 7805 [b] [8]).

In March 1985, PW obtained an "updated" opinion letter from tax counsel regarding the continued use of the Rule of 78's.[FN3] In this second letter, counsel again expressed its opinion that it was more likely than not that any challenge by the IRS to the use of the Rule of 78's regarding the CPG limited partnerships would fail. This letter included several specific warnings including that the IRS Revenue Rulings are "presumed to be retroactive" unless otherwise indicated, that an interest rate penalty of 120% could be imposed if the IRS found the investments to be "tax motivated transactions", that ***186** continued use of the Rule of 78's in computing interest deductions "would no doubt provoke vigorous opposition from the IRS and probably result in litigation," and that if the limited partners were unsuccessful in this litigation they would have to recapture interest deductions previously taken and be liable for interest and penalties for the amount recaptured. Again, these specific warnings were omitted from PW's subsequent transmittal letters sent to plaintiffs.

> FN3 The IAS Court found, and plaintiffs continue to argue, that counsel's letters were not an "opinion" but rather were "couched in terms of beliefs." Our review of these letters reveals that the terms "opinion" and "belief" were used interchangeably with respect to the crucial representations in this case.

Meanwhile, in 1983 the IRS began auditing the CPG-sponsored limited partnerships, resulting in deficiency notices being issued to several limited partners. During the pendency of the audits, PW continued to advise the limited partners that the interest deductions would be upheld. In PW's 1988 audit reports sent to the limited partners, PW stated that "the General Partner and special tax counsel continue to be of the opinion" that the continued use of the Rule of 78's in computing interest deductions would survive IRS challenge. Further, PW stated in a 1985 letter that it would be "handl[ing] [the audit] on behalf of the partnership in general and on your behalf as limited partner," and advised the partners to refuse a pending IRS settlement offer.

The Ackerman plaintiffs contested the tax deficiencies by commencing administrative proceedings. Once the administrative appeals were exhausted, several plaintiffs filed petitions in the United States Tax Court, while others stayed their protest pending determination by the Tax Court in an unrelated test case. In that December 1988 test case, the United States Tax Court upheld the retroactive application of Revenue Ruling 83-84 by the IRS (*see, Prabel v Commissioner of Internal Revenue*, 91 TC 1101

[hereinafter *Prabel*]), which determination was affirmed by the Third Circuit Court of Appeals in August 1989 (*see*, *Prabel v Commissioner of Internal Revenue*, 882 F2d 820). In *Prabel*, the Tax Court held that there were no revenue rulings or any other existing authority permitting utilization of the Rule of 78's accrual method in long-term real estate loans, and that therefore, the tax advisors to the partnerships in *Prabel* could not have relied on authority that "did not exist."

As the limited partnership investments in this case were similar to the long-term loans in *Prabel*, it became clear that the IRS would reject the use of the Rule of 78's with respect to the CPG limited partnerships. In March 1989, three months after the *Prabel* decision, PW prepared and forwarded to the limited partners the 1988 Schedules K-1, which continued to utilize the Rule of 78's. This time, however, CPG (not PW) attached ***187** a letter advising the limited partners not to rely on the Schedules K-1.

Prior to the determination in *Prabel*, the IRS had offered plaintiffs a 100% deduction of capital contributions--but in the wake of *Prabel*, it reduced that offer to 85%, which the plaintiffs were encouraged by new counsel to accept, and plaintiff Ackerman did so. In addition, the IRS concluded that the CPG limited partnerships were "tax motivated transactions" and assessed penalty interest on the unpaid taxes.

In 1989, some of the limited partners of CPG partnerships commenced a class action in United States District Court for the Eastern District of New York (*see*, *Graf v Commercial Props. Group*, 89 Civ 2057 [hereinafter *Graf* action]) against CPG, PW and others, alleging fraud in relation to the sale of the limited partnership interests.[FN4] CPG and other defendants settled the action with the plaintiffs for $40 million, plus an agreement to restructure the limited partnerships. PW, however, was not a party to the *Graf* settlement and the action was discontinued against it without prejudice.

FN4 Many of the Ackerman plaintiffs were plaintiffs in the *Graf* action.

In April 1990, the Ackerman plaintiffs commenced this action in State court against PW, alleging negligence and accountant malpractice regarding PW's continued use of the Rule of 78's in the preparation of the Schedules K-1 for the CPG limited partnerships. The complaint was subsequently amended in February 1994 to add two causes of action for breach of contract.

Class Certification Motions

In April 1993, the Ackerman plaintiffs moved pursuant to CPLR 901 and 902 for an order certifying a class and for the appointment of plaintiff Ackerman as class representative. The proposed class was defined as all investors in CPG-sponsored limited partnerships during the relevant period who had not received a 90-day deficiency notice from the IRS prior to April 1986, and who had not signed a settlement agreement with the IRS or paid the disputed amount relating to the use of the Rule of 78's. The proposed class was divided into two subclasses of (a) residents of New York or any other State that maintains a three-year Statute of Limitations for accountant malpractice or negligence by an accountant; and (b) residents of the State of Pennsylvania or any other State that has a two-year Statute of Limitations period for the same claims.***188**

In support of their motion, the Ackerman plaintiffs alleged that all of the requirements of CPLR 901 and 902 had been satisfied. With respect to the second requirement in CPLR 901, that common questions of law or fact predominate over any questions affecting only individual members (CPLR 901 [a] [2]), the Ackerman plaintiffs pointed to the common issue of whether PW was negligent or committed malpractice in preparing each partner's Schedules K-1, or made any negligent misrepresentations with respect thereto.

PW opposed the motion, arguing that plaintiff Ack-

erman's claims were atypical of the class she purported to represent because she was an unsophisticated investor who stated during discovery that she relied on her personal accountant for all investment decisions. PW also asserted that common questions did not predominate because the court would have to apply the laws of the different States where the plaintiffs resided, and that the States had different standards for proving accountant malpractice. PW also claimed that individual issues of reliance existed since many class members relied on advice from their personal accountants regarding use of the Schedules K-1.

By order entered November 16, 1993, the IAS Court denied the motion for class certification, with leave to renew after discovery concerning the place of residence of the proposed class members, and a showing of unity of standards for liability on the claims in plaintiffs' complaint. Without such evidence, the court concluded that plaintiffs had failed to demonstrate that common issues of law or fact predominated. This order was not appealed.

In March 1994, after amending the complaint to add the breach of contract claims, the Ackerman plaintiffs renewed their motion for class certification. They provided information regarding the residences of the proposed class, consisting of 38 States and four foreign countries. New York, with 525 partners or 36%, and Pennsylvania, with 192 partners or 13%, were the States with the largest percentage of partners. The Ackerman plaintiffs again highlighted the common course of conduct by PW in preparing the Schedules K-1, and the limited partners' reliance thereon. By order dated November 15, 1994, the IAS Court again denied class certification on the basis that the application of the law of different jurisdictions to each of plaintiffs' claims in contract and tort, both as to the substantive claims and defenses as well as Statute of Limitations, would require the court to scrutinize the possibly conflicting law of multiple jurisdictions. The court concluded that these possible conflicts ***189** of law problems weighed strongly against granting class certification. The Ackerman plaintiffs filed a notice of appeal on December 9, 1994 (Appeal No. 61788). Around this time, the IAS Court also warned the Ackerman plaintiffs' counsel that renewal of the class certification motions might result in sanctions.

Nevertheless, in June and August 1995, respectively, the Ackerman plaintiffs filed two additional motions for class certification. The June motion sought certification for a limited class of investors in CPG limited partnerships who were residents of New York State, or, alternatively, for certification of either the New York residents' contract or tort claims. The August motion sought to certify a class of all remaining class members who were not residents of New York, and asserted that Pennsylvania law should be applied to the contract claims of these class members.

In the second order appealed from (Appeal No. 61789), entered April 22, 1997, the IAS Court denied both class certification motions and imposed a $5,000 sanction against plaintiffs' counsel for bringing the motions, stating that the original impediments to certification remained. The court reasoned that individual issues of reliance would still predominate in a class action by only New York investors. Regarding what it termed as the "Global Class Application," the court rejected the plaintiffs' claim that Pennsylvania law, rather than the law of each plaintiff's residence, would apply, and found that claim irresponsible since a contract action against an accountant for malpractice in Pennsylvania was more limited in scope than under New York law. The court further found that Ackerman's claims were atypical due to her lack of sophistication, and that she was an inadequate class representative for that reason and because of her apparent indifference to the litigation.

Summary Judgment Motions

In August 1995, PW moved for summary judgment dismissing the class action complaint. PW argued

that reasonable reliance by the investors-clients was an indispensable element of an accounting malpractice action, brought in tort or contract, and that the element of reliance was negated in this case by the warnings in the CPG limited partnerships' offering memoranda regarding the use of the Rule of 78's. PW made the additional arguments that no proximate cause existed between PW's representations and plaintiffs' injuries because the plaintiffs relied exclusively on their personal accountants for ***190** tax advice; that PW's use of the Rule of 78's did not constitute negligence since the law was unsettled at the time of the investments; that plaintiffs were not damaged because recovery of back taxes and interest are legally barred; and that many of the claims were time barred based on a retroactive application of the recent amendment to CPLR 214 (6), which clarified that the Statute of Limitations for professional malpractice actions is three years, irrespective of whether the claim is asserted in tort or contract.

The Ackerman plaintiffs opposed the motion, arguing that the disclosures in the offering memoranda did not absolve PW from its responsibility to provide professional services under the contract, especially in light of Revenue Ruling 83-84 and the subsequent *Prabel* ruling announcing the IRS's disapproval of the Rule of 78's. Plaintiffs also presented evidence concerning PW's provision of accounting services until 1989, thereby supporting a claim for continuous treatment and a corresponding toll of the Statute of Limitations.

In the third order on appeal (Appeal No. 61790), entered April 29, 1997, the IAS Court granted PW's summary judgment motion only to the extent of limiting damages to those directly attributable to the improper use of the Rule of 78's, and otherwise denied the request for summary relief. The court found that triable issues of fact existed as to whether PW's conduct constituted malpractice, whether the plaintiffs reasonably relied on the alleged misrepresentations of PW and whether that reliance was negated by the warnings in the offering memoranda. The IAS Court also rejected PW's Statute of Limitations arguments, finding that the amendment to CPLR 214 (6) did not apply retroactively, and that the continuous treatment doctrine was applicable to toll the Statute of Limitations for accountant malpractice.

II.

DISCUSSION

A. CLASS CERTIFICATION

The Ackerman plaintiffs appeal the IAS Court's denial of their second, third and fourth motions for class certification, and its imposition of sanctions. The court's decisions make clear that the motions were denied for three primary reasons. First, common issues of law did not predominate because the different laws of each jurisdiction where the plaintiffs resided would apply to their respective claims, and those States' laws vary significantly regarding the scope and theories of accountant ***191** malpractice liability, and the defenses available to such claims, including the Statute of Limitations. Second, individual issues of reliance would predominate in the actions since the limited partners had varying reactions to the communications from PW, and some of them relied exclusively on their personal accountants. Third, Ackerman was not a proper class representative because her claims were not typical of most class members, and she and her counsel were not competent to represent the interests of the class she purported to represent. As detailed below, we respectfully disagree with the second and third reasons, and partially disagree with the first.

A class action may be maintained in New York only after the following five prerequisites of CPLR 901 (a) have been met: (1) the class is so numerous that joinder of all members is impracticable; (2) common questions of law or fact predominate over

any questions affecting only individual members; (3) the claims of the representative parties are typical of the class as a whole; (4) the representative parties will fairly and adequately protect the interests of the class; and (5) the class action is superior to other available methods for the fair and efficient adjudication of the controversy (CPLR 901 [a] [1]-[5]; *see, Matter of Colt Indus. Shareholder Litig.*, 77 NY2d 185, 194;*Friar v Vanguard Holding Corp.*, 78 AD2d 83, 90-91).

Once these prerequisites are satisfied, the court must consider the factors set out in CPLR 902, to wit, the possible interest of class members in maintaining separate actions and the feasibility thereof, the existence of pending litigation regarding the same controversy, the desirability of the proposed class forum and the difficulties likely to be encountered in the management of a class action (CPLR 902 [1]-[5]; *see, Askey v Occidental Chem. Corp.*, 102 AD2d 130, 137). Plaintiff bears the burden of establishing compliance with the requirements of both CPLR 901 and 902, and the determination is ultimately vested in the sound discretion of the trial court (*supra*, at 137).

The predominance requirement has been termed the "most troublesome" of the CPLR 901 requirements (*Friar v Vanguard Holding Corp.*, *supra*, at 96), and it is the pivotal question on this appeal. As the Ackerman plaintiffs challenge the IAS Court's conclusion that common questions of law do not predominate due to the necessity of applying conflicting laws from various jurisdictions, we must briefly turn to the relevant choice of law principles.***192**

1. Choice of Law Issues

(1) Our choice of law rules with respect to tort and contract cases are firmly established. "In the context of tort law, New York utilizes interest analysis to determine which of two competing jurisdictions has the greater interest in having its law applied in the litigation" (*Padula v Lilarn Props. Corp.*, 84 NY2d 519, 521;*Cooney v Osgood Mach.*, 81 NY2d 66, 72). "The greater interest is determined by an evaluation of the ' "facts or contacts which ... relate to the purpose of the particular law in conflict " ' " (*Padula v Lilarn Props. Corp.*, *supra*, at 521, quoting *Schultz v Boy Scouts*, 65 NY2d 189, 197).

New York applies a "grouping of contacts" or "center of gravity" approach to choice of law questions in contract cases (*Zurich Ins. Co. v Shearson Lehman Hutton*, 84 NY2d 309, 317;*Matter of Allstate Ins. Co. [Stolarz--New Jersey Mfrs. Ins. Co.]*, 81 NY2d 219, 226). The five generally significant contacts in contract cases are: the place of contracting, negotiation and performance of the contract; the location of the subject matter of the contract; and the domicile of the parties (Restatement [Second] of Conflict of Laws § 188 [2]; *Matter of Allstate Ins. Co. [Stolarz--New Jersey Mfrs. Ins. Co.]*, *supra*, at 227). A court considering these factors must focus on the contacts that are significant in the particular contract dispute (*supra*, at 226).

(i) New York Class

Applying these tests to the proposed class of New York residents, we believe that the IAS Court could properly apply the law of a single State, either New York or Pennsylvania, to the plaintiffs' tort and contract claims, thereby obviating any conflicts of laws problem. In this class, all the plaintiffs are New York residents, and PW's main offices are located in New York as well.[FN5] With respect to the tort causes of action, the interest analysis approach would mandate application of New York law. Where the laws alleged to be in conflict are conduct regulating, such as the standards for liability of accountants, "the law of the jurisdiction where the tort occurred will generally apply because that jurisdiction has the greatest interest in regulating behavior within its borders" (*Cooney v Osgood Mach.*, 81 NY2d 66, 72,*supra*). The place of occurrence of the tort ***193** will be where the plaintiff suffered the injury sued upon (*Schultz v Boy Scouts*, *supra*, at 195).

FN5 A partnership's legal residence is where it maintains its principal place of business (*see, Schultz v Boy Scouts, supra,* at 194;*Wilcox v PRC of N. Y. Ltd. Partnership,* 1997 US Dist LEXIS 3854 [ND NY, Mar. 24, 1997, Munson, J.]; *McMahan & Co. v Donaldson, Lufkin & Jenrette Sec. Corp.,* 727 F Supp 833, 834 [SD NY 1989]).

In this proposed class, the place of injury is New York since that is where the New York plaintiffs felt the economic injury of the IRS's disallowance of the tax deductions (*supra,* at 195 [when defendant's negligent conduct occurs in one jurisdiction and the plaintiff's injuries are suffered in another, the place of the wrong is considered to be the place where the last event necessary to make the actor liable occurred]; *see also, Altschuler v University of Pa. Law School,* 1997 US Dist LEXIS 3248 [SD NY, Mar. 21, 1997, Stanton, J.]; *Kramer v Showa Denko K.K.,* 929 F Supp 733, 741). Thus, since the plaintiffs' injuries occurred in New York, New York law will apply to the tort claims.

Even if the other allegedly conflicting rules, such as those regarding contributory negligence and assumption of the risk, are considered loss allocating, the same result obtains. Under the interest analysis test, "[w]here the conflicting rules at issue are loss allocating and the parties to the lawsuit share a common domicile, the loss allocation rule of the common domicile will apply" (*Padula v Lilarn Props. Corp., supra,* at 522, citing *Cooney v Osgood Mach., supra,* at 73). Here, the New York plaintiffs and PW are residents of the same State, which mandates application of New York's loss allocation rules.

As to the New York residents' contract causes of action, a grouping of contacts analysis would recommend application of Pennsylvania or New York law. Plaintiffs note that the retainer agreement between PW and CPG was negotiated and entered into in Pennsylvania, all the tax preparation work, including the preparation of the Schedules K-1, was completed in PW's offices in Philadelphia, Pennsylvania, and the partnership returns and schedules were delivered to CPG in Pennsylvania. Of lesser significance is that the CPG partnership was organized under the laws of Pennsylvania and the partnership agreements provided that they are to be construed under Pennsylvania law. The other contacts are with New York--chiefly the parties' residences and the location where the plaintiffs received the subject matter of the contract. For present purposes, we need not decide which jurisdiction has the greater contacts--it is sufficient to conclude that the trial court could apply one of these State's laws to the New York residents' contract claims, and, thus, no conflict problem exists.

(ii) Global Class

(2) With respect to the applications for certification of a global class (the second and fourth motions), we come to the ***194** opposite conclusion. Although we have some reservations concerning the IAS Court's summary finding that the substantive law of the jurisdiction of each plaintiff's residence will apply to the contract claims of the global class, we nonetheless conclude, as the IAS Court did, that the plaintiffs have not met their burden of establishing that the relevant choice of law principles will not ultimately require application of widely divergent laws of multiple jurisdictions concerning the claims and defenses in this action (*see, In re Laser Arms Corp. Sec. Litig.,* 794 F Supp 475 [SD NY 1989], *affd*969 F2d 15 [2d Cir 1992]; *Bresson v Thomson McKinnon Sec.,* 118 FRD 339, 344 [SD NY 1988]).

PW has persuasively argued that the differences in the various States' laws in several pertinent areas compel the conclusion that common questions of law would not predominate in the global class action. For example, in some jurisdictions, including New York, a professional may be held liable for negligent misrepresentation only to those in actual privity, "or near privity" with the defendant (*Credit Alliance Corp. v Andersen & Co.,* 65 NY2d 536; *Ward v Ernst & Young,* 246 Va 317, 324, 435 SE2d

628, 631 [Sup Ct Va 1993]; *Robertson v White*, 633 F Supp 954, 970-971 [Arkansas law]). Conversely, a majority of States have adopted the slightly different view found in Restatement (Second) of Torts § 552 that a professional may be liable only to a limited group of persons for whose benefit the professional intended to supply the information, or knew that the recipient intended to supply it (*see, Nycal Corp. v KPMG Peat Marwick*, 426 Mass 491, 688 NE2d 1368 [Sup Jud Ct Mass 1998]; *Bily v Arthur Young & Co.*, 3 Cal 4th 370, 11 Cal Rptr 2d 51 [Sup Ct Cal 1992]; *Scottish Heritable Trust v Peat Marwick Main & Co.*, 81 F3d 606 [5th Cir 1996] [Texas law], *cert denied*519 US 869;*First Fla. Bank v Mitchell & Co.*, 558 So 2d 9 [Fla Sup Ct 1990]).

Similarly, while under New York law a malpractice action against a professional may properly be pleaded in contract or tort (*Santulli v Englert, Reilly & McHugh*, 78 NY2d 700), other jurisdictions have held that such actions lie only in tort (*Federal Deposit Ins. Corp. v Clark*, 978 F2d 1541, 1552 [10th Cir 1992] [applying Colorado law]; *Federal Deposit Ins. Corp. v Ernst & Young*, 967 F2d 166, 172 [5th Cir 1992] [applying Texas law]; *Brueck v Krings*, 230 Kan 466, 638 P2d 904 [Sup Ct Kan 1982]).

Even more divergent are the various jurisdictions' laws concerning the defenses of comparative negligence and assumption ***195** of risk. A minority of jurisdictions retain pure contributory negligence rules whereby a client's negligence will operate as an absolute bar to recovery in a malpractice action against a professional (*see, Pizel v Whalen*, 252 Kan 384, 845 P2d 37 [Sup Ct Kan 1993] [contributory negligence defense available in legal malpractice action]; *Wegad v Howard St. Jewelers*, 326 Md 409, 605 A2d 123 [Ct App Md 1992] [contributory negligence is a defense in accountant malpractice action]; *Lyle, Siegel, Croshaw & Beale v Tidewater Capital Corp.*, 249 Va 426, 457 SE2d 28 [Sup Ct Va 1995]). In other jurisdictions, courts have held that the defense of contributory or comparative negligence is available only where the client's negligence contributed to the professional's failure to perform the contract (*see, Fullmer v Wohlfeiler & Beck*, 905 F2d 1394 [10th Cir 1990] [under Utah law]; *Lincoln Grain v Coopers & Lybrand*, 216 Neb 433, 345 NW2d 300 [Sup Ct Neb 1984]; *see also, National Sur. Corp. v Lybrand*, 256 App Div 226). Still other States have adopted comparative negligence rules that operate to reduce the client's recovery by the percentage it contributed to the loss (*see, Halla Nursery v Baumann-Furrie & Co.*, 454 NW2d 905 [Sup Ct Minn 1990]; *Capital Mtge. Corp. v Coopers & Lybrand*, 142 Mich App 531, 369 NW2d 922 [1985];*Devco Premium Fin. Co. v North Riv. Ins. Co.*, 450 So 2d 1216 [Fla Dist Ct App 1984]).

Distinctions also exist regarding the defense of assumption of risk (*compare, Dantzler v S.P. Parks, Inc.*, 715 F Supp 680, 683-684 [ED Pa 1989] [assumption of risk applies as complete bar to recovery], *with Blair v Mt. Hood Meadows Dev. Corp.*, 291 Ore 293, 300, 630 P2d 827, 831 [1981]; Conn Gen Stat Annot § 52-572h [assumption of risk doctrine abolished]). These variations alone support the IAS Court's conclusion that certification of the global class would be entirely unmanageable, and result in a series of mini-trials.

Moreover, even if the substantive law of a single State could conceivably be applied to the claims of the global class, there is a strong likelihood that the Statute of Limitations of each plaintiffs' State of residence will apply to their claims under CPLR 202. CPLR 202, New York's “borrowing statute,” provides that in actions brought by non-New York residents, the shorter of the New York Statute of Limitations or the limitations period of the jurisdiction where the cause of action accrued will apply. “Critical to the application of the borrowing statute is the determination of the jurisdiction in which a cause of action 'accrues'.” (*Martin v Dierck Equip. Co.*, 43 NY2d 583, 589.)***196**

Most courts that have addressed this issue have applied a “place of injury” test in determining where a

cause of action has accrued for purposes of the borrowing statute (*see, Investigative Group v Brooke Group*, 1997 US Dist LEXIS 18513 [SD NY, Nov. 20, 1997, Haight, J.]; *Stafford v International Harvester Co.*, 668 F2d 142, 149-150 [2d Cir 1981]). We agree and hold that the multi-State plaintiffs' contract claims for economic damage accrued in the place where they were injured, which in this case was in their States of residence "where the economic impact of the defendant's conduct [was] felt" (*see, Sack v Low*, 478 F2d 360, 366 [2d Cir 1973]; *Block v First Blood Assocs.*, 988 F2d 344 [2d Cir 1993]; *Investigative Group v Brooke Group, supra*, at * 9;*see also, Ackerman v Price Waterhouse*, 84 NY2d 535, 541;*Martin v Dierck Equip. Co., supra*, at 591 [even if breach of warranty claim could be brought under contract theory, the cause of action still accrued at place of injury]). Recognizing it would potentially be forced to examine the Statutes of Limitations of multiple jurisdictions, including the various tolls and extensions that those jurisdictions permit, the IAS Court ruled that this was another ground to deny class certification (*see, Georgine v Amchem Prods.*, 83 F3d 610 [3d Cir 1996], *affd sub nom.Anchem Prods. v Windsor*, 521 US 591, 117 S Ct 2231). We fully agree with this determination.

2. Reliance Issues

(3) We also disagree with the court's conclusion that individual issues of reliance predominate over the issues common to all class members, to wit, whether PW breached its contract with the CPG partners to provide professional accounting services, and whether PW was negligent and/or committed malpractice by its continued use of the Rule of 78's, and its omission of the various warnings, after Revenue Ruling 83-84 was issued.

This conclusion is easily reached with respect to the New York residents' breach of contract claims. Under New York law, a breach of contract action for professional services may be based on an implied promise to exercise due care in performing the services required by the contract (*Santulli v Englert Reilly & McHugh*, 78 NY2d 700, 705,*supra*). No specific promise to achieve a specific result is required (*supra*). Thus, any purported reliance by the plaintiffs on actions or representations by the defendant is irrelevant (*see, Hoerger v Board of Educ.*, 98 AD2d 274, 283).***197**

The issue of whether reliance predominates in the New York residents' negligence and malpractice causes of action is more difficult. Generally, reliance is an element of a negligent misrepresentation claim against a professional (*Prudential Ins. Co. v Dewey, Ballantine, Bushby, Palmer & Wood*, 80 NY2d 377, 384). Reliance provides the requisite causal connection between the defendant's misrepresentation and the plaintiff's injury (*see, Basic Inc. v Levinson*, 485 US 224, 243;*In re Laser Arms*, 794 F Supp 475,*affd*969 F2d 15,*supra*). However, it is less clear that proof of reliance by an individual plaintiff is required where the plaintiff is the client of the defendant, and the alleged malpractice is committed in the furtherance of the professional services provided by the defendant to plaintiff, as alleged in this case.

Plaintiffs urge that under circumstances analogous to those present here, reliance upon a defendant's negligent misrepresentations may be presumed. The analogy drawn is to those Federal cases applying a rebuttable presumption of reliance in actions brought under the Federal securities laws for false statements of material fact or material omissions in connection with the sale or purchase of securities (15 USC § 78j [b]; 17 CFR 240.10 b-5 [Rule 10b-5]). These cases discuss what is termed the "fraud-on-the-market theory," wherein reliance by purchasers of securities on the alleged misrepresentations of the issuers is presumed because the purchasers necessarily rely on the integrity of the market price in making investment decisions, which market is inexorably affected by the issuers' public statements (*see, Basic Inc. v Levinson, supra*, at 241-245).

PW notes, however, that many Federal courts de-

ciding class action applications under Federal Rules of Procedure, rule 23 have granted certification regarding the Federal securities causes of action, while denying certification on common-law fraud and misrepresentation claims, due to the inapplicability of the presumption of reliance to the latter (*see, In re One Bancorp Sec. Litig.,* 136 FRD 526, 532-533 [D Me 1991]; *see also, Cammer v Bloom,* 711 F Supp 1264, 1297-1299 [D NJ 1989], *appeal dismissed*993 F2d 875;*see also, Strauss v Long Is. Sports,* 60 AD2d 501, 509-510).

While we conclude that the analogy to the fraud-on-the-market theory is inapt, we do not reject a presumption of reliance in toto. In discussing the element of reliance in a Rule 10b-5 case, the Supreme Court stated in *Affiliated Ute:* "Under the circumstances of this case, involving primarily a failure to ***198** disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. [Citations omitted.] This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." (*Affiliated Ute Citizens v United States,* 406 US 128, 153-154;*see also, Basic Inc. v Levinson, supra,* at 243.)

We believe that a presumption of reliance is available under the circumstances presented (*see, Brandon v Chefetz,* 106 AD2d 162, 167 [proof of individual reliance unnecessary in cases involving fraudulent material omissions]). Indeed, we have previously held that where a defendant makes materially misleading omissions, justifying a presumption of reliance, class certification should not be denied on the ground that individual issues of reliance exist (*see, Weinberg v Hertz Corp.,* 116 AD2d 1, 7,*affd*69 NY2d 979;*Brandon v Chefetz, supra; King v Club Med,* 76 AD2d 123, 127-128). Additionally, we have stated that reliance issues are no bar to class certification where identical representations are made in writing to a large group (*see, Pruitt v Rockefeller Ctr. Props.,* 167 AD2d 14, 21). In the present case, plaintiffs allege that the Schedules K-l were negligently prepared in the same manner, i.e., by the continued use of the disfavored Rule of 78's, and they rely on the identical written misrepresentations and omitted warnings in the transmittal letters from PW.

The New York cases discussing the scope of a professional's liability to those not in actual privity are also instructive. These cases hold that a professional may be liable for negligent misrepresentations to those in a position approaching privity where: (1) the professional making the representation is aware of the particular purpose for which it is to be used, (2) a known party relies on the statement in furtherance of that purpose, and (3) there is some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance (*see, Prudential Ins. Co. v Dewey, Ballantine, Bushby, Palmer & Wood,* 80 NY2d 377, 384,*supra; Credit Alliance Corp. v Andersen & Co.,* 65 NY2d 536,*supra; Ultramares Corp. v Touche,* 255 NY 170). The theory evolved from *Glanzer v Shepard* (233 NY 236, 238-239), where a public weigher hired by a bean seller was held liable to the *buyer* who suffered a loss due to the inaccuracy of the weight. The Court of Appeals held that the law imposed a duty on the weigher in favor of the buyer despite the absence of privity because the weigher's ***199** representations were made "for the very purpose of inducing action" by the buyer, and the buyer's action was not a collateral consequence but the "end and aim of the transaction." (*Supra,* at 238-239.)

The principle was subsequently applied in cases involving the liability of accountants such as *Ultramares Corp. v Touche* (*supra*),*White v Guarente* (43 NY2d 356),*Credit Alliance Corp. v Andersen & Co.* (*supra*) and *European Am. Bank & Trust Co. v Strauhs & Kaye* (65 NY2d 536). In *Ultramares* and *Credit Alliance* (*supra*), accountants defendants were found not liable to parties not in privity because the evidence failed to establish that the de-

fendants prepared the financial reports for the specific use by the nonprivy. Conversely, in *White* and *European Am.* (*supra*), the accountants defendants were held liable in the absence of privity because it was found that the accountants' services were obtained for the specific purpose of providing the plaintiffs with certain information, and that the defendants were aware that plaintiffs intended to rely on the same.

Consistent with *White* and *European Am.* (*supra*), it is not disputed that PW was engaged by CPG for the specific purpose of preparing the partnership returns, including the Schedules K-1, for use by the limited partners in filing their own individual tax returns. Further, by preparing the documents, attaching a transmittal letter addressed to each partner, and indicating the Schedules K-l "for filing," PW was plainly aware that their work was going to be relied on by the partners. Indeed, in *White* (*supra,* at 361), which, like here, involved limited partners suing the partnership's accountant for negligent preparation of tax documents, the Court stated that "the accountant must have been aware that a limited partner *would necessarily rely on or make use of* the audit and tax returns of the partnership ... in order to properly prepare his or her own tax returns" (emphasis added).

The cases cited by PW for the proposition that the presumption is inapplicable to common-law fraud or misrepresentation claims are invariably distinguishable on the ground that they do not involve the direct professional relationship between accountant and client present here (*see, Vermeer Owners v Guterman,* 169 AD2d 442, 445,*affd*78 NY2d 1114 [class certification denied in fraud case where no evidence that coop investors relied on misrepresentations in offering plan]; *Katz v NVF Co.,* 100 AD2d 470, 473 [individual issues of reliance predominated where shareholders alleged that they retained shares upon ***200** public misrepresentations by corporation regarding proposed merger]; *Strauss v Long Is. Sports,* 60 AD2d 501, 507,*supra* [season ticket holders' claims for false advertising not certified where individual issues of reliance predominated]; *see also, Morgan v A. O. Smith Corp.,* 233 AD2d 375;*Norwalk v Manufacturers & Traders Trust Co.,* 80 AD2d 745, 746). The common thread running through most of these cases is the issue of whether a purchaser relied on the misrepresentations of the sellers in making the decision to purchase or retain shares. In contrast, no purchasing decision was involved here; this was an express contract to perform specific services.

We reject PW's contention that the issue of reliance predominates because the limited partners had varying reactions to the transmittal letters from PW regarding the use of the Rule of 78's (*see, Weinberg v Hertz Corp., supra; Friar v Vanguard Holding Corp., supra; Bresson v Thomson McKinnon Sec., supra*), and because many plaintiffs relied on their own personal accountants for advice on how to proceed in light of PW's representations. That some of the plaintiffs relied on their personal accountants for advice does not negate reliance on the documents prepared by PW pursuant to the accounting contract. While PW asserts that several plaintiffs did not rely on PW's Schedules K-1, this contention ignores the obvious fact that reliance is established, at least in part, by the mere submission of the Schedules K-1, prepared by PW "for filing." Moreover, as plaintiffs note, PW can hardly shift blame from themselves to the individual accountants where the information relevant to the preparation of the K-1's was solely in PW's hands (*see, Goulding v United States,* 957 F2d 1420, 1428 [7th Cir 1992]).

Nor do we believe the issue of reliance will predominate because of the initial warnings in the offering materials regarding the use of the Rule of 78's. While the use of cautionary language in offering materials may render any alleged misrepresentations immaterial as a matter of law (*In re Trump Casino Sec. Litig.,* 7 F3d 357, 371 [3d Cir 1993], *cert denied sub nom.Gollomp v Trump,* 510 US 1178), this principle, known as the "bespeaks caution" doctrine, will not insulate from liability a de-

fendant who has failed to disclose current adverse conditions (*In re WRT Energy Sec. Litig.*, 1997 US Dist LEXIS 14009 [SD NY, Sept. 15, 1997, Keenan, J.]). As the IAS Court noted, the Ackerman plaintiffs are not suing for misrepresentation with regard to making the initial investment. Their claims are limited to PW's use of the ***201**Rule of 78's *after* the issuance of Revenue Ruling 83-84. While the warnings in the offering materials would certainly negate any misrepresentation claim regarding the initial investment and use of the Rule of 78's, Revenue Ruling 83-84 drastically changed the circumstances. The crux of plaintiffs' argument is that PW continued to use a repudiated accounting method and made misrepresentations concerning its viability *after* its own internal evaluation of the practice. In this light, PW's initial warnings cannot absolve it of liability (*supra*).

In sum, we conclude that the causal connection between PW's alleged malpractice and plaintiffs' injuries may be readily inferred by the contractual relationship between PW and the CPG partners for specified accounting services. It must be remembered that the predominance requirement in CPLR 901 requires that common issues predominate over individual ones, not that class members be identical or that individual issues be nonexistent (*Friar v Vanguard Holding Corp., supra,* at 98). Thus, the issue of reliance need not be completely removed from the case. For all these reasons, we believe plaintiffs have satisfied this element as to the proposed class of New York residents.

3. Typicality and Other Class Certification Issues

(4) The remainder of the CPLR 901 requirements have also been satisfied. PW does not seriously dispute that the approximately 1,444 investors in CPG partnerships meet the statute's numerosity requirement (CPLR 901 [a] [1]). We disagree with the IAS Court's determination that Ackerman's[FN6] claims are not typical of the class she purports to represent because she was an unsophisticated investor, and because she initially misrepresented that she understood the risks of a tax shelter, when in fact she did not. Since her claims that she suffered tax losses from PW's continued use of the Rule of 78's arose out of the same course of conduct and are based on the same theories as the other class members, they are plainly typical of the entire class (*see, Pruitt v Rockefeller Ctr. Props., supra,* at 22;*Friar v Vanguard Holding Corp., supra,* at 99;*see also, Marisol A. v Giuliani,* 126 F3d 372, 376 [2d Cir 1997]). Ackerman's alleged misrepresentations of her financial status were both insignificant and unrelated to merits of the case or the class certification motion (*Pruitt v Rockefeller Ctr. Props., supra,* at 25). We are not persuaded that Ackerman's alleged ***202** lack of sophistication or indifference to the litigation render her claims atypical (*see, Brandon v Chefetz, supra,* at 170;*In re One Bancorp Sec. Litig., supra,* at 531-532).

> FN6 We note that Ackerman was a resident of New York State during the relevant period.

We also disagree with the IAS Court's determination that Ackerman and her counsel will not fairly and adequately represent the interests of the class (CPLR 901 [a] [4]). The factors to be considered in determining adequacy of representation are whether any conflict exists between the representative and the class members, the representative's familiarity with the lawsuit and his or her financial resources, and the competence and experience of class counsel (*Pruitt v Rockefeller Ctr. Props., supra,* at 24;*see also, Marisol A. v Giuliani, supra,* at 378). The court stated that Ackerman's counsel was not acting in the best interests of the entire class by arguing for the application of Pennsylvania law, which would not be in the New York residents' best interests. This view, however, fails to take into account the obvious purpose of plaintiff's bifurcated class certification motions in circumventing the existing choice of law questions. We discern no conflict between Ackerman and the other class members, and conclude that her general awareness of the claims and the litigation, as demonstrated in her de-

position, sufficiently qualify her to act as class representative (*Brandon v Chefetz*, *supra*, at 170). Lastly, we believe Ackerman's counsel has amply demonstrated its experience and skill in class action litigation, and that it will adequately represent the interest of all class members.

For many of the reasons previously stated, we disagree with the IAS Court's conclusion that a class action is not the superior method of adjudicating this controversy (CPLR 901 [a] [5]), and that the action would be unmanageable as to the New York class (CPLR 902 [5]). Since adjudication of the common issues in this case--whether PW's actions constituted negligence, professional malpractice and/or a breach of contract--would dispose of most if not all of the issues in the case, it is clearly the superior method (*Friar v Vanguard Holding Corp.*, *supra*, at 100).

(5) We also reverse the IAS Court's imposition of sanctions on plaintiffs' counsel for filing its third and fourth motions for class certification. Contrary to the IAS Court's view, we believe the motions were precisely addressed to overcome the impediments identified by the court in its initial denial of class certification. Further, these two motions were made only *after* crucial evidence had been discovered, namely, PW's internal policy acknowledging that the Rule of 78's should not be ***203** utilized unless an alternative method justified the deduction or a "more likely than not" opinion was obtained.[FN7] This evidence enhanced plaintiffs' argument that given PW's clear concealment of a known risk, individual proof of reliance was unnecessary. We do not consider the motions "frivolous conduct" under 22 NYCRR 130-1.1 (c). Inapposite are cases where the party sanctioned continued to make meritless arguments already rejected by the sanctioning court (*see, e.g., Pahl Equip. Corp. v Kassis*, 182 AD2d 22, 32-33,*lv denied in part and dismissed in part*80 NY2d 1005).

FN7 We note that there is support in the record for plaintiffs' accusation that this policy was, at a minimum, untimely disclosed during the litigation.

B. SUMMARY JUDGMENT MOTION

1. Reliance Issue

(3) PW asserts that the claims of five of the Ackerman plaintiffs--Daliana, Gatewood, Kommitt, Mandala and Slutsky--should be dismissed due to the absence of evidence that they relied on PW's tax advice. PW argues that each of these plaintiffs relied exclusively on their personal accountants. However, as discussed above, the direct professional relationship between the limited partners and PW provided the necessary nexus between PW's alleged malpractice and plaintiffs' injuries. At a minimum, this nexus raised an inference of reliance that alone is a sufficient basis to deny summary judgment. Additionally, questions of fact exist as to whether the warnings in the offering materials negated reasonable reliance by plaintiffs, and whether PW's conduct constituted negligence and malpractice, or, as PW argues, mere honest misjudgment.

2. The Effect of the Settlement in the Federal *Graf* Action

(6) PW asserts that the Ackerman plaintiffs' acceptance of the settlement in the *Graf* action entitles it to a setoff of any damages recovered by plaintiffs. The class action complaint filed in the *Graf* action in the Eastern District alleged causes of action in fraud, negligence, breach of fiduciary duty and Federal securities laws violations in connection with the plaintiffs' investment in the CPG partnerships. The damages requested by the plaintiffs were "the amount of their investments, interest payments on the financing notes, plus lost use of the money invested, and consequential damages." Several of the Ackerman plaintiffs were parties to the action.

The *Graf* action was settled by an Amended and Restated Settlement Agreement dated January 18, 1990, and a Final ***204** Order and Judgment of Dis-

missal was signed by District Judge Thomas Platt on February 21, 1990. PW argues that any proceeds received by the plaintiffs in the *Graf* settlement should be set off against any recovery by the plaintiffs in this action pursuant to General Obligations Law § 15-108. PW further asserts that plaintiffs have been made whole by the $40 million settlement in *Graf*, and further recovery regarding the same investment would constitute a double recovery.

General Obligations Law § 15-108 (a) provides that a release given to "one of two or more persons liable or claimed to be liable in tort for the same injury" does not discharge the remaining tortfeasors from liability unless the release expressly says so, "but it reduces the claim of the releasor against the other tortfeasors" by the greater of the amount stipulated or the amount of the released tortfeasor's equitable share of damages. The section only applies where tortfeasors are "liable in tort for the same injury" (*see, Roma v Buffalo Gen. Hosp.*, 103 AD2d 606, 607-608;*see also, Gettner v Getty Oil Co.*, 226 AD2d 502).

The plaintiffs' causes of action in the *Graf* action related solely to initial investment, basically a fraud in the inducement claim. In contrast, the Ackerman plaintiffs' amended complaint raised no fraudulent inducement claim; rather, it relates solely to PW's postinvestment actions regarding the continued use of the Rule of 78's on the CPG partnerships. We agree with the IAS Court that these actions did not seek recovery for the same injury, and therefore General Obligations Law § 15-108 is not applicable.[FN8] Of course, General Obligations Law § 15-108 has no applicability at all to the contract causes of action.

FN8 While successive tortfeasors are covered by the statute (*Hill v St. Clare's Hosp.*, 67 NY2d 72, 83), PW is not a successive tortfeasor here because the *Ackerman* and *Graf* actions do not seek recovery for the same injury (*Roma v Buffalo Gen. Hosp.*, *supra*, at 608).

3. Statute of Limitations Issues

(7) PW argues that some or all of the Ackerman plaintiffs' claims are barred by the applicable Statute of Limitations. First, PW asserts that the 1996 amendment to CPLR 214 (6) (L 1996, ch 623 [eff Sept. 4, 1996]), which clarified that the Statute of Limitations for nonmedical malpractice is three years "regardless of whether the underlying theory is based in contract or tort," is a remedial amendment that should be applied retroactively to claims that accrued prior to its enactment. PW notes that certain legislative memoranda offered in ***205** support of the legislation indicate that the amendment was designed to remedy the effect of the Court of Appeals decision in *Santulli v Englert, Reilly & McHugh* (78 NY2d 700,*supra*), and to "reaffirm the legislative intent" that the Statute of Limitations for all nonmedical malpractice cases is three years.

We have recently held that the amendment is to be given prospective application only (*see, Ruffolo v Garbarini & Scher*, 239 AD2d 8;*Vogel v Lyman*, 246 AD2d 422;*Amateur Hockey Assn. v Parson*, 244 AD2d 222). The Second and Third Departments are in accord with this view (*see, Board of Mgrs. v Mandel*, 235 AD2d 382 [2d Dept]; *Unadilla Silo Co. v Ernst & Young*, 234 AD2d 754 [3d Dept]). Thus, the six-year Statute of Limitations for contract actions is applicable here.

(8) A second Statute of Limitations issue raised by the parties is whether the doctrine of continuous representation is applicable to this case. It is beyond dispute that the doctrine applies to actions against accountants, and will operate to toll the Statute of Limitations if facts supporting its application exist (*see, Smith Plumbing & Heating Co. v Christensen*, 242 AD2d 429;*Zaref v Berk & Michaels*, 192 AD2d 346). The continuous representation must be in connection with the specific matter directly in dispute, and not merely the continuation of a general professional relationship (*supra*, at 347-348). " 'The mere recurrence of professional services does not constitute continuous representation where the later services performed were not re-

lated to the original services' " (*Kearney v Firley, Moran, Freer & Eassa,* 234 AD2d 967, 968, quoting *Hall & Co. v Steiner & Mondore,* 147 AD2d 225, 228-229).

Applying these principles to the instant motion, the branch of PW's motion seeking dismissal on Statute of Limitations grounds was properly denied. The Ackerman plaintiffs provided ample evidence supporting the application of continuous representation, including the repeated use of an improper accounting method and the repeated failure to disclose the risks associated with the same (*see, Zwecker v Kulberg,* 209 AD2d 514, 515 [continuous treatment applicable where limited partners alleged that defendant accountant continued to utilize deductions in preparing their tax returns despite knowledge that IRS would likely invalidate the deduction]). Continuous representation was further demonstrated by PW's representations that it was "handling" the IRS audit for the CPG partnerships. Since PW prepared the Schedules K-1 through 1988, and the Ackerman complaint was filed in April 1990, the claims would be timely under either the six-year Statute of Limitations for ***206** contract actions (CPLR 213 [2]) or the three-year Statute of Limitations for actions involving injury to property (CPLR 214 [4]).

We have examined the parties' remaining contentions and find them to be without merit.

Accordingly, the order of the Supreme Court, New York County (Ira Gammerman, J.), entered November 15, 1994, which denied the Ackerman plaintiffs' motion for class certification, should be affirmed, without costs. Order, same court and Justice, entered April 22, 1997, which denied plaintiffs' renewed motions for class certifications and imposed $5,000 sanctions on the Ackerman plaintiffs' attorneys for frivolous litigation, should be modified, on the law, the facts and in the exercise of discretion, to the extent that the third motion for certification of a class of New York residents only is granted and the sanctions are vacated, and otherwise affirmed, without costs. Order, same court and Justice, entered April 29, 1997, which, to the extent appealed from, denied PW's motion for summary judgment, should be affirmed, without costs.

Tom, J.

(Concurring). The motion court's orders should be affirmed in their denial of class certification for the "global" (non-New York residents) subclass, but reversed to the extent that the class consists of New York residents. While I concur with Justice Mazzarelli's result, I conclude that additional factors, particularly the burden imposed on New York courts in the absence of a demonstrable New York interest, support this partial affirmance.

Some 1,444 of these putative class members invested in various limited partnerships affiliated with the Commercial Properties Group (CPG) during the 1980's for tax shelters. The investors were advised that as a consequence of their investment, they would be entitled to certain tax benefits realized by accelerating the deduction of interest expenses of loans made to the partnerships. However, the Internal Revenue Services (IRS) subsequent audits of the limited partnerships resulted in findings of tax underpayments by individual plaintiffs, many of whom settled with the IRS, satisfying arrears and paying interest.

The present case, sounding originally in negligence claims and accountant malpractice claims against Price Waterhouse and other defendants, was commenced by the filing of a class action complaint in 1990. After significant motion practice on the Statute of Limitations defense, most of the original complaint ***207** was dismissed in December 1994 as untimely. By then, though, plaintiffs had amended the complaint to add two breach of contract claims, and to allege continuous treatment in connection with the still-extant tort and malpractice claims to toll commencement of the Statute of Limitations.

Plaintiffs sought to incorporate into the original class all other limited partners of the CPG partnerships that were audited and penalized by Federal and State tax authorities in connection with the ac-

counting advice by Price Waterhouse concerning the “Rule of 78's”. The class has now been defined to include some 1,444 investors in 38 States and four foreign countries. The breakdown of investors by State is as follows: 525 investors are from New York, representing 36% of the proposed class; 192 investors are from Pennsylvania; 130 investors are from Oklahoma; 120 investors are from New Jersey; 80 investors are from Florida; 60 investors are from California; 52 investors are from Washington; 50 investors are from Connecticut; 47 investors are from Virginia; and 188 investors are from 25 more States and four foreign countries.

Justice Gammerman entertained, and ultimately rejected, the Ackerman plaintiffs' class certification efforts in several successive orders.

By motion dated April 30, 1993, the Ackerman plaintiffs moved to certify as a class, for whom Ackerman would serve as class representative, all persons who invested in any of the limited partnerships listed in the attached appendix. The motion court, in an order dated November 16, 1993, denied class certification with leave to renew after discovery of the State of residence of the putative class members. The court noted the geographic diversity of the putative class members, the absence of demonstrable common class issues, especially in view of the diversity of jurisdictions involved, and that for the tort and malpractice claims, State laws varied greatly, further defeating commonality. This order was not appealed.

After the above-noted amendment of the complaint to add breach of contract claims, and after discovery was conducted as to class members' residences (providing the class composition noted above), the application for class certification was renewed in March 1994. In its November 15, 1994 order, the court again denied certification. The court noted that plaintiffs claimed damages for both Federal and State tax assessment and penalties, claims that were made not only under the tax laws of the United States but also pursuant to the statutory and administrative schemes of 38 different States, and that Price Water ***208** house was entitled to scrutinize the validity of all such tax rulings. Justice Gammerman again noted the significant conflicts of law issues, now also including diverse State treatments of the contract claims. The court also noted that different States utilized different laws of waiver and estoppel in connection with Statutes of Limitation. This order was appealed, and presently is under review.

Plaintiffs, despite a warning from the court that another renewal might elicit sanctions, renewed the motion in June 1995 and again in August 1995. The June 1995 motion sought certification for investors who were New York residents, bifurcated between contract and tort claims. The August 1995 motion sought certification for all non-New York investors and argued for the application of Pennsylvania law to the contract claims. The court denied both motions and imposed sanctions in its April 22, 1997 order, also presently under review, finding that for all claims, the law of each investor's forum likely would apply, so that the original factors militating against certification still remained. Specifically with respect to the non-New York “global” class, the court rejected the plaintiffs' position that Pennsylvania law would govern the contract claims, but also found that Pennsylvania's restrictiveness on accountant malpractice claims, requiring proof of reliance, actually was contrary to the best interests of the class and that the allegations of the complaint might not even make out contract claims under Pennsylvania law. The court also found that the tort claims raised on behalf of the global class would require analysis of the laws of dozens of States, making resolution of those claims in a single forum unmanageable.

CPLR article 9 sets forth five criteria, comprehensively analyzed in Justice Mazzarelli's opinion, that basically seek to balance the competing complexities and benefits of litigating the claims individually, perhaps in diverse forums, and litigating the claims together in a single forum. These criteria, though, basically require an evaluation of the bur-

dens on the respective parties, and are less than clear on how to factor in the burden on the host forum. As a practical matter, many certification proceedings litigated in New York have addressed New York-accrued claims or New York residents seeking relief, and usually both (*see, e.g., Weinberg v Hertz Corp.*, 116 AD2d 1,*affd*69 NY2d 979, certifying a class of persons renting cars in New York asserting violation of General Business Law § 349, when a similar class consisting of California residents and renters within California, suing under California law, was ***209** recognized by that State [*Lazar v Hertz Corp.*, 143 Cal App 3d 128, 191 Cal Rptr 849;*accord, Super Glue Corp. v Avis Rent A Car Sys.*, 132 AD2d 604]). To the extent that plaintiffs now seek to certify a non-New York subclass, though, the present case presents circumstances less typical of State court certification proceedings and warrants greater scrutiny of the sum benefits as contrasted with complexity and cost to the host forum.

Certifying a non-New York subclass to litigate the tort issues, in which the law of each State of residence would be invoked despite the absence of a New York interest, clearly would impose unreasonable burdens on our courts (*see generally*, Zabel and Eyres, *Conflict-of-Law Issues in Multistate Product Liability Class Actions*, 19 Hamline L Rev 429 [1996]). As to the tort claims, we all agree that for this reason, certification should not be granted.

As to the global class certification on the contract claims, similar reasoning should apply. In addition to the majority's trenchant analysis of the statutory criteria, there is an additional question which, under these facts, I think is important: why should the courts of New York be burdened with a massive class of non-New York residents (919 parties) from some 37 foreign States and numerous foreign nations, all of whom lack any significant connection with New York regarding the matter in litigation? As to these contract claims, it seems to me to be a critical consideration that all major events occurred in Pennsylvania rather than New York. The contract between CPG and Price Waterhouse was negotiated and entered into in Pennsylvania; all relevant tax preparation work was completed in Price Waterhouse's Philadelphia office; the partnership returns and schedules were delivered to CPG in Pennsylvania and then sent to the parties at their out-of-State places of residence; CPG was organized under the laws of Pennsylvania, and the various partnership agreements provided for application of Pennsylvania law. Once New York residents are excluded from the class, almost all New York contacts also are removed. One must question what possible interest New York has in resolution of those claims. I would conclude that the manifest lack of any New York interest in resolution of the non-New York parties' contract claims, especially when balanced against the burden to be imposed on our courts, provided an ample basis for the exercise of discretion to deny certification. The natural question is why certification was not sought in a State where non-New York claims are clustered.***210**

The administrative burden on our courts will be enormous, with no sum benefits to the residents of our State, resolving legal claims for which New York interest is lacking. At present, the conflicts issue remains unresolved. If further litigation results in a more eclectic approach to these contract claims, numerous hearings will be required on the applicability and requirements of numerous State laws and defenses. The damages of each class member will have to be individually proved. Although this, by itself, likewise would not require denial of class certification, this underscores the hydra-like nature of the putative non-New York class and the excessive burdens that our courts will assume in furtherance of nonresidents asserting claims arising outside of the State. Moreover, the damage claims for each class member, rather then being marginal, as is more typical of class actions and which provides one rationale for certification of a class, tend to be substantial in this case. While this factor by itself might not be dispositive, it further places in doubt the efficacy of certifying this subclass and litigating the matter in New York.

Multiple rulings will be necessary to sort out the applicability of the respective Statutes of Limitation and when time periods accrue for each class member. Particularly for the Statutes of Limitation of these numerous States, issues of waiver and estoppel from pleading the defense likely will require litigation. Litigation regarding defenses to contractual liability, and methods of proving damages, whether for a single foreign forum or for numerous foreign forums, in addition to enhancing the predominance of individual claims as noted by the majority, only adds to New York's litigation burden in this case. Further, to the extent that individual damage awards require an evaluation of particular State tax laws, additional litigation will be necessary to sort out the particular claims, ascertain the applicability of foreign tax laws, evaluate the validity of any foreign tax assessments, and measure damages, potentially employing numerous mini-trials on tax issues alone. Even if some of these many issues ultimately are resolved without undue commitment of judicial resources, the aggregate effect still threatens to impose on our courts an enormous litigation burden for matters that New York has scant, if any, interest.

Finally, it is well established that the findings of the motion court in ruling on proposed class certifications are to be accorded substantial deference (*Matter of Colt Indus. Shareholder Litig.*, 155 AD2d 154, 159,*mod*77 NY2d 185). In this case, we should accord that deference with respect to ruling concerning the non-New York plaintiffs.***211**

Ellerin, J. P., Rubin and Andrias, JJ., concur with Mazzarelli, J.; Tom, J., concurs in a separate opinion.

Order, Supreme Court, New York County, entered November 15, 1994, affirmed, without costs; order, same court and Justice, entered April 22, 1997, modified, on the law, the facts and in the exercise of discretion, to the extent that the third motion for certification of a class of New York residents only is granted and the sanctions vacated, and otherwise affirmed, without costs; order, same court and Justice, entered April 29, 1997, affirmed, without costs.***212**

N.Y.A.D.,1998.

ACKERMAN v PRICE WATERHOUSE

252 A.D.2d 179, 683 N.Y.S.2d 1796021998 WL 8518909991998 N.Y. Slip Op. 109424603, 683 N.Y.S.2d 1796021998 WL 8518909991998 N.Y. Slip Op. 109424603, 683 N.Y.S.2d 1796021998 WL 8518909991998 N.Y. Slip Op. 109424603

END OF DOCUMENT

Case Name:

Air Canada (Re)

APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C.36, as amended
IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C.36, as amended
AND IN THE MATTER OF Section 191 of the Canada Business Corporations Act, R.S.C. 1985, c. C.44, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of Air Canada and those subsidiaries listed on Schedule "A"*

[2004] O.J. No. 303

47 C.B.R. (4th) 169

128 A.C.W.S. (3d) 1067

2004 CarswellOnt 469

Court File No. 03-CL-4932

Ontario Superior Court of Justice
Commercial List

Farley J.

Heard: January 16, 2004.
Judgment: January 16, 2004.

(16 paras.)

Insolvency law -- Practice -- Administration of the estate -- Application to court for directions.

Application for directions on the entering into certain agreements by Air Canada.

HELD: Application granted. The agreements were beneficial to Air Canada and its stakeholders.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, RSC 1985.

Counsel:

Sean F. Dunphy and Ashley John Taylor, for Air Canada.
Peter J. Osborne and Peter H. Griffin, for the Monitor.
Howard Gorman, for the Ad Hoc Unsecured Creditors Committee.
Aubrey Kauffman, for the Ad Hoc Committee of Various Creditors.
Jay Swartz, for Deutsche Bank.
Mark Gelowitz, for Trinity Time Investments.
Robert Thornton and Gregory Azeff, for GE Capital Aviation Services Inc.
J. Porter, for Cerberus.
Kevin McElcheran, for CIBC.
Murray Gold, for CUPE.
Ian Dick, for AG Canada.
James Tory, for Air Canada Board.
Joseph J. Bellissimo, for the Aircraft Lessor/Lender Group.
Terri Hilborn, for Unionized Retiree Committee.
William Sasso and Sharon Strosberg, for Mizuho International, PLC.
Jim Dube, for Deutsche Lufthansa A.G.

[* Editor's note: Schedule A was not attached to the copy received from the Court and therefore is not included in the judgment.]

1 **FARLEY J.**:-- These reasons deal with three matters which the court was asked to approve Air Canada (AC) entering into various agreements; simply put they were as follows:

(1) the Merrill Lynch (ML) indemnity;
(2) the entering into the amendments to the Trinity Agreement; and
(3) the Global Restructuring Agreements (GRA).

ML Indemnity

2 There was no opposition to this. The court was advised that such an indemnity was customarily given and that the terms of this particular one were such as is normally given. I therefore approve AC granting such an indemnity to ML.

Trinity Amendments

3 As I understood the submissions this morning, Mizuho a member of the Unsecured Creditors

Committee (UCC) was the only interested party which spoke out against the Trinity amendments. It continues to be dissatisfied with the process by which Trinity was selected as the equity plan sponsor. I merely point out, once again, that this process was not of the Court's choosing but rather one which AC commenced on notice to the service list and as to which there were no objections before Trinity was selected on November 8, 2003 (together with the "fiduciary out" provision contained in its proposal). Aside from the court approvals envisaged by that process, the court only became involved when it was appreciated that there were some difficulties with the practical implementation of the process.

4 I further understand that the Ad Hoc Committee of Various Creditors (CVC) withdrew its opposition yesterday along with its cross motion. The UCC (one assumes on some majority basis) supported the Trinity Amendments but indicated that, as a sounding board, it wished to continue sounding that it still had concerns about aspects of corporate governance and management incentives.

5 I have no doubt, if adjustments in any particular area make sense between the signatories (AC and Trinity) and to the extent that any beneficiaries are involved, that such adjustments will be made for everyone's overall benefit (everyone in the sense of AC including all of its stakeholders including creditors, labour, management, pensioners, etc.) not only for the short term interests but the long term interests of AC emerging from these CCAA proceedings as an ongoing viable enterprise on into the future, well able to serve the public (both Canadian and foreign). A harmonious relationship with trust and respect flowing in all directions amongst the stakeholders will be to everyone's long term advantage. With respect to corporate governance though, I am able to make a more direct observation. A director, no matter who nominates that person, owes duties and obligations to the corporation, not the nominator: see 820099 Ontario Ltd. v. Harold E. Ballard Ltd., [1991] O.J. No. 266, (1991), 3 B.L.R. (2d) 113 at 123 (Ont. Gen. Div.), aff'd, [1991] O.J. No. 1082, (1991), 3 B.L.R. (2d) 113 (Div. Ct.).

6 There was no evidence to show that the Board of AC in exercising its fiduciary duties did not properly consider on a quantitative and qualitative basis the factors (on a pro and con basis) relating to whether Cerberus had provided a Superior Proposal (as that was defined in section 9 of the Trinity Agreement approved earlier by this Court). Indeed there was no complaint from Cerberus in this respect. The Board's letter to me of December 22, 2003 carefully reviewed the considerations which the Board (with the assistance of Seabury and ML, together with the general oversight and views of the Monitor) gave in their deliberations with their ultimate decision that the Cerberus December 10, 2003 proposal was not a Superior Proposal with the result that the Board has selected Trinity to be the equity program sponsor in accordance with the Trinity amended deal. I approve AC executing the Trinity amended deal and implementing same, with the recognition and proviso that there may be further amendments/adjustments which may be entered into subject to the guidelines of my discussion above. I note in particular that the UCC helpfully pointed out that section 7.3 still needs to be modified, and that is being worked on. The Air Canada Pilots Association observed that there still needed to be some fine-tuning at para. 22 of its factum noting

that: "These matters of the detailed implementation of the Amended Trinity Investment Agreement can all be resolved by good faith negotiations between Air Canada, Trinity and affected stakeholders, with the assistance and support of the Monitor"; I did not have the benefit of any submissions in this regard (para. 22) nor was any expected to either be given or taken as the parties all appreciated that this was not to be an exercise in "nitpicking".

7 At paragraph 71 of its 19th report, the Monitor stated:

> 71. The Monitor is of the continuing view that the Equity Solicitation Process must be completed as soon as possible. The restructuring process and many other restructuring initiatives have been delayed by approximately two months as a result of the continued uncertainty concerning the selection of the equity plan sponsor. The equity solicitation process must be concluded so that the balance of the restructuring process can be completed before the expiry on April 30, 2004 of the financing commitments from each of Trinity, GECC and DB pursuant to the Standby Agreement. The Monitor recommends that this Honourable Court approve the Company's motion seeking approval of the Amended Trinity Investment Agreement.

8 I would therefore approve the Trinity amendments so that AC can proceed to enter into and implement the Amended Trinity Investment Agreement. I note that this approval is not intended to determine any rights which third parties may have.

GRA

9 As with the previous approvals, I take the requirement under the CCAA is that approval of the Court may be given where there is consistency with the purpose and spirit of that legislation, a conclusion by the Court that as a primary consideration, the transaction is fair and reasonable and will be beneficial to the debtor and its stakeholders generally: see Northland Properties Ltd. v. Excelsior Life Ins. Co. of Canada (1989), 73 C.B.R. (N.S.) 195 at 201 (B.C.C.A.). In Re Canadian Red Cross Society (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.), Blair J. at p. 316 adopted the principles in Royal Bank of Canada v. Soundair Corp. (1991), 7 C.B.R. (3d) 1 (Ont. C.A.) as an appropriate guideline for determining when an agreement or transaction should be approved during a CCAA restructuring but prior to the actual plan of reorganization being in place. In Re Sammi Atlas Inc. (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div.), I observed at p. 173 that in considering what is fair and reasonable treatment, one must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to the confiscation of rights. I think that philosophy should be applicable to the circumstances here involving the various stakeholders. As I noted immediately above in Sammi, equitable treatment is not necessarily equal treatment.

10 The Monitor's 19th report at paragraphs 20-21 indicates that:

> 20. The GRA provides the following benefits for Air Canada:
>
> * The retention of a significant portion of its fleet of core aircraft, spare engines and flight simulators, which are critical to its ongoing operations;
> * The restructuring of obligations with respect to 106 of 107 Air Canada and Jazz air operating, parked and undelivered aircraft (effective immediately for 12 GECC-managed aircraft and upon exit from CCAA for the remaining 94 GECC-owned aircraft, except as indicated below), including lease rate reductions on 51 aircraft (of which 3 aircraft have been returned as of the current date), cash flow relief for 29 aircraft, termination of the Applicants' obligations with respect to 20 parked aircraft (effective immediately), the cancellation of 4 future aircraft lease commitments and the restructuring of the overall obligations with respect to 2 aircraft. Obligations with respect to the last remaining aircraft remain unaffected as it is management's view that this lease was already at market;
> * Exit financing of approximately US $585 million (the "Exit Facility") to be provided by GECC upon the Company's emergence from CCAA;
> * Aircraft financing up to a maximum of US $950 million (the "RJ Aircraft Financing") to be provided by GECC and to be used by Air Canada to finance the future purchase of approximately 43 regional jet aircraft; and
> * The surrender of any distribution on account of any deficiency claims under the CCAA Plan with respect to GECC-owned aircraft only, without in any way affecting GECC's right to vote on the Plan in respect of any deficiency claim.
>
> 21. In return for these restructuring and financing commitments, the GRA provides for the following:
>
> * Payment of all current aircraft rent by Air Canada to GECC, during the interim period until emergence from CCAA proceedings, at contractual lease rates for GECC-owned aircraft and at revised lease rates for GECC-managed aircraft;
> * The delivery of notes refinancing existing obligations to GECC in

connection with 2 B747-400 cross-collateralized leases (the "B747 Restructuring) including one note convertible into equity of the restructured Air Canada at GECC's option;

* The delivery of stock purchase warrants (the "Warrants") for the purchase of an additional 4% of the common stock of the Company at a strike price equal to the price paid by any equity plan sponsor; and
* The cross-collateralization of all GECC and affiliate obligations (the "Interfacility Collateralization Agreement") on Air Canada's emergence from CCAA proceedings for a certain period of time.

The Monitor concluded at paragraph 70:

> 70. The Monitor notes that, if considered on their own, the lease concessions provided to Air Canada by GECC pursuant to the GRA differ substantially from those being provided by other aircraft lessors. In addition, the Monitor notes that GECC has benefitted from the cross collateralization on 22 aircraft pursuant to the CCAA Credit Facility and Interfacility Collateralization Agreement, particularly as it relates to the settlement of Air Canada's obligations to GECC under the B747 Restructuring. However, the Monitor also notes that the substantial benefits provided to Air Canada under the GRA including the availability of US $585 million of exit financing and US $950 million of regional jet aircraft financing are significant and critical to the Company's emergence from CCAA proceedings in an expedited manner. In the Monitor's view the financial benefits provided to Air Canada under the GRA outweigh the costs to the Applicants' estate arising as a result of the cross collateralization benefit provided to GECC under the CCAA Credit Facility and Interfacility Collateralization Agreement. Accordingly, the Monitor recommends to this Honourable Court that the GRA be approved.

11 The GRA was opposed by the UCC (again apparently on some majority basis as one of its members, Cara, was indicated as being in favour and I also understand that Lufthansa was also supportive); the UCC's position was supplemented by separate submissions by another of its members, CIBC. I agree with the position of the UCC that the concern of the court is not with respect to the past elements of the DIP financing by GE and the cross-collateralization of 22 aircraft that agreement provided for. I also note the position of the UCC that it recognizes that the GRA is a package deal which cannot be cherry picked by any stakeholder nor modified by the Court; the UCC accepts that the GRA must be either taken as a package deal or rejected. It suggested that GE, if the court rejects the GRA as advocated by the UCC, will not abandon the field but rather it will stay and negotiate terms which the UCC feels would be more appropriate. That may be true but I would observe that in my view the delay and uncertainty involved would likely be devastating for

AC. Would AC be able to meet the April 30, 2004 deadline for the Trinity deal which requires that the GRA be in place? What would the effect be upon the booking public?

12 I note that the UCC complains that other creditors are not being given equal treatment. However, counsel for another large group of aircraft lessors and financiers indicated that they had no difficulty with the GRA. Indeed, it seems to me that GE is in a somewhat significantly different position than the other creditors given the aforesaid commitment to provide an Exit Facility and an RJ facility. Trinity and Deutsche Bank (DB) with respect to their proposed inflow of $1 billion in equity would be subordinate to GE; this new money (as opposed to sunk old money of the UCC and as well as that of the other creditors) supports the GRA. I note as well although it is "past history" that GE has compromised a significant portion of its $2 billion claim for existing commitments down to $1.4 billion, while at the same time committing to funding of large amounts for future purposes, all at a time when the airline industry generally does not have ready access to such.

13 With respect to the two 747 LILOs (lease in, lease out), there is the concession that AC will enjoy any upside potential in an after marketing while being shielded from any further downside. GE has also provided AC with some liquidity funding assistance by deferring some of its charges to a latter period post emergence. Further it has been calculated that as to post filing arrears, there will be a true up on emergence and assuming that would be March 31, 2004, it is expected that there would be a wash as between AC and GE, with a slight "advantage" to AC if emergence were later. I pause to note here that emergence sooner rather than later is in my view in everyone's best interests - and that everyone should focus on that and give every reasonable assistance and cooperation.

14 With respect to the snapback rights, I note that AC would be able to eliminate same by repaying the LILO notes and the Tranche Loans and AC would be legally permitted to eliminate this concern 180 days post emergence. I recognize that AC would be in a much stronger functional and psychological bargaining position to obtain replacement funding post emergence than it is now able to do while in CCAA protection proceedings. I would assume that such a project would be a financial priority for AC post emergence and that timing should not prevent AC from starting to explore that possibility in the near future (even before emergence). I also note that GE anticipates that the snapback rights would not likely come into play, given, I take it, its analysis of the present and future condition of AC and its experience and expertise in the field. I take it as a side note that GE from this observation by it will not have a quick trigger finger notwithstanding the specific elements in the definition of Events of Default; that of course may only be commercial reality - and that could of course change, but one would think that GE would have to be concerned about its ongoing business reputation and thus have to justify such action. Snapback rights only come into existence upon emergence, not on the entry into the GRA.

15 I conclude that on balance the GRA is beneficial to AC and its stakeholders; in my view it is fair and reasonable and in the best interests of AC. It will permit AC to get on with the remaining and significant steps its needs to accomplish before it can emerge. The same goes for the Trinity deal. I therefore approve AC's entering into and implementing the GRA, subject to the same

considerations as to completing the documentation and making amendments/adjustments as I discussed above in Trinity Amendments.

16 Orders accordingly.

FARLEY J.

cp/e/nc/qw/qlrme/qlhcs/qlmjb

Indexed as:

Amoco Canada Petroleum Co. v. Propak Systems Ltd.

Between

Amoco Canada Petroleum Company Ltd., the George R. Brown Partnership, Encor Energy Corporation Inc., David W. Feeney, Trustee of the Estate of Eleanor Deering, deceased, Feliciana Corporation, Heather Oil Ltd., Joli Fou Petroleums Ltd., Lacana Petroleum Limited, Ralph S. O'Connor, Mark Resources Inc., Star Oil and Gas Ltd., Union Pacific Resources Inc., Westcoast Petroleum Ltd. and Wintershall Oil of Canada Ltd., respondents/(plaintiffs), and

Propak Systems Ltd., Lynn Tylosky, L. Moore, appellants/(defendants), and

Quantel Engineering (1981) Ltd., V.J. Pamensky Canada Inc., WEG Exportadora S.A., Electromotores WEG S.A. and Gerry Brooks carrying on business as SDL Trucking and Cawa Operating & Consulting Ltd., respondents/(defendants), and

Standard Electric Ltd., Mark Resources Inc., Able Industries Limited, Terrence Dingwall operating as Able Industries, Cawa Operating & Consulting Ltd., Flint Canada Inc. formerly known as Flint Engineering & Construction Ltd., Lovejoy Inc. and Engineered Bearings & Drives Ltd. formerly known as Engineered Bearings Co. Ltd. and Quantel Engineering (1981) Ltd., respondents/(third parties), and

ABC Company Ltd., not a party to this appeal/(third party), and

Able Industries Limited, Terrence Dingwall operating as Able Industries or Able Industries Limited, Cawa Operating & Consulting Ltd. and Flint Canada Inc., formerly known as Flint Engineering & Construction Ltd., Lovejoy Inc., Engineered Bearings & Drives Ltd. formerly known as Engineered Bearings Co. Ltd. and Quantel Engineering (1981) Ltd., respondents/(fourth parties), and

Able Industries Limited, Standard Electric Ltd., Gerry Brooks, carrying on business as SDL Trucking, Quantel Engineering (1981) Ltd., Flint Canada Inc., formerly known as Flint Engineering & Construction Ltd., V.J. Pamensky Canada Inc. WEG Exportadora S.A., respondents/(fifth parties), and Propak Systems Ltd., appellant/(fifth party)

[2001] A.J. No. 600

2001 ABCA 110

200 D.L.R. (4th) 667

[2001] 6 W.W.R. 628

91 Alta. L.R. (3d) 13

281 A.R. 185

4 C.P.C. (5th) 20

105 A.C.W.S. (3d) 56

Docket: 99-18589

Alberta Court of Appeal
Calgary, Alberta

Conrad, Sulatycky and Fruman JJ.A.

Heard: June 12, 2000.
Judgment: filed May 4, 2001.

(55 paras.)

On appeal from the order of Hart J. Dated the 3rd day of September, A.D. 1999. Filed the 23rd day of November, A.D. 1999.

Counsel:

D.A. McDermott, Q.C., for the appellants.
J.J.S. Peacock, for the respondents Amoco Canada et al.

A.D. Lytle, for the respondent Quantel Engineering.
J.B. Rooney, Q.C., for the respondent V.J. Pamensky Canada Inc.
G.S. Dunnigan, for the respondent Gerry Brooks.
D.K. Yasui, for the respondent Cawa Operating and Consulting Ltd.
D.J. Chernichen, Q.C., for the respondent Standard Electric Ltd.
D.J. Cichy, for the respondent Mark Resources Inc.
H.D.D. Lloyd, for the respondent Lovejoy Inc.

[Quicklaw note: An Erratum was released by the Court February 6, 2002. The correction has been made to the text and the Erratum is appended to this document.]

REASONS FOR JUDGMENT RESERVED

The judgment of the Court was delivered by

1 FRUMAN J.A.:-- The question in this appeal is whether Alberta courts should permit some defendants in complex multi-party litigation to settle, even though the defendants who are left behind might encounter difficulties gathering pre-trial evidence to defend the lawsuit. The answer is yes.

BACKGROUND

2 On November 1, 1990, a fire occurred at the Eta Lake Gas Processing facility, near Drayton Valley, Alberta. The resulting claims for loss of property and profit allege both negligence and breach of contract for which the plaintiffs seek damages of several million dollars. Given the sizeable stakes, the plaintiffs cast their litigation nets as widely as possible, adding more defendants in successive amended versions of the statement of claim. The defendants in turn endeavoured to minimize their respective risk by maximizing the number of parties potentially responsible for the loss. They issued notices to co-defendants and added third, fourth and fifth parties to this action. With the current tally at eleven groups of defendants, a schematic diagram of who is suing whom looks like the "triple reverse" from a football play book.

3 The case has meandered towards trial, with extensive though as yet incomplete discovery and document production. Now, nearly a decade after the fire occurred, ten groups of defendants want out and the plaintiffs want to let them go. They have entered into a type of settlement agreement known as a "Pierringer agreement" named after Pierringer v. Hoger et al., 124 N.W. (2d) 106 (Wis. S.C. 1963), the Wisconsin case in which this type of agreement was first considered. Such agreements permit some parties to withdraw from the litigation, leaving the remaining defendants responsible only for the loss they actually caused, with no joint liability. As the non-settling defendants are responsible only for their proportionate share of the loss, a Pierringer agreement can

properly be characterized as a "proportionate share settlement agreement".

4 If given effect, the settlement agreement in this case would greatly simplify the trial by reducing the number of litigants from twelve groups, represented by twelve different lawyers, to two groups: the plaintiffs, and the appellants, Propak Systems Ltd. together with two of its employees, Lynn Tylosky and L. Moore ("Propak"). The settlement agreement entered into on June 23, 1999 (AB II at 150), stipulates the removal from this suit of the third, fourth and fifth parties and co-defendants (the "settling defendants") as a condition precedent to its main provisions coming into effect. It provides that:

1. The plaintiffs will discontinue their claims against all of the settling defendants (s. 1);
2. The plaintiffs covenant not to sue any of the settling defendants (s. 2);
3. The plaintiffs will amend their pleadings to abandon their claims against Propak, except to the extent of Propak's several share of liability, and will not seek to recover from Propak any amounts for which Propak would be entitled to contribution or indemnity from the settling defendants (s. 3);
4. All of the settling defendants will abandon their indemnity claims and any claims for costs against one another, and against Propak (s. 6);
5. The settling defendants will cooperate with the plaintiffs by making witnesses, documents and expert reports available to them (s. 10); and
6. To the extent required by law and the rulings and guidelines of the Law Society of Alberta, the agreement will be disclosed to the Court of Queen's Bench and to Propak (s. 11).

5 The agreement requires amendments to the statement of claim that would focus the issue for determination at trial solely on Propak's proportionate share of the loss. The previous version of the statement of claim set out diverse claims of alternative liability against various defendants in 28 paragraphs and sub-paragraphs (AB I at P-39). The newly amended statement of claim refers to four specific breaches by Propak relating to its faulty reinstallation of a motor in a refrigeration compressor on the Eta Lake Gas Processing facility (AB II at 145, paras. 29 - 31). It alleges that Propak's failure to properly preload the bolts fastening the coupling to the hub of the motor and its failure to align the motor led to the escape of gas and resulting fire.

6 The litigation is under case management. On September 3, 1999, the settling defendants brought an application before the case management judge to remove them from the lawsuit. At the same time, the plaintiffs applied to amend the statement of claim.

7 Propak resisted both applications, arguing that due to potential prejudice it would be made a scapegoat for liability at trial. It noted that because the Alberta Rules of Court, Alta. Reg. 390/68 do not contain an express rule permitting pre-trial discovery against third parties, Propak would lose its pre-trial procedural rights against the settling defendants if they were released from the lawsuit.

Propak contended that this would affect its ability to gather evidence to show that the fire resulted from the settling defendants' actions, and would impede the court's ability to apportion Propak's share of the liability fairly.

THE CASE MANAGEMENT JUDGE'S DECISION

8 The case management judge granted both applications. He noted that the settlement agreement limits Propak's liability to its own several liability to the plaintiffs. Given Propak's limited exposure, he queried the basis on which Propak's claims for contribution and indemnity from the settling defendants could continue (AB I at 100).

9 The judge then observed that even if the settling defendants were removed from the suit, leaving the plaintiffs and Propak as the only remaining litigants, the court would nevertheless be compelled to determine the degrees of fault of all contributors to the plaintiffs' damages, whether parties to the action or not. The court would be required to make this assessment for two reasons: in order to isolate Propak's several liability, and because s. 2(1) of the Contributory Negligence Act, R.S.A. 1980, c. C-23 compels the court to do so (AB I at 102). Therefore, even though the settlement agreement sufficed to extinguish all issues of liability among the plaintiffs and settling defendants, and the settling defendants and Propak, removing the settling defendants from the suit could affect the court's ability to apportion fault properly.

10 The case management judge recognized that removing the settling defendants from the action would cause Propak to lose its rights of discovery and production of documents in respect of those parties. The judge noted that although examinations for discovery were not complete, Propak had the advantage of significant oral examination and discovery of the documents. He was unable to find that "Propak would be in any way prejudiced or disadvantaged by 'losing' the opportunity of further discovery of parties to whom it would no longer be adverse in interest [by virtue of the agreement taking effect]" (AB I at 105). Accordingly, he directed that the third, fourth and fifth party notices and notices to co-defendants be struck, the respective parties be dismissed from the suit, and the amendments to the statement of claim be allowed (AB I at 105-106).

PROPORTIONATE SHARE SETTLEMENT AGREEMENTS

An Introduction

11 The litigation of large losses in Canada has been characterized by two opposing trends: first, the practice of adding every conceivable party as a defendant or third party in order to spread out the risk of liability, which complicates and slows the litigation process; and second, the use of settlement agreements to help speed litigation and curb legal fees. See Barbara Billingsley, "Margetts v. Timmer Estate: The Continuing Development of Canadian Law Relating to Mary Carter Agreements" (1998) 36 Alta. L. Rev. (No. 4) 1017.

12 Now past is the day when "settlement agreement" can be understood to refer solely to the final

resolution of all outstanding issues between all parties to a lawsuit, effectively bringing the suit to an end. In the last several years, in response to increasingly complex and commensurately dilatory and costly litigation, a new generation of settlement agreements has been cautiously adopted by the litigation bar.

13 The new settlement agreements, which include such exotically named species as the Mary Carter agreement and the Pierringer agreement, endeavour to attain a more limited objective: rather than trying to resolve all outstanding issues among all parties, a difficult task in complicated suits, they aim to manage proactively the risk associated with litigation. In short, contracting litigants prefer the certainty of settlement to the uncertainty and expense of a trial and the possibility of an undesirable outcome. This "risk-management" objective is accomplished by settling issues of liability between some but not all of the parties, thereby reducing the number of issues in dispute, simplifying the action, and expediting the suit. Ancillary benefits include a reduction in the financial and opportunity costs associated with complex, protracted litigation, as well as savings of court time and resources.

14 To the extent that a proportionate share settlement agreement completely removes the settling defendants from the suit, it is like a conventional settlement agreement that brings all outstanding issues between the settling parties to a conclusion. Proportionate share settlement agreements therefore typically include the following elements:

1. The plaintiff receives a payment from the settling defendants in full satisfaction of the plaintiff's claim against them;
2. In return, the settling defendants receive from the plaintiff a promise to discontinue proceedings, effectively removing the settling defendants from the suit;
3. Subsequent amendments to the pleadings formally remove the settling defendants from the suit; and
4. The plaintiff then continues its suit against the non-settling defendants.

15 There is, however, an added complication that a proportionate share settlement agreement must address. As a result of third party proceedings, settling defendants are almost always subject to claims for contribution and indemnity from non-settling defendants for the amount of the plaintiff's loss alleged to be attributable to the fault of the settling defendants. Before the settling defendants can be released from the suit, some provision must be made to satisfy these claims.

16 This obstacle is overcome by including an indemnity clause in which the plaintiff covenants to indemnify the settling defendants for any portion of the damages that a court may determine to be attributable to their fault and for which the non-settling defendants would otherwise be liable due to the principle of joint and several liability. Alternatively, the plaintiff may covenant not to pursue the non-settling defendants for that portion of the liability that a court may determine to be attributable to the fault of the settling defendants. It is the latter approach that prevails in the agreement at issue

in this suit, but in either case the goal of the proportionate share settlement agreement is to limit the liability of the non-settling party to its several liability.

The Competing Positions

17 This court recently considered the validity of a "new generation" settlement agreement in Margetts v. Timmer Estate, [1997] 1 W.W.R. 25 (Q.B.), aff'd (1999) 178 D.L.R. (4th) 577 (C.A.). There, the trial court recognized and this court affirmed that a tortfeasor has a legitimate and "undoubted right to contract to minimize his financial exposure to the plaintiffs": at W.W.R. 39.

18 However, in Margetts, supra, the settlement was in the nature of a Mary Carter agreement, which did not completely remove the settling defendants from the suit. As the settling parties continued to be adversarial in interest, a non-settling party remained entitled to full pre-trial disclosure from them. In Margetts, therefore, the court did not need to reconcile settlement rights with a non-settling defendant's ability to exercise its pre-trial procedural rights in an effort to deflect the plaintiff's accusation of fault.

19 In addition to being grounded in fundamental principles of justice and framed in the Alberta Rules of Court, a non-settling defendant's ability to defend against a suit is anchored in the statutory requirement found in s. 2(1) of the Contributory Negligence Act:

> 2(1) When damage or loss has been caused by the fault of 2 or more persons, the court shall determine the degree in which each person was at fault.

20 The effect of this provision is to compel the court to determine the degrees of fault of all contributors to the plaintiffs' damage, whether or not they currently are or ever have been parties to the action. In effect, this provision acts as a safeguard to establish the proportionate share of each defendant's liability, whether settling or non-settling.

21 It therefore becomes apparent that the right to settle, fixing a settling defendant's financial liability to the plaintiff through contract, may have a direct effect on a non-settling defendant's pre-trial rights of discovery and production of documents in order to gather evidence to defend the lawsuit.

The B.C. Ferry Approach

22 The Canadian cases in which proportionate share settlement agreements have been considered attempt to balance the right to settle against the right to pre-trial disclosure. One approach is represented by the decision of the British Columbia Court of Appeal in British Columbia Ferry Corp. et al. v. T&N plc. et al. (1995), 27 C.C.L.T. (2d) 287. There, the court decided that the non-settling defendants could not maintain a claim for contribution or indemnity against third parties that had settled with the plaintiffs, pursuant to the terms of a proportionate share settlement agreement. However, the court allowed the non-settling defendants to maintain a claim for a

declaration to determine the degree to which the plaintiff's damages were attributable to the settling defendants. The court therefore permitted the action for declaratory relief to remain, keeping the settling defendants in the lawsuit for the purely procedural purpose of allowing the non-settling parties access to pre-trial procedural rights.

23 The court concluded that the non-settling defendants would be prejudiced in establishing the fault of the third parties, and thus in maintaining their own defence, if they did not retain the benefit of full pre-trial procedural rights against the settling parties: at 302. The decision is based on the proposition that it would be "manifestly wrong if a private accord between plaintiff and third party could work to deprive a defendant of the ability to establish an element of proof essential to a just resolution of the action": at 302 (emphasis added).

24 The difficulty with the B.C. Ferry approach is its emphasis on the potential prejudice a non-settling party might suffer. Indeed, it is likely that a non-settling party will always be able to allege some possible disadvantage when it remains as the sole target for liability after other parties abandon the litigation. That is true whether a partial settlement occurs during the course of litigation or even before an action is launched. The B.C. Ferry approach would seem to permit an action for declaratory relief to be maintained for purely procedural purposes against anyone who settled, whether or not they were ever a named party to the litigation, and even though there were no possibility that they might be liable.

25 Litigation, including settlement, is all about advantage, and corresponding disadvantage or prejudice. Settlement, after all, is nothing more than a compromise, in which parties gamble by trading prospective rights for certainty. Nor does prejudice run in only one direction. Failure to allow settlement by parties who want an exit ramp from costly and prolonged litigation may give a party who refuses to settle an even stronger tactical advantage. An unreasonable party can hold the other parties at ransom, virtually dictating the terms of settlement.

26 It is argued that without complete pre-trial disclosure a court will be unable to properly apportion the loss. This argument cuts both ways. The plaintiff always bears the burden of proof at trial. By agreeing to remove the settling defendants from the suit and focussing only on the non-settling defendant's alleged misdeeds, a plaintiff runs the risk of no recovery at trial, for it may fail to prove any basis on which a trial court could assign liability to the non-settling party. Decisions to settle with some but not all defendants give rise to challenging issues. What use can be made by the non-settling defendant of settling defendants' discoveries? Will adverse inferences be drawn against the plaintiff if it does not call settling defendants as witnesses? A plaintiff may encounter considerable obstacles in its attempt to recover any damages. It by no means follows that as a result of a partial settlement the non-settling defendant will shoulder a greater portion of the liability than it ought.

27 The B.C. Ferry approach undervalues the importance of settlement. In these days of spiralling litigation costs, increasingly complex cases and scarce judicial resources, settlement is critical to the

administration of justice. The Supreme Court of Canada noted the strong public policy reason which encourages settlement in Kelvin Energy v. Lee, [1992] 3 S.C.R. 235 at 259, citing Sparling v. Southam Inc. et al. (1988), 66 O.R. (2d) 225 at 230 (H.C.J.):

> [T]he Courts consistently favour the settlement of lawsuits in general. To put it another way, there is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial Court system.

[Emphasis deleted.]

In Gelata v. Alberta (1996), 193 A.R. 67 at 69 (C.A.), this court recognized that "public policy is to encourage compromise, whether it is partial or full".

28 Indeed, the Court of Queen's Bench of Alberta gives a high priority towards settlement. It has devoted considerable judicial resources to a successful judicial dispute resolution initiative and case management program. Proportionate share settlement agreements are most likely to be used in complex multi-party lawsuits, which are expected to consume more than 25 days of trial time. Such cases are considered to be "very long" trials which are subject to mandatory case management under Court of Queen's Bench of Alberta Civil Practice Note No. 7 - The Very Long Trial (September 1, 1995). Practice Note No. 7 focuses on full or partial settlement. One of its purposes is "to canvass settlement or other disposition of all or as many of the issues as possible" (s. 23). It provides for mandatory settlement conferences, "to settle some or all of the issues in the action" (s. 48). In decisions upholding proportionate share settlement agreements, Alberta trial courts have relied upon the public policy reason which supports settlement: Slaferek v. TCG International Inc. (1997), 46 Alta. L.R. (3d) 279 at 286 (Q.B.); and Wright (Next friend of) v. VIA Rail Canada Inc. (2000), 76 Alta. L.R. (3d) 166 at 175 (Q.B.).

Potential Prejudice

29 Alberta courts have grappled with the B.C. Ferry approach, attempting to balance the certain benefit of settlement against the potential problem of prejudice. Faced with the difficulty of predicting future prejudice, they have looked to the past, assessing such things as the age and complexity of the action; the number of parties involved; how long the present structure of defendants and third parties has been in place; at what stage in the proceedings the application was made; whether discoveries have taken place, documents been produced and expert reports exchanged; whether a trial date has been set; delays and the reason for them; and whether the non-settling party has diligently exercised discovery rights. See Slaferek, supra; Viridian Inc. v. Dresser Canada Inc. (1999), 73 Alta. L.R. (3d) 348 at 363 (Q.B.); Vandevelde v. Smith (1999), 243 A.R. 161 (Q.B.); and Wright, supra.

30 Generally, the longer the action has been in existence and the greater the pre-trial disclosure received by the non-settling defendant, the less likely an Alberta judge will find potential prejudice and the more likely the settlement agreement will be given effect. See Slaferek, supra; and Wright, supra. Indeed, that approach was followed in the present case. The case management judge concluded that because Propak had the advantage of significant oral examination and discovery of documents, it was "clearly better off" than if the settling parties had not been sued or had been formally released by the plaintiffs from the outset, and would not "in any way" be disadvantaged or prejudiced (AB I at 105).

31 This approach has a number of flaws. First, the analysis tends to be superficial and the conclusions unpersuasive. From a pre-trial disclosure point of view, most parties will be better off at a more advanced stage in the litigation process. But a non-settling party, although better off, could still be disadvantaged if a court were to truncate its pre-trial procedural rights by giving effect to a proportionate share settlement agreement. No matter how dilatory the defendant has been, no matter how interminable its efforts to mine for information, the potential always exists for the next discovery question it asks to be the one that blows the litigation apart. It is difficult for any judge to definitively conclude that there is no potential for prejudice.

32 A second flaw is that this approach always favours settlement at advanced stages rather than earlier stages of litigation. But public policy dictates otherwise. Early settlement means reduced legal costs and less strain on the court system. In modern, complex litigation, it is the pre-trial skirmishes that consume most of the court's calendar. The surge in the number of cases under case management, and the need for intricate practice notes regulating long trials, such as Practice Note No. 7, confirm this.

33 A third flaw is that it gives little guidance to judges, and creates uncertainty for litigants. Because courts are looking at potential rather than actual prejudice, they sometimes have a difficult time evaluating the competing positions. In Viridian, supra at 363, for example, the judge noted that he did not "have a clear appreciation of the comparative procedural consequences" and was uncertain whether the negative effects would be of substantial significance. He concluded that "the appropriate response to my uncertainty [...] is to maintain the existing structure of this action".

34 A test which institutionalizes this degree of uncertainty is no test at all. By properly drafting a proportionate share settlement agreement, settling parties can ensure that a non-settling defendant is responsible only for its proportionate share of the loss. But a non-settling defendant can always assert some form of potential prejudice, which settling parties cannot avoid by contractual means. Litigants will no doubt be reluctant to spend time evaluating their legal position and displaying their hand in settlement negotiations if there is little ability to predict whether a proportionate share settlement agreement will be given effect by the court.

35 The fundamental problem with the current approach is that it requires judges to balance two competing interests, but gives judges few tools with which to do so. The Alberta Rules of Court

contain no express rule permitting third party discovery and at least to this point, no one has come up with a creative way of achieving equivalent disclosure by practice note, statute or private agreement.

36 Judges in other jurisdictions do not face the same difficulty. For example, in Ontario New Home Warranty Program v. Chevron Chemical Co. (1999), 46 O.R. (3d) 130 (Sup. Ct. Just.) the court evaluated the non-settling defendant's procedural objections in light of the public policy which encourages settlement, concluding that the procedural complaints could be addressed without "a wholesale rejection of the proposed settlement agreement": at 147. The court made specific orders requiring pre-trial disclosure by the settling parties, as permitted by the Ontario class action statute being considered in that case. See also The Ontario Rules of Civil Procedure, R.R.O. 1990, Reg. 194, R. 31.10 and British Columbia Supreme Court Civil Rules, B.C. Reg. 221/90, R. 28(1), which permit parties to apply to examine on discovery third parties, who may have information relevant to a material issue in an action.

37 Alberta judges do not enjoy this type of flexibility. Because they can do little to remedy potential prejudice, the so-called balance they are supposed to achieve is no balance at all: to uphold a settlement agreement, a judge must conclude that there is little or no potential for prejudice. But in reality, curtailing pre-trial disclosure rights will almost always result in possible procedural disadvantage to the non-settling defendant. In most cases the disadvantage does not stem from the fact of settlement, but from the pre-trial disclosure regime which exists in this province. It is therefore more productive to focus on the cause, rather than the potential for prejudice.

38 Alberta's current pre-trial disclosure regime severely restricts third party discovery rights. This limitation, which affects all litigants equally, should not be equated to prejudice. Nor should it be used to justify jettisoning proportionate share settlement agreements in this province. A better solution is to introduce some form of third party discovery in Alberta, to address the type of procedural complaints levied in this case. The fact that non-settling defendants are confined to a statutory disclosure regime constrained by the Alberta Rules of Court is not a proper basis for refusing to give effect to proportionate share settlement agreements.

39 It is one thing when the Alberta Rules of Court limit rights of pre-trial disclosure. It is another matter entirely when settling parties deliberately thwart a non-settling party's ability to get at the truth. Courts need not countenance agreements containing express provisions that narrow the procedural rights a non-settling defendant would otherwise have or create other obstacles, for example, prohibiting a settling party from cooperating with a non-settling party, participating in interviews, or voluntarily making documents available.

40 A proportionate share settlement agreement should be disclosed to the non-settling party: Hudson Bay Mining & Smelting Co. v. Fluor Daniel Wright, [1997] 10 W.W.R. 622 (Q.B.), aff'd (1998) 131 Man. R. (2d) 133 (C.A.). To ensure that the trial judge is aware of the circumstances under which the non-settling defendant has operated, the terms of the agreement, although not

necessarily the amount of the settlement, should also be disclosed to the court.

Summary

41 In summary, in evaluating proportionate share settlement agreements:

1. A court must keep in mind the strong public policy reason which encourages settlement;
2. The fact that a non-settling defendant has restricted rights of third party disclosure under the Alberta Rules of Court does not justify refusing to give effect to a proportionate share settlement agreement;
3. A court need not approve a proportionate share settlement agreement containing contractual provisions that directly limit the procedural rights a non-settling defendant would otherwise have; and
4. A proportionate share settlement agreement should be disclosed to the non-settling party. To further reduce potential prejudice, the terms of the agreement, although not necessarily the amount of the settlement, should also be disclosed to the court.

APPLICATION

42 The case management judge decided that Propak's liability was strictly limited to its own several liability to the plaintiffs and that it faced "no exposure for anything beyond that" as all claims, including claims for contribution and indemnity, had been settled (AB I at 100). That finding was not attacked by Propak on appeal. However, during oral argument the panel asked whether Propak asserted that its third party notices established independent duties which continue to give rise to a claim for indemnification.

43 Some confusion exists about claims for contribution and claims for indemnity. Although it is common practice for multiple defendants to issue cross-claims against one another seeking "contribution and indemnity" in respect of the plaintiff's loss, a claim for contribution is usually based on s. 2 of the Contributory Negligence Act and s. 3 of the Tort-feasors Act, R.S.A. 1980, c. T-6. The combined effect of these statutory provisions is the creation of joint and several liability, whereby a plaintiff may claim the whole of its loss from any one defendant, and that defendant may in turn claim contribution from the other defendants in proportion to their respective degree of fault. In contrast to the statutory basis for a claim for contribution, a claim for indemnity is grounded in either contract or tort, arising from an independent duty of care that one defendant or third party owed to another.

44 Proportionate share settlement agreements are relatively straightforward when all defendants are potentially liable to the plaintiff. A settlement is proper so long as the non-settling defendant's liability is strictly limited to the loss it actually caused. The situation is more complicated when the non-settling defendant has issued a third party notice claiming an independent duty that is owed to

it, but not to the plaintiff. A settlement cannot extinguish the non-settling defendant's entitlement to indemnification from the third party unless it also extinguishes the non-settling defendant's liability to the plaintiff in respect of claims for which it could seek indemnification from the third party.

45 Propak was invited to present additional written submissions on these points, but did not avail itself of this opportunity. Having reviewed the settlement agreement, amended statement of claim and pleadings, we see no reason to question the case management judge's determination that Propak faces no exposure beyond its several liability for which it has no remaining right to indemnification.

46 The case management judge distinguished B.C. Ferry, supra, in which an action for declaratory relief was permitted to remain for purely procedural purposes, on the basis that no claim for declaratory relief had been advanced in this case. While B.C. Ferry should not be applied, the case need not have been distinguished on this basis. In Alberta, claims for declaratory relief are rarely maintained for purely procedural purposes; instead a legal right or interest must be at stake: Brown v. Alberta (1999), 64 Alta. L.R. (3d) 62 at 74 (Q.B.). Whether or not the non-settling party has asked for a declaration setting out its proportionate share of fault, a court is compelled to determine the degree of fault of all contributors to a plaintiff's damages, pursuant to s. 2(1) of the Contributory Negligence Act. The presence, or absence, of a request for declaratory relief adds little to the analytical framework and is not a factor which weighs in the balance.

47 The case management judge commented that "it would be a rare case [...] in which optimizing a non-settling party's access to discovery and/or production of documents would outweigh the benefits of a multi-party settlement and a shortened trial" (AB I at 105). He therefore properly considered the strong public policy reason which favours settlement. The judge noted that under the Rules only parties who are adverse in interest have discovery rights and that no such rights would exist with respect to the settling parties, who would be "mere witnesses". He commented that Propak "would have full recourse to all rights of subpoena and production which would apply to any party seeking to call evidence in a civil trial in Alberta" (AB I at 105). He therefore recognized that potential prejudice which arises as a result of the third party disclosure regime in the Alberta Rules of Court is not a proper basis for refusing to give effect to a proportionate share settlement agreement.

48 The case management judge did not mention disclosure provisions contained in the agreement, although he undoubtedly considered them. In fact, they do not limit Propak's procedural rights. Section 10 requires the settling defendants to cooperate with the plaintiffs, by making witnesses, documents and expert reports available to them, but does not restrict the settling defendants from cooperating with Propak. As Propak has a continuing right to examine the plaintiffs, it will also be entitled to any documents received by the plaintiffs from the settling defendants. Section 11 provides for disclosure of the settlement agreement to both Propak and the Court of Queen's Bench.

49 Propak has failed to show that the case management judge erred.

OTHER ISSUES

50 Propak has advanced several other issues in this appeal, which will be dealt with summarily.

51 Although R. 77 requires that a notice to a co-defendant be filed and served within ten days after filing a defence, Propak filed notices to co-defendants more than five years after its statement of defence. Propak sought leave for late filing in the application heard by the case management judge on September 3, 1999. The judge declined to grant leave. Noting that the delay was inordinate, he found the real issue to be whether Propak had advanced a reasonable excuse for the delay. On the evidence before him, he was unable to make such a finding (AB I at 111). Propak appeals this decision.

52 In light of the decision giving effect to the proportionate share settlement agreement, this issue is academic.

53 Second, Propak asks that this court "deem [it] released along with [the] other joint tortfeasors" on the basis of its interpretation of the Tort-feasors Act, R.S.A. 1980, c. T-6 (Propak's Factum at 26). Whether the settling defendants and Propak are joint tort-feasors is a question of mixed fact and law, requiring an evidentiary basis and fact finding. Whether a proper interpretation of the Tort-feasors Act supports Propak's release from this action is a question of law. Neither issue was put before the case management judge and no evidence was adduced. It is inappropriate for this court to consider such questions for the first time on appeal.

54 Finally, Propak asks this court to provide guidance on the procedural and substantive limits they have "as to what response they may make to the restructured lawsuit" (Propak's Factum at 26). As a court of appeal sitting in review, it is not our job to provide this type of guidance. Propak should address its request to the case management judge.

55 The appeal is dismissed.

FRUMAN J.A.
CONRAD J.A.:-- I concur.
SULATYCKY J.A.:-- I concur.

* * * * *

ERRATUM

Released: February 6, 2002.

An Errata has been issued for the above reasons for judgment reserved. The correction made is as follows:

On page 12, paragraph 52 of the reasons, the sentence:

> "In any event, a review of the evidence filed in support of Propak's leave application indicates no error in the casee management judge's conclusion."

has been deleted.

Please replace your present page 12 with this new amended version.

FRUMAN J.A.

cp/i/qljpn/qlmjb

Case Name:

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

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 and Arrangement involving Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 4446372 Canada Inc. and 6932819 Canada Inc., Trustees of the Conduits Listed In Schedule "A" Hereto

Between

The Investors represented on the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper listed in Schedule "B" hereto, Applicants (Respondents in Appeal), and Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits listed in Schedule "A" hereto, Respondents (Respondents in Appeal), and Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal Inc., Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Domtar Inc., Domtar Pulp and Paper Products Inc., GIRO Inc., Vêtements de sports R.G.R. Inc., 131519 Canada Inc., Air Jazz LP, Petrifond Foundation Company Limited, Petrifond Foundation Midwest Limited, Services hypothécaires la patrimoniale Inc., TECSYS Inc., Société générale de financement du Québec, VibroSystM

Inc., Interquisa Canada L.P., Redcorp Ventures Ltd., Jura Energy Corporation, Ivanhoe Mines Ltd., WebTech Wireless Inc., Wynn Capital Corporation Inc., Hy Bloom Inc., Cardacian Mortgage Services, Inc., West Energy Ltd., Sabre Enerty Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd. and Standard Energy Inc., Respondents (Appellants)

[2008] O.J. No. 3164

2008 ONCA 587

45 C.B.R. (5th) 163

296 D.L.R. (4th) 135

2008 CarswellOnt 4811

168 A.C.W.S. (3d) 698

240 O.A.C. 245

47 B.L.R. (4th) 123

92 O.R. (3d) 513

Docket: C48969 (M36489)

Ontario Court of Appeal
Toronto, Ontario

J.I. Laskin, E.A. Cronk and R.A. Blair JJ.A.

Heard: June 25-26, 2008.
Judgment: August 18, 2008.

(121 paras.)

Bankruptcy and insolvency law -- Proceedings in bankruptcy and insolvency -- Practice and procedure -- General principles -- Legislation -- Interpretation -- Courts -- Jurisdiction -- Federal -- Companies' Creditors Arrangement Act -- Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal sanctioning of that Plan -- Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of

Compromise and Arrangement that formed the subject matter of the proceedings -- Plan dealt with liquidity crisis threatening Canadian market in Asset Backed Commercial Paper -- Plan was sanctioned by court -- Leave to appeal allowed and appeal dismissed -- CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court -- Companies' Creditors Arrangement Act, ss. 4, 6.

Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal the sanctioning of that Plan. In August 2007, a liquidity crisis threatened the Canadian market in Asset Backed Commercial Paper (ABCP). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on US sub-prime mortgages. By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007, pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that formed the subject matter of the proceedings. The Plan was sanctioned on June 5, 2008. The applicants raised an important point regarding the permissible scope of restructuring under the Companies' Creditors Arrangement Act: could the court sanction a Plan that called for creditors to provide releases to third parties who were themselves insolvent and not creditors of the debtor company? They also argued that if the answer to that question was yes, the application judge erred in holding that the Plan, with its particular releases (which barred some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

HELD: Application for leave to appeal allowed and appeal dismissed. The appeal raised issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There were serious and arguable grounds of appeal and the appeal would not unduly delay the progress of the proceedings. In the circumstances, the criteria for granting leave to appeal were met. Respecting the appeal, the CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where the releases were reasonably connected to the proposed restructuring. The wording of the CCAA, construed in light of the purpose, objects and scheme of the Act, supported the court's jurisdiction and authority to sanction the Plan proposed in this case, including the contested third-party releases contained in it. The Plan was fair and reasonable in all the circumstances.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3,

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 4, s. 6

Constitution Act, 1867, R.S.C. 1985, App. II, No. 5, s. 91(21), s. 92(13)

Appeal From:

On appeal from the sanction order of Justice Colin L. Campbell of the Superior Court of Justice, dated June 5, 2008, with reasons reported at [2008] O.J. No. 2265.

Counsel:

See Schedule "A" for the list of counsel.

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

A. INTRODUCTION

1 In August 2007 a liquidity crisis suddenly threatened the Canadian market in Asset Backed Commercial Paper ("ABCP"). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on U.S. sub-prime mortgages. The loss of confidence placed the Canadian financial market at risk generally and was reflective of an economic volatility worldwide.

2 By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007 pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee, chaired by Purdy Crawford, C.C., Q.C., was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that forms the subject-matter of these proceedings. The Plan was sanctioned by Colin L. Campbell J. on June 5, 2008.

3 Certain creditors who opposed the Plan seek leave to appeal and, if leave is granted, appeal from that decision. They raise an important point regarding the permissible scope of a restructuring under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended ("CCAA"): can the court sanction a Plan that calls for creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company? They also argue that, if the answer to this question is yes, the application judge erred in holding that this Plan, with its particular releases (which bar some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

Leave to Appeal

4 Because of the particular circumstances and urgency of these proceedings, the court agreed to collapse an oral hearing for leave to appeal with the hearing of the appeal itself. At the outset of argument we encouraged counsel to combine their submissions on both matters.

5 The proposed appeal raises issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There are serious and arguable grounds of appeal and -- given the expedited time-table -- the appeal will not unduly delay the progress of the proceedings. I am satisfied that the criteria for granting leave to appeal in CCAA proceedings, set out in such cases as *Re Cineplex Odeon Corp.* (2001), 24 C.B.R. (4th) 21 (Ont. C.A.), and *Re Country Style Food Services* (2002), 158 O.A.C. 30, are met. I would grant leave to appeal.

Appeal

6 For the reasons that follow, however, I would dismiss the appeal.

B. FACTS

The Parties

7 The appellants are holders of ABCP Notes who oppose the Plan. They do so principally on the basis that it requires them to grant releases to third party financial institutions against whom they say they have claims for relief arising out of their purchase of ABCP Notes. Amongst them are an airline, a tour operator, a mining company, a wireless provider, a pharmaceuticals retailer, and several holding companies and energy companies.

8 Each of the appellants has large sums invested in ABCP -- in some cases, hundreds of millions of dollars. Nonetheless, the collective holdings of the appellants -- slightly over $1 billion -- represent only a small fraction of the more than $32 billion of ABCP involved in the restructuring.

9 The lead respondent is the Pan-Canadian Investors Committee which was responsible for the creation and negotiation of the Plan on behalf of the creditors. Other respondents include various major international financial institutions, the five largest Canadian banks, several trust companies, and some smaller holders of ABCP product. They participated in the market in a number of different ways.

The ABCP Market

10 Asset Backed Commercial Paper is a sophisticated and hitherto well-accepted financial instrument. It is primarily a form of short-term investment -- usually 30 to 90 days -- typically with a low interest yield only slightly better than that available through other short-term paper from a government or bank. It is said to be "asset backed" because the cash that is used to purchase an ABCP Note is converted into a portfolio of financial assets or other asset interests that in turn provide security for the repayment of the notes.

11 ABCP was often presented by those selling it as a safe investment, somewhat like a guaranteed investment certificate.

12 The Canadian market for ABCP is significant and administratively complex. As of August

2007, investors had placed over $116 billion in Canadian ABCP. Investors range from individual pensioners to large institutional bodies. On the selling and distribution end, numerous players are involved, including chartered banks, investment houses and other financial institutions. Some of these players participated in multiple ways. The Plan in this proceeding relates to approximately $32 billion of non-bank sponsored ABCP the restructuring of which is considered essential to the preservation of the Canadian ABCP market.

13 As I understand it, prior to August 2007 when it was frozen, the ABCP market worked as follows.

14 Various corporations (the "Sponsors") would arrange for entities they control ("Conduits") to make ABCP Notes available to be sold to investors through "Dealers" (banks and other investment dealers). Typically, ABCP was issued by series and sometimes by classes within a series.

15 The cash from the purchase of the ABCP Notes was used to purchase assets which were held by trustees of the Conduits ("Issuer Trustees") and which stood as security for repayment of the notes. Financial institutions that sold or provided the Conduits with the assets that secured the ABCP are known as "Asset Providers". To help ensure that investors would be able to redeem their notes, "Liquidity Providers" agreed to provide funds that could be drawn upon to meet the demands of maturing ABCP Notes in certain circumstances. Most Asset Providers were also Liquidity Providers. Many of these banks and financial institutions were also holders of ABCP Notes ("Noteholders"). The Asset and Liquidity Providers held first charges on the assets.

16 When the market was working well, cash from the purchase of new ABCP Notes was also used to pay off maturing ABCP Notes; alternatively, Noteholders simply rolled their maturing notes over into new ones. As I will explain, however, there was a potential underlying predicament with this scheme.

The Liquidity Crisis

17 The types of assets and asset interests acquired to "back" the ABCP Notes are varied and complex. They were generally long-term assets such as residential mortgages, credit card receivables, auto loans, cash collateralized debt obligations and derivative investments such as credit default swaps. Their particular characteristics do not matter for the purpose of this appeal, but they shared a common feature that proved to be the Achilles heel of the ABCP market: because of their long-term nature there was an inherent timing mismatch between the cash they generated and the cash needed to repay maturing ABCP Notes.

18 When uncertainty began to spread through the ABCP marketplace in the summer of 2007, investors stopped buying the ABCP product and existing Noteholders ceased to roll over their maturing notes. There was no cash to redeem those notes. Although calls were made on the Liquidity Providers for payment, most of the Liquidity Providers declined to fund the redemption of the notes, arguing that the conditions for liquidity funding had not been met in the circumstances.

Hence the "liquidity crisis" in the ABCP market.

19 The crisis was fuelled largely by a lack of transparency in the ABCP scheme. Investors could not tell what assets were backing their notes -- partly because the ABCP Notes were often sold before or at the same time as the assets backing them were acquired; partly because of the sheer complexity of certain of the underlying assets; and partly because of assertions of confidentiality by those involved with the assets. As fears arising from the spreading U.S. sub-prime mortgage crisis mushroomed, investors became increasingly concerned that their ABCP Notes may be supported by those crumbling assets. For the reasons outlined above, however, they were unable to redeem their maturing ABCP Notes.

The Montreal Protocol

20 The liquidity crisis could have triggered a wholesale liquidation of the assets, at depressed prices. But it did not. During the week of August 13, 2007, the ABCP market in Canada froze -- the result of a standstill arrangement orchestrated on the heels of the crisis by numerous market participants, including Asset Providers, Liquidity Providers, Noteholders and other financial industry representatives. Under the standstill agreement -- known as the Montréal Protocol -- the parties committed to restructuring the ABCP market with a view, as much as possible, to preserving the value of the assets and of the notes.

21 The work of implementing the restructuring fell to the Pan-Canadian Investors Committee, an applicant in the proceeding and respondent in the appeal. The Committee is composed of 17 financial and investment institutions, including chartered banks, credit unions, a pension board, a Crown corporation, and a university board of governors. All 17 members are themselves Noteholders; three of them also participated in the ABCP market in other capacities as well. Between them, they hold about two thirds of the $32 billion of ABCP sought to be restructured in these proceedings.

22 Mr. Crawford was named the Committee's chair. He thus had a unique vantage point on the work of the Committee and the restructuring process as a whole. His lengthy affidavit strongly informed the application judge's understanding of the factual context, and our own. He was not cross-examined and his evidence is unchallenged.

23 Beginning in September 2007, the Committee worked to craft a plan that would preserve the value of the notes and assets, satisfy the various stakeholders to the extent possible, and restore confidence in an important segment of the Canadian financial marketplace. In March 2008, it and the other applicants sought CCAA protection for the ABCP debtors and the approval of a Plan that had been pre-negotiated with some, but not all, of those affected by the misfortunes in the Canadian ABCP market.

The Plan

a) Plan Overview

24 Although the ABCP market involves many different players and kinds of assets, each with their own challenges, the committee opted for a single plan. In Mr. Crawford's words, "all of the ABCP suffers from common problems that are best addressed by a common solution." The Plan the Committee developed is highly complex and involves many parties. In its essence, the Plan would convert the Noteholders' paper -- which has been frozen and therefore effectively worthless for many months -- into new, long-term notes that would trade freely, but with a discounted face value. The hope is that a strong secondary market for the notes will emerge in the long run.

25 The Plan aims to improve transparency by providing investors with detailed information about the assets supporting their ABCP Notes. It also addresses the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on the new notes. Further, the Plan adjusts some of the underlying credit default swap contracts by increasing the thresholds for default triggering events; in this way, the likelihood of a forced liquidation flowing from the credit default swap holder's prior security is reduced and, in turn, the risk for ABCP investors is decreased.

26 Under the Plan, the vast majority of the assets underlying ABCP would be pooled into two master asset vehicles (MAV1 and MAV2). The pooling is designed to increase the collateral available and thus make the notes more secure.

27 The Plan does not apply to investors holding less than $1 million of notes. However, certain Dealers have agreed to buy the ABCP of those of their customers holding less than the $1-million threshold, and to extend financial assistance to these customers. Principal among these Dealers are National Bank and Canaccord, two of the respondent financial institutions the appellants most object to releasing. The application judge found that these developments appeared to be designed to secure votes in favour of the Plan by various Noteholders, and were apparently successful in doing so. If the Plan is approved, they also provide considerable relief to the many small investors who find themselves unwittingly caught in the ABCP collapse.

b) The Releases

28 This appeal focuses on one specific aspect of the Plan: the comprehensive series of releases of third parties provided for in Article 10.

29 The Plan calls for the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants -- in Mr. Crawford's words, "virtually all participants in the Canadian ABCP market" -- from any liability associated with ABCP, with the exception of certain narrow claims relating to fraud. For instance, under the Plan as approved, creditors will have to give up their claims against the Dealers who sold them their ABCP Notes, including challenges to the way the Dealers characterized the ABCP and provided (or did not provide) information about the ABCP. The claims against the proposed defendants are mainly in

tort: negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/advisor, acting in conflict of interest, and in a few cases fraud or potential fraud. There are also allegations of breach of fiduciary duty and claims for other equitable relief.

30 The application judge found that, in general, the claims for damages include the face value of the Notes, plus interest and additional penalties and damages.

31 The releases, in effect, are part of a *quid pro quo*. Generally speaking, they are designed to compensate various participants in the market for the contributions they would make to the restructuring. Those contributions under the Plan include the requirements that:

a) Asset Providers assume an increased risk in their credit default swap contracts, disclose certain proprietary information in relation to the assets, and provide below-cost financing for margin funding facilities that are designed to make the notes more secure;
b) Sponsors -- who in addition have cooperated with the Investors' Committee throughout the process, including by sharing certain proprietary information -- give up their existing contracts;
c) The Canadian banks provide below-cost financing for the margin funding facility and,
d) Other parties make other contributions under the Plan.

32 According to Mr. Crawford's affidavit, the releases are part of the Plan "because certain key participants, whose participation is vital to the restructuring, have made comprehensive releases a condition for their participation."

The CCAA Proceedings to Date

33 On March 17, 2008 the applicants sought and obtained an Initial Order under the CCAA staying any proceedings relating to the ABCP crisis and providing for a meeting of the Noteholders to vote on the proposed Plan. The meeting was held on April 25th. The vote was overwhelmingly in support of the Plan -- 96% of the Noteholders voted in favour. At the instance of certain Noteholders, and as requested by the application judge (who has supervised the proceedings from the outset), the Monitor broke down the voting results according to those Noteholders who had worked on or with the Investors' Committee to develop the Plan and those Noteholders who had not. Re-calculated on this basis the results remained firmly in favour of the proposed Plan -- 99% of those connected with the development of the Plan voted positively, as did 80% of those Noteholders who had not been involved in its formulation.

34 The vote thus provided the Plan with the "double majority" approval -- a majority of creditors representing two-thirds in value of the claims -- required under s. 6 of the CCAA.

35 Following the successful vote, the applicants sought court approval of the Plan under s. 6.

Hearings were held on May 12 and 13. On May 16, the application judge issued a brief endorsement in which he concluded that he did not have sufficient facts to decide whether all the releases proposed in the Plan were authorized by the CCAA. While the application judge was prepared to approve the releases of negligence claims, he was not prepared at that point to sanction the release of fraud claims. Noting the urgency of the situation and the serious consequences that would result from the Plan's failure, the application judge nevertheless directed the parties back to the bargaining table to try to work out a claims process for addressing legitimate claims of fraud.

36 The result of this renegotiation was a "fraud carve-out" -- an amendment to the Plan excluding certain fraud claims from the Plan's releases. The carve-out did not encompass all possible claims of fraud, however. It was limited in three key respects. First, it applied only to claims against ABCP Dealers. Secondly, it applied only to cases involving an express fraudulent misrepresentation made with the intention to induce purchase and in circumstances where the person making the representation knew it to be false. Thirdly, the carve-out limited available damages to the value of the notes, minus any funds distributed as part of the Plan. The appellants argue vigorously that such a limited release respecting fraud claims is unacceptable and should not have been sanctioned by the application judge.

37 A second sanction hearing -- this time involving the amended Plan (with the fraud carve-out) -- was held on June 3, 2008. Two days later, Campbell J. released his reasons for decision, approving and sanctioning the Plan on the basis both that he had jurisdiction to sanction a Plan calling for third-party releases and that the Plan including the third-party releases in question here was fair and reasonable.

38 The appellants attack both of these determinations.

C. LAW AND ANALYSIS

39 There are two principal questions for determination on this appeal:

1) As a matter of law, may a CCAA plan contain a release of claims against anyone other than the debtor company or its directors?
2) If the answer to that question is yes, did the application judge err in the exercise of his discretion to sanction the Plan as fair and reasonable given the nature of the releases called for under it?

(1) Legal Authority for the Releases

40 The standard of review on this first issue -- whether, as a matter of law, a CCAA plan may contain third-party releases -- is correctness.

41 The appellants submit that a court has no jurisdiction or legal authority under the CCAA to sanction a plan that imposes an obligation on creditors to give releases to third parties other than the

directors of the debtor company.[1] The requirement that objecting creditors release claims against third parties is illegal, they contend, because:

a) on a proper interpretation, the CCAA does not permit such releases;
b) the court is not entitled to "fill in the gaps" in the CCAA or rely upon its inherent jurisdiction to create such authority because to do so would be contrary to the principle that Parliament did not intend to interfere with private property rights or rights of action in the absence of clear statutory language to that effect;
c) the releases constitute an unconstitutional confiscation of private property that is within the exclusive domain of the provinces under s. 92 of the *Constitution Act*, 1867;
d) the releases are invalid under Quebec rules of public order; and because
e) the prevailing jurisprudence supports these conclusions.

42 I would not give effect to any of these submissions.

Interpretation, "Gap Filling" and Inherent Jurisdiction

43 On a proper interpretation, in my view, the CCAA permits the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where those releases are reasonably connected to the proposed restructuring. I am led to this conclusion by a combination of (a) the open-ended, flexible character of the CCAA itself, (b) the broad nature of the term "compromise or arrangement" as used in the Act, and (c) the express statutory effect of the "double-majority" vote and court sanction which render the plan binding on all creditors, including those unwilling to accept certain portions of it. The first of these signals a flexible approach to the application of the Act in new and evolving situations, an active judicial role in its application and interpretation, and a liberal approach to that interpretation. The second provides the entrée to negotiations between the parties affected in the restructuring and furnishes them with the ability to apply the broad scope of their ingenuity in fashioning the proposal. The latter afford necessary protection to unwilling creditors who may be deprived of certain of their civil and property rights as a result of the process.

44 The CCAA is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme. The scope of the Act and the powers of the court under it are not limitless. It is beyond controversy, however, that the CCAA is remedial legislation to be liberally construed in accordance with the modern purposive approach to statutory interpretation. It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy: *Canadian Red Cross Society (Re)* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.). As Farley J. noted in *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 at 111 (Ont. Gen. Div.), "[t]he history of CCAA law has been an evolution of judicial interpretation."

45 Much has been said, however, about the "evolution of judicial interpretation" and there is some controversy over both the source and scope of that authority. Is the source of the court's authority statutory, discerned solely through application of the principles of statutory interpretation, for example? Or does it rest in the court's ability to "fill in the gaps" in legislation? Or in the court's inherent jurisdiction?

46 These issues have recently been canvassed by the Honourable Georgina R. Jackson and Dr. Janis Sarra in their publication "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters,"[2] and there was considerable argument on these issues before the application judge and before us. While I generally agree with the authors' suggestion that the courts should adopt a hierarchical approach in their resort to these interpretive tools -- statutory interpretation, gap-filling, discretion and inherent jurisdiction -- it is not necessary in my view to go beyond the general principles of statutory interpretation to resolve the issues on this appeal. Because I am satisfied that it is implicit in the language of the CCAA itself that the court has authority to sanction plans incorporating third-party releases that are reasonably related to the proposed restructuring, there is no "gap-filling" to be done and no need to fall back on inherent jurisdiction. In this respect, I take a somewhat different approach than the application judge did.

47 The Supreme Court of Canada has affirmed generally -- and in the insolvency context particularly -- that remedial statutes are to be interpreted liberally and in accordance with Professor Driedger's modern principle of statutory interpretation. Driedger advocated that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 at para. 21, quoting E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983); *Bell Expressvu Ltd. Partnership v. R.*, [2002] 2 S.C.R. 559 at para. 26.

48 More broadly, I believe that the proper approach to the judicial interpretation and application of statutes -- particularly those like the CCAA that are skeletal in nature -- is succinctly and accurately summarized by Jackson and Sarra in their recent article, *supra*, at p. 56:

> The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the

> intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

49 I adopt these principles.

50 The remedial purpose of the CCAA -- as its title affirms -- is to facilitate compromises or arrangements between an insolvent debtor company and its creditors. In *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 4 C.B.R. (3d) 311 at 318 (B.C.C.A.), Gibbs J.A. summarized very concisely the purpose, object and scheme of the Act:

> Almost inevitably, liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A., to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

51 The CCAA was enacted in 1933 and was necessary -- as the then Secretary of State noted in introducing the Bill on First Reading -- "because of the prevailing commercial and industrial depression" and the need to alleviate the effects of business bankruptcies in that context: see the statement of the Hon. C.H. Cahan, Secretary of State, *House of Commons Debates (Hansard)* (April 20, 1933) at 4091. One of the greatest effects of that Depression was what Gibbs J.A. described as "the social evil of devastating levels of unemployment". Since then, courts have recognized that the Act has a broader dimension than simply the direct relations between the debtor company and its creditors and that this broader public dimension must be weighed in the balance together with the interests of those most directly affected: see, for example, *Elan Corp. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (C.A.), *per* Doherty J.A. in dissent; *Re Skydome Corp.* (1998), 16 C.B.R. (4th) 125 (Ont. Gen. Div.); *Re Anvil Range Mining Corp.* (1998), 3 C.B.R. (4th) 93 (Ont. Gen. Div.).

52 In this respect, I agree with the following statement of Doherty J.A. in *Elan, supra,* at pp. 306-307:

> ... [T]he Act was designed to serve a "broad constituency of investors, creditors and employees".[3] Because of that "broad constituency" the court must, when considering applications brought under the Act, *have regard not only to the*

> *individuals and organizations directly affected by the application, but also to the wider public interest*. [Emphasis added.]

Application of the Principles of Interpretation

53 An interpretation of the CCAA that recognizes its broader socio-economic purposes and objects is apt in this case. As the application judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself.

54 The appellants argue that the application judge erred in taking this approach and in treating the Plan and the proceedings as an attempt to restructure a financial market (the ABCP market) rather than simply the affairs between the debtor corporations who caused the ABCP Notes to be issued and their creditors. The Act is designed, they say, only to effect reorganizations between a corporate debtor and its creditors and not to attempt to restructure entire marketplaces.

55 This perspective is flawed in at least two respects, however, in my opinion. First, it reflects a view of the purpose and objects of the CCAA that is too narrow. Secondly, it overlooks the reality of the ABCP marketplace and the context of the restructuring in question here. It may be true that, in their capacity as ABCP *Dealers*, the releasee financial institutions are "third-parties" to the restructuring in the sense that they are not creditors of the debtor corporations. However, in their capacities as *Asset Providers* and *Liquidity Providers*, they are not only creditors but they are prior secured creditors to the Noteholders. Furthermore -- as the application judge found -- in these latter capacities they are making significant contributions to the restructuring by "foregoing immediate rights to assets and ... providing real and tangible input for the preservation and enhancement of the Notes" (para. 76). In this context, therefore, the application judge's remark at para. 50 that the restructuring "involves the commitment and participation of all parties" in the ABCP market makes sense, as do his earlier comments at paras. 48-49:

> Given the nature of the ABCP market and all of its participants, it is more appropriate to consider all Noteholders as claimants and the object of the Plan to restore liquidity to the assets being the Notes themselves. The restoration of the liquidity of the market necessitates the participation (including more tangible contribution by many) of all Noteholders.
>
> In these circumstances, *it is unduly technical to classify the Issuer Trustees as debtors and the claims of the Noteholders as between themselves and others as being those of third party creditors*, although I recognize that the restructuring structure of the CCAA requires the corporations as the vehicles for restructuring. [Emphasis added.]

56 The application judge did observe that "[t]he insolvency is of the ABCP market itself, the

restructuring is that of the market for such paper ..." (para. 50). He did so, however, to point out the uniqueness of the Plan before him and its industry-wide significance and not to suggest that he need have no regard to the provisions of the CCAA permitting a restructuring as between debtor and creditors. His focus was on *the effect* of the restructuring, a perfectly permissible perspective, given the broad purpose and objects of the Act. This is apparent from his later references. For example, in balancing the arguments against approving releases that might include aspects of fraud, he responded that "what is at issue is a liquidity crisis that affects the ABCP market in Canada" (para. 125). In addition, in his reasoning on the fair-and-reasonable issue, he stated at para. 142: "Apart from the Plan itself, there is a need to restore confidence in the financial system in Canada and this Plan is a legitimate use of the CCAA to accomplish that goal."

57 I agree. I see no error on the part of the application judge in approaching the fairness assessment or the interpretation issue with these considerations in mind. They provide the context in which the purpose, objects and scheme of the CCAA are to be considered.

The Statutory Wording

58 Keeping in mind the interpretive principles outlined above, I turn now to a consideration of the provisions of the CCAA. Where in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases? As summarized earlier, the answer to that question, in my view, is to be found in:

a) the skeletal nature of the CCAA;
b) Parliament's reliance upon the broad notions of "compromise" and "arrangement" to establish the framework within which the parties may work to put forward a restructuring plan; and in
c) the creation of the statutory mechanism binding all creditors in classes to the compromise or arrangement once it has surpassed the high "double majority" voting threshold and obtained court sanction as "fair and reasonable".

Therein lies the expression of Parliament's intention to permit the parties to negotiate and vote on, and the court to sanction, third-party releases relating to a restructuring.

59 Sections 4 and 6 of the CCAA state:

4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by

> proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (*a*) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
>
> (*b*) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act* or is in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

Compromise or Arrangement

60 While there may be little practical distinction between "compromise" and "arrangement" in many respects, the two are not necessarily the same. "Arrangement" is broader than "compromise" and would appear to include any scheme for reorganizing the affairs of the debtor: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, loose-leaf, 3rd ed., vol. 4 (Toronto: Thomson Carswell) at 10A-12.2, N para. 10. It has been said to be "a very wide and indefinite [word]": *Re Refund of Dues under Timber Regulations*, [1935] A.C. 184 at 197 (P.C.), affirming S.C.C. [1933] S.C.R. 616. See also, *Re Guardian Assur. Co.*, [1917] 1 Ch. 431 at 448, 450; *Re T&N Ltd. and Others (No. 3)*, [2007] 1 All E.R. 851 (Ch.).

61 The CCAA is a sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest. Parliament wisely avoided attempting to anticipate the myriad of business deals that could evolve from the fertile and creative minds of negotiators restructuring their financial affairs. It left the shape and details of those deals to be worked out within the framework of the comprehensive and flexible concepts of a "compromise" and "arrangement." I see no reason why a release in favour of a third party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring cannot fall within that framework.

62 A proposal under the *Bankruptcy and Insolvency Act*, R.S., 1985, c. B-3 (the "BIA") is a contract: *Employers' Liability Assurance Corp. Ltd. v. Ideal Petroleum* (1959) Ltd. [1978] 1 S.C.R. 230 at 239; *Society of Composers, Authors & Music Publishers of Canada v. Armitage* (2000), 50 O.R. (3d) 688 at para. 11 (C.A.). In my view, a compromise or arrangement under the CCAA is directly analogous to a proposal for these purposes, and therefore is to be treated as a contract between the debtor and its creditors. Consequently, parties are entitled to put anything into such a plan that could lawfully be incorporated into any contract. See *Re Air Canada* (2004), 2 C.B.R.

(5th) 4 at para. 6 (Ont. S.C.J.); *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 at 518 (Gen. Div.).

63 There is nothing to prevent a debtor and a creditor from including in a contract between them a term providing that the creditor release a third party. The term is binding as between the debtor and creditor. In the CCAA context, therefore, a plan of compromise or arrangement may propose that creditors agree to compromise claims against the debtor and to release third parties, just as any debtor and creditor might agree to such a term in a contract between them. Once the statutory mechanism regarding voter approval and court sanctioning has been complied with, the plan -- including the provision for releases -- becomes binding on all creditors (including the dissenting minority).

64 *Re T&N Ltd. and Others, supra,* is instructive in this regard. It is a rare example of a court focussing on and examining the meaning and breadth of the term "arrangement". T&N and its associated companies were engaged in the manufacture, distribution and sale of asbestos-containing products. They became the subject of many claims by former employees, who had been exposed to asbestos dust in the course of their employment, and their dependents. The T&N companies applied for protection under s. 425 of the U.K. *Companies Act 1985,* a provision virtually identical to the scheme of the CCAA -- including the concepts of compromise or arrangement.[4]

65 T&N carried employers' liability insurance. However, the employers' liability insurers (the "EL insurers") denied coverage. This issue was litigated and ultimately resolved through the establishment of a multi-million pound fund against which the employees and their dependants (the "EL claimants") would assert their claims. In return, T&N's former employees and dependants (the "EL claimants") agreed to forego any further claims against the EL insurers. This settlement was incorporated into the plan of compromise and arrangement between the T&N companies and the EL claimants that was voted on and put forward for court sanction.

66 Certain creditors argued that the court could not sanction the plan because it did not constitute a "compromise or arrangement" between T&N and the EL claimants since it did not purport to affect rights as between them but only the EL claimants' rights against the EL insurers. The Court rejected this argument. Richards J. adopted previous jurisprudence -- cited earlier in these reasons -- to the effect that the word "arrangement" has a very broad meaning and that, while both a compromise and an arrangement involve some "give and take", an arrangement need not involve a compromise or be confined to a case of dispute or difficulty (paras. 46-51). He referred to what would be the equivalent of a solvent arrangement under Canadian corporate legislation as an example.[5] Finally, he pointed out that the compromised rights of the EL claimants against the EL insurers were not unconnected with the EL claimants' rights against the T&N companies; the scheme of arrangement involving the EL insurers was "an integral part of a single proposal affecting all the parties" (para. 52). He concluded his reasoning with these observations (para. 53):

> In my judgment it is not a necessary element of an arrangement for the purposes

> of s. 425 of the 1985 Act that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement between the company and the members or creditors concerned, it will fall within s. 425. It is ... neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach over many years to give the term its widest meaning. *Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that party*. [Emphasis added.]

67 I find Richard J.'s analysis helpful and persuasive. In effect, the claimants in *T&N* were being asked to release their claims against the EL insurers in exchange for a call on the fund. Here, the appellants are being required to release their claims against certain financial third parties in exchange for what is anticipated to be an improved position for all ABCP Noteholders, stemming from the contributions the financial third parties are making to the ABCP restructuring. The situations are quite comparable.

The Binding Mechanism

68 Parliament's reliance on the expansive terms "compromise" or "arrangement" does not stand alone, however. Effective insolvency restructurings would not be possible without a statutory mechanism to bind an unwilling minority of creditors. Unanimity is frequently impossible in such situations. But the minority must be protected too. Parliament's solution to this quandary was to permit a wide range of proposals to be negotiated and put forward (the compromise or arrangement) and to bind all creditors by class to the terms of the plan, but to do so only where the proposal can gain the support of the requisite "double majority" of votes[6] and obtain the sanction of the court on the basis that it is fair and reasonable. In this way, the scheme of the CCAA supports the intention of Parliament to encourage a wide variety of solutions to corporate insolvencies without unjustifiably overriding the rights of dissenting creditors.

The Required Nexus

69 In keeping with this scheme and purpose, I do not suggest that any and all releases between creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between the debtor and its creditors. Nor do I think the fact that the releases may be "necessary" in the sense that the third parties or the debtor may refuse to proceed without them, of itself, advances the argument in favour of finding jurisdiction (although it may well be relevant in terms of the fairness and reasonableness analysis).

70 The release of the claim in question must be justified as part of the compromise or arrangement between the debtor and its creditors. In short, there must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan. This nexus exists here, in my view.

71 In the course of his reasons, the application judge made the following findings, all of which are amply supported on the record:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) *The claims to be released are rationally related to the purpose of the Plan and necessary for it*;
c) The Plan cannot succeed without the releases;
d) *The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan*; and
e) The Plan will benefit not only the debtor companies but creditor Noteholders generally.

72 Here, then -- as was the case in *T&N* -- there is a close connection between the claims being released and the restructuring proposal. The tort claims arise out of the sale and distribution of the ABCP Notes and their collapse in value, just as do the contractual claims of the creditors against the debtor companies. The purpose of the restructuring is to stabilize and shore up the value of those notes in the long run. The third parties being released are making separate contributions to enable those results to materialize. Those contributions are identified earlier, at para. 31 of these reasons. The application judge found that the claims being released are not independent of or unrelated to the claims that the Noteholders have against the debtor companies; they are closely connected to the value of the ABCP Notes and are required for the Plan to succeed. At paras. 76-77 he said:

> [76] I do not consider that the Plan in this case involves a change in relationship among creditors "that does not directly involve the Company." Those who support the Plan and are to be released are "directly involved in the Company" in the sense that many are foregoing immediate rights to assets and are providing real and tangible input for the preservation and enhancement of the Notes. It would be unduly restrictive to suggest that the moving parties' claims against released parties do not involve the Company, since the claims are directly related to the value of the Notes. The value of the Notes is in this case the value of the Company.
>
> [77] This Plan, as it deals with releases, doesn't change the relationship of the creditors apart from involving the Company and its Notes.

73 I am satisfied that the wording of the CCAA -- construed in light of the purpose, objects and

scheme of the Act and in accordance with the modern principles of statutory interpretation -- supports the court's jurisdiction and authority to sanction the Plan proposed here, including the contested third-party releases contained in it.

The Jurisprudence

74 Third party releases have become a frequent feature in Canadian restructurings since the decision of the Alberta Court of Queen's Bench in *Re Canadian Airlines Corp*. (2000), 265 A.R. 201, leave to appeal refused by *Resurgence Asset Management LLC v. Canadian Airlines Corp.* (2000), 266 A.R. 131 (C.A.), and [2001] S.C.C.A. No. 60, (2001) 293 A.R. 351 (S.C.C.). In *Re Muscle Tech Research and Development Inc.* (2006), 25 C.B.R (5th) 231 (Ont. S.C.J.) Justice Ground remarked (para. 8):

> [It] is not uncommon in CCAA proceedings, in the context of a plan of compromise and arrangement, to compromise claims against the Applicants and other parties against whom such claims or related claims are made.

75 We were referred to at least a dozen court-approved CCAA plans from across the country that included broad third-party releases. With the exception of *Re Canadian Airlines*, however, the releases in those restructurings -- including *Muscle Tech* -- were not opposed. The appellants argue that those cases are wrongly decided, because the court simply does not have the authority to approve such releases.

76 In *Re Canadian Airlines* the releases in question were opposed, however. Paperny J. (as she then was) concluded the court had jurisdiction to approve them and her decision is said to be the well-spring of the trend towards third-party releases referred to above. Based on the foregoing analysis, I agree with her conclusion although for reasons that differ from those cited by her.

77 Justice Paperny began her analysis of the release issue with the observation at para. 87 that "[p]rior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company." It will be apparent from the analysis in these reasons that I do not accept that premise, notwithstanding the decision of the Quebec Court of Appeal in *Michaud v. Steinberg,*[7] of which her comment may have been reflective. Paperny J.'s reference to 1997 was a reference to the amendments of that year adding s. 5.1 to the CCAA, which provides for limited releases in favour of directors. Given the limited scope of s. 5.1, Justice Paperny was thus faced with the argument -- dealt with later in these reasons -- that Parliament must not have intended to extend the authority to approve third-party releases beyond the scope of this section. She chose to address this contention by concluding that, although the amendments "[did] not authorize a release of claims against third parties other than directors, [they did] not prohibit such releases either" (para. 92).

78 Respectfully, I would not adopt the interpretive principle that the CCAA permits releases because it does not expressly prohibit them. Rather, as I explain in these reasons, I believe the open-ended CCAA permits third-party releases that are reasonably related to the restructuring at

issue because they are encompassed in the comprehensive terms "compromise" and "arrangement" and because of the double-voting majority and court sanctioning statutory mechanism that makes them binding on unwilling creditors.

79 The appellants rely on a number of authorities, which they submit support the proposition that the CCAA may not be used to compromise claims as between anyone other than the debtor company and its creditors. Principal amongst these are *Michaud v. Steinberg, supra*; *NBD Bank, Canada v. Dofasco Inc.*, (1999), 46 O.R. (3d) 514 (C.A.); *Pacific Coastal Airlines Ltd. v. Air Canada* (2001), 19 B.L.R. (3d) 286 (B.C.S.C.); and *Re Stelco Inc.* (2005), 78 O.R. (3d) 241 (C.A.) ("*Stelco I*"). I do not think these cases assist the appellants, however. With the exception of *Steinberg*, they do not involve third party claims that were reasonably connected to the restructuring. As I shall explain, it is my opinion that *Steinberg* does not express a correct view of the law, and I decline to follow it.

80 In *Pacific Coastal Airlines*, Tysoe J. made the following comment at para. 24:

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

81 This statement must be understood in its context, however. Pacific Coastal Airlines had been a regional carrier for Canadian Airlines prior to the CCAA reorganization of the latter in 2000. In the action in question it was seeking to assert separate tort claims against Air Canada for contractual interference and inducing breach of contract in relation to certain rights it had to the use of Canadian's flight designator code prior to the CCAA proceeding. Air Canada sought to have the action dismissed on grounds of *res judicata* or issue estoppel because of the CCAA proceeding. Tysoe J. rejected the argument.

82 The facts in *Pacific Coastal* are not analogous to the circumstances of this case, however. There is no suggestion that a resolution of Pacific Coastal's separate tort claim against Air Canada was in any way connected to the Canadian Airlines restructuring, even though Canadian -- at a contractual level -- may have had some involvement with the particular dispute. Here, however, the disputes that are the subject-matter of the impugned releases are not simply "disputes between parties other than the debtor company". They are closely connected to the disputes being resolved between the debtor companies and their creditors and to the restructuring itself.

83 Nor is the decision of this Court in the *NBD Bank* case dispositive. It arose out of the financial collapse of Algoma Steel, a wholly-owned subsidiary of Dofasco. The Bank had advanced funds to Algoma allegedly on the strength of misrepresentations by Algoma's Vice-President, James Melville. The plan of compromise and arrangement that was sanctioned by Farley J. in the Algoma

CCAA restructuring contained a clause releasing Algoma from all claims creditors "may have had against Algoma or its directors, officers, employees and advisors." Mr. Melville was found liable for negligent misrepresentation in a subsequent action by the Bank. On appeal, he argued that since the Bank was barred from suing Algoma for misrepresentation by its officers, permitting it to pursue the same cause of action against him personally would subvert the CCAA process -- in short, he was personally protected by the CCAA release.

84 Rosenberg J.A., writing for this Court, rejected this argument. The appellants here rely particularly upon his following observations at paras. 53-54:

> 53 In my view, the appellant has not demonstrated that allowing the respondent to pursue its claim against him would undermine or subvert the purposes of the Act. As this court noted in *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289 at 297, the *CCAA* is remedial legislation "intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both". It is a means of avoiding a liquidation that may yield little for the creditors, especially unsecured creditors like the respondent, and the debtor company shareholders. However, the appellant has not shown that allowing a creditor to continue an action against an officer for negligent misrepresentation would erode the effectiveness of the Act.
>
> 54 In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors". L.W. Houlden and C.H. Morawetz, the editors of *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to the insolvency, has misrepresented the financial affairs of the corporation to its creditors. It may be necessary to permit the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement. [Footnote omitted.]

85 Once again, this statement must be assessed in context. Whether Justice Farley had the authority in the earlier Algoma CCAA proceedings to sanction a plan that included third party releases was not under consideration at all. What the Court was determining in *NBD Bank* was whether the release extended by its terms to protect a third party. In fact, on its face, it does not appear to do so. Justice Rosenberg concluded only that not allowing Mr. Melville to rely upon the release did not subvert the purpose of the CCAA. As the application judge here observed, "there is little factual similarity in *NBD* to the facts now before the Court" (para. 71). Contrary to the facts of this case, in *NBD Bank* the creditors had not agreed to grant a release to officers; they had not voted on such a release and the court had not assessed the fairness and reasonableness of such a release as a term of a complex arrangement involving significant contributions by the beneficiaries of the release -- as is the situation here. Thus, *NBD Bank* is of little assistance in determining whether the court has authority to sanction a plan that calls for third party releases.

86 The appellants also rely upon the decision of this Court in *Stelco I*. There, the Court was dealing with the scope of the CCAA in connection with a dispute over what were called the "Turnover Payments". Under an inter-creditor agreement one group of creditors had subordinated their rights to another group and agreed to hold in trust and "turn over" any proceeds received from Stelco until the senior group was paid in full. On a disputed classification motion, the Subordinated Debt Holders argued that they should be in a separate class from the Senior Debt Holders. Farley J. refused to make such an order in the court below, stating:

> [Sections] 4, 5 and 6 [of the CCAA] talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves *and not directly involving the company*. [Citations omitted; emphasis added.]
>
> See *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 297 (Ont. S.C.J.) at para. 7.

87 This Court upheld that decision. The legal relationship between each group of creditors and Stelco was the same, albeit there were inter-creditor differences, and creditors were to be classified in accordance with their legal rights. In addition, the need for timely classification and voting decisions in the CCAA process militated against enmeshing the classification process in the vagaries of inter-corporate disputes. In short, the issues before the Court were quite different from those raised on this appeal.

88 Indeed, the Stelco plan, as sanctioned, included third party releases (albeit uncontested ones). This Court subsequently dealt with the same inter-creditor agreement on an appeal where the Subordinated Debt Holders argued that the inter-creditor subordination provisions were beyond the reach of the CCAA and therefore that they were entitled to a separate civil action to determine their rights under the agreement: *Re Stelco Inc.*, (2006), 21 C.B.R. (5th) 157 (Ont. C.A.) ("*Stelco II*").

The Court rejected that argument and held that where the creditors' rights amongst themselves were sufficiently related to the debtor and its plan, they were properly brought within the scope of the CCAA plan. The Court said (para. 11):

> In [*Stelco I*] -- the classification case -- the court observed that it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company ... *[H]owever, the present case is not simply an inter-creditor dispute that does not involve the debtor company; it is a dispute that is inextricably connected to the restructuring process*. [Emphasis added.]

89 The approach I would take to the disposition of this appeal is consistent with that view. As I have noted, the third party releases here are very closely connected to the ABCP restructuring process.

90 Some of the appellants -- particularly those represented by Mr. Woods -- rely heavily upon the decision of the Quebec Court of Appeal in *Michaud v. Steinberg, supra*. They say that it is determinative of the release issue. In *Steinberg*, the Court held that the CCAA, as worded at the time, did not permit the release of directors of the debtor corporation and that third-party releases were not within the purview of the Act. Deschamps J.A. (as she then was) said (paras. 42, 54 and 58 -- English translation):

> [42] Even if one can understand the extreme pressure weighing on the creditors and the respondent at the time of the sanctioning, a plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement. In other words, one cannot, under the pretext of an absence of formal directives in the Act, transform an arrangement into a potpourri.
>
> ...
>
> [54] The Act offers the respondent a way to arrive at a compromise with is creditors. It does not go so far as to offer an umbrella to all the persons within its orbit by permitting them to shelter themselves from any recourse.
>
> ...
>
> [58] The [CCAA] and the case law clearly do not permit extending the application of an arrangement to persons other than the respondent and its creditors and, consequently, the plan should not have been sanctioned as is [that is, including the releases of the directors].

91 Justices Vallerand and Delisle, in separate judgments, agreed. Justice Vallerand summarized his view of the consequences of extending the scope of the CCAA to third party releases in this fashion (para. 7):

> In short, the Act will have become the Companies' *and Their Officers and Employees* Creditors Arrangement Act -- an awful mess -- and likely not attain its purpose, which is to enable the company to survive in the face of *its* creditors and through their will, and not in the face of the creditors of its officers. This is why I feel, just like my colleague, that such a clause is contrary to the Act's mode of operation, contrary to its purposes and, for this reason, is to be banned.

92 Justice Delisle, on the other hand, appears to have rejected the releases because of their broad nature -- they released directors from all claims, including those that were altogether unrelated to their corporate duties with the debtor company -- rather than because of a lack of authority to sanction under the Act. Indeed, he seems to have recognized the wide range of circumstances that could be included within the term "compromise or arrangement". He is the only one who addressed that term. At para. 90 he said:

> The CCAA is drafted in general terms. It does not specify, among other things, what must be understood by "compromise or arrangement". However, it may be inferred from the purpose of this [A]ct that these terms *encompass all that should enable the person who has recourse to it to fully dispose of his debts*, both those that exist on the date when he has recourse to the statute and *those contingent on the insolvency in which he finds himself* ... [Emphasis added.]

93 The decision of the Court did not reflect a view that the terms of a compromise or arrangement should "encompass all that should enable the person who has recourse to [the Act] to dispose of his debts ... and those contingent on the insolvency in which he finds himself," however. On occasion such an outlook might embrace third parties other than the debtor and its creditors in order to make the arrangement work. Nor would it be surprising that, in such circumstances, the third parties might seek the protection of releases, or that the debtor might do so on their behalf. Thus, the perspective adopted by the majority in *Steinberg*, in my view, is too narrow, having regard to the language, purpose and objects of the CCAA and the intention of Parliament. They made no attempt to consider and explain why a compromise or arrangement could not include third-party releases. In addition, the decision appears to have been based, at least partly, on a rejection of the use of contract-law concepts in analysing the Act -- an approach inconsistent with the jurisprudence referred to above.

94 Finally, the majority in *Steinberg* seems to have proceeded on the basis that the CCAA cannot interfere with civil or property rights under Quebec law. Mr. Woods advanced this argument before this Court in his factum, but did not press it in oral argument. Indeed, he conceded that if the Act encompasses the authority to sanction a plan containing third-party releases -- as I have concluded it does -- the provisions of the CCAA, as valid federal insolvency legislation, are paramount over provincial legislation. I shall return to the constitutional issues raised by the appellants later in these reasons.

95 Accordingly, to the extent *Steinberg* stands for the proposition that the court does not have authority under the CCAA to sanction a plan that incorporates third-party releases, I do not believe it to be a correct statement of the law and I respectfully decline to follow it. The modern approach to interpretation of the Act in accordance with its nature and purpose militates against a narrow interpretation and towards one that facilitates and encourages compromises and arrangements. Had the majority in *Steinberg* considered the broad nature of the terms "compromise" and "arrangement" and the jurisprudence I have referred to above, they might well have come to a different conclusion.

The 1997 Amendments

96 *Steinberg* led to amendments to the CCAA, however. In 1997, s. 5.1 was added, dealing specifically with releases pertaining to directors of the debtor company. It states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> Exception
>
> (2) A provision for the compromise of claims against directors may not include claims that
>
> (*a*) relate to contractual rights of one or more creditors; or
>
> (*b*) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> Powers of court
>
> (3) The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.
>
> Resignation or removal of directors

> (4) Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.
>
> 1997, c. 12, s. 122.

97 Perhaps the appellants' strongest argument is that these amendments confirm a prior lack of authority in the court to sanction a plan including third party releases. If the power existed, why would Parliament feel it necessary to add an amendment specifically permitting such releases (subject to the exceptions indicated) in favour of directors? *Expressio unius est exclusio alterius*, is the Latin maxim sometimes relied on to articulate the principle of interpretation implied in that question: to express or include one thing implies the exclusion of the other.

98 The maxim is not helpful in these circumstances, however. The reality is that there *may* be another explanation why Parliament acted as it did. As one commentator has noted:[8]

> Far from being a rule, [the maxim *expressio unius*] is not even lexicographically accurate, because it is simply not true, generally, that the mere express conferral of a right or privilege in one kind of situation implies the denial of the equivalent right or privilege in other kinds. Sometimes it does and sometimes its does not, and whether it does or does not depends on the particular circumstances of context. Without contextual support, therefore there is not even a mild presumption here. Accordingly, the maxim is at best a description, after the fact, of what the court has discovered from context.

99 As I have said, the 1997 amendments to the CCAA providing for releases in favour of directors of debtor companies in limited circumstances were a response to the decision of the Quebec Court of Appeal in *Steinberg*. A similar amendment was made with respect to proposals in the BIA at the same time. The rationale behind these amendments was to encourage directors of an insolvent company to remain in office during a restructuring, rather than resign. The assumption was that by remaining in office the directors would provide some stability while the affairs of the company were being reorganized: see Houlden and Morawetz, vol. 1, *supra*, at 2-144, Es.11A; *Le Royal Penfield Inc. (Syndic de)*, [2003] R.J.Q. 2157 at paras. 44-46 (C.S.).

100 Parliament thus had a particular focus and a particular purpose in enacting the 1997 amendments to the CCAA and the BIA. While there is some merit in the appellants' argument on this point, at the end of the day I do not accept that Parliament intended to signal by its enactment of s. 5.1 that it was depriving the court of authority to sanction plans of compromise or arrangement in all circumstances where they incorporate third party releases in favour of anyone other than the debtor's directors. For the reasons articulated above, I am satisfied that the court does have the

authority to do so. Whether it sanctions the plan is a matter for the fairness hearing.

The Deprivation of Proprietary Rights

101 Mr. Shapray very effectively led the appellants' argument that legislation must not be construed so as to interfere with or prejudice established contractual or proprietary rights -- including the right to bring an action -- in the absence of a clear indication of legislative intention to that effect: *Halsbury's Laws of England*, 4th ed. reissue, vol. 44 (1) (London: Butterworths, 1995) at paras. 1438, 1464 and 1467; Driedger, 2nd ed., *supra*, at 183; Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed., (Markham: Butterworths, 2002) at 399. I accept the importance of this principle. For the reasons I have explained, however, I am satisfied that Parliament's intention to clothe the court with authority to consider and sanction a plan that contains third party releases is expressed with sufficient clarity in the "compromise or arrangement" language of the CCAA coupled with the statutory voting and sanctioning mechanism making the provisions of the plan binding on all creditors. This is not a situation of impermissible "gap-filling" in the case of legislation severely affecting property rights; it is a question of finding meaning in the language of the Act itself. I would therefore not give effect to the appellants' submissions in this regard.

The Division of Powers and Paramountcy

102 Mr. Woods and Mr. Sternberg submit that extending the reach of the CCAA process to the compromise of claims as between solvent creditors of the debtor company and solvent third parties to the proceeding is constitutionally impermissible. They say that under the guise of the federal insolvency power pursuant to s. 91(21) of the *Constitution Act, 1867*, this approach would improperly affect the rights of civil claimants to assert their causes of action, a provincial matter falling within s. 92(13), and contravene the rules of public order pursuant to the *Civil Code of Quebec*.

103 I do not accept these submissions. It has long been established that the CCAA is valid federal legislation under the federal insolvency power: *Reference re: Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659. As the Supreme Court confirmed in that case (p. 661), citing Viscount Cave L.C. in *Royal Bank of Canada v. Larue* [1928] A.C. 187, "the exclusive legislative authority to deal with all matters within the domain of bankruptcy and insolvency is vested in Parliament." Chief Justice Duff elaborated:

> Matters normally constituting part of a bankruptcy scheme but not in their essence matters of bankruptcy and insolvency may, of course, from another point of view and in another aspect be dealt with by a provincial legislature; but, when treated as matters pertaining to bankruptcy and insolvency, they clearly fall within the legislative authority of the Dominion.

104 That is exactly the case here. The power to sanction a plan of compromise or arrangement

that contains third-party releases of the type opposed by the appellants is embedded in the wording of the CCAA. The fact that this may interfere with a claimant's right to pursue a civil action -- normally a matter of provincial concern -- or trump Quebec rules of public order is constitutionally immaterial. The CCAA is a valid exercise of federal power. Provided the matter in question falls within the legislation directly or as necessarily incidental to the exercise of that power, the CCAA governs. To the extent that its provisions are inconsistent with provincial legislation, the federal legislation is paramount. Mr. Woods properly conceded this during argument.

Conclusion With Respect to Legal Authority

105 For all of the foregoing reasons, then, I conclude that the application judge had the jurisdiction and legal authority to sanction the Plan as put forward.

(2) The Plan is "Fair and Reasonable"

106 The second major attack on the application judge's decision is that he erred in finding that the Plan is "fair and reasonable" and in sanctioning it on that basis. This attack is centred on the nature of the third-party releases contemplated and, in particular, on the fact that they will permit the release of some claims based in fraud.

107 Whether a plan of compromise or arrangement is fair and reasonable is a matter of mixed fact and law, and one on which the application judge exercises a large measure of discretion. The standard of review on this issue is therefore one of deference. In the absence of a demonstrable error an appellate court will not interfere: see *Re Ravelston Corp. Ltd.* (2007), 31 C.B.R. (5th) 233 (Ont. C.A.).

108 I would not interfere with the application judge's decision in this regard. While the notion of releases in favour of third parties -- including leading Canadian financial institutions -- that extend to claims of fraud is distasteful, there is no legal impediment to the inclusion of a release for claims based in fraud in a plan of compromise or arrangement. The application judge had been living with and supervising the ABCP restructuring from its outset. He was intimately attuned to its dynamics. In the end he concluded that the benefits of the Plan to the creditors as a whole, and to the debtor companies, outweighed the negative aspects of compelling the unwilling appellants to execute the releases as finally put forward.

109 The application judge was concerned about the inclusion of fraud in the contemplated releases and at the May hearing adjourned the final disposition of the sanctioning hearing in an effort to encourage the parties to negotiate a resolution. The result was the "fraud carve-out" referred to earlier in these reasons.

110 The appellants argue that the fraud carve-out is inadequate because of its narrow scope. It (i) applies only to ABCP Dealers, (ii) limits the type of damages that may be claimed (no punitive damages, for example), (iii) defines "fraud" narrowly, excluding many rights that would be

protected by common law, equity and the Quebec concept of public order, and (iv) limits claims to representations made directly to Noteholders. The appellants submit it is contrary to public policy to sanction a plan containing such a limited restriction on the type of fraud claims that may be pursued against the third parties.

111 The law does not condone fraud. It is the most serious kind of civil claim. There is therefore some force to the appellants' submission. On the other hand, as noted, there is no legal impediment to granting the release of an antecedent claim in fraud, provided the claim is in the contemplation of the parties to the release at the time it is given: *Fotinis Restaurant Corp. v. White Spot Ltd*. (1998), 38 B.L.R. (2d) 251 at paras. 9 and 18 (B.C.S.C.). There may be disputes about the scope or extent of what is released, but parties are entitled to settle allegations of fraud in civil proceedings -- the claims here all being untested allegations of fraud -- and to include releases of such claims as part of that settlement.

112 The application judge was alive to the merits of the appellants' submissions. He was satisfied in the end, however, that the need "to avoid the potential cascade of litigation that ... would result if a broader 'carve out' were to be allowed" (para. 113) outweighed the negative aspects of approving releases with the narrower carve-out provision. Implementation of the Plan, in his view, would work to the overall greater benefit of the Noteholders as a whole. I can find no error in principle in the exercise of his discretion in arriving at this decision. It was his call to make.

113 At para. 71 above I recited a number of factual findings the application judge made in concluding that approval of the Plan was within his jurisdiction under the CCAA and that it was fair and reasonable. For convenience, I reiterate them here -- with two additional findings -- because they provide an important foundation for his analysis concerning the fairness and reasonableness of the Plan. The application judge found that:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) The claims to be released are rationally related to the purpose of the Plan and necessary for it;
c) The Plan cannot succeed without the releases;
d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan;
e) The Plan will benefit not only the debtor companies but creditor Noteholders generally;
f) The voting creditors who have approved the Plan did so with knowledge of the nature and effect of the releases; and that,
g) The releases are fair and reasonable and not overly broad or offensive to public policy.

114 These findings are all supported on the record. Contrary to the submission of some of the

appellants, they do not constitute a new and hitherto untried "test" for the sanctioning of a plan under the CCAA. They simply represent findings of fact and inferences on the part of the application judge that underpin his conclusions on jurisdiction and fairness.

115 The appellants all contend that the obligation to release the third parties from claims in fraud, tort, breach of fiduciary duty, etc. is confiscatory and amounts to a requirement that they -- as individual creditors -- make the equivalent of a greater financial contribution to the Plan. In his usual lively fashion, Mr. Sternberg asked us the same rhetorical question he posed to the application judge. As he put it, how could the court countenance the compromise of what in the future might turn out to be fraud perpetrated at the highest levels of Canadian and foreign banks? Several appellants complain that the proposed Plan is unfair to them because they will make very little additional recovery if the Plan goes forward, but will be required to forfeit a cause of action against third-party financial institutions that may yield them significant recovery. Others protest that they are being treated unequally because they are ineligible for relief programs that Liquidity Providers such as Canaccord have made available to other smaller investors.

116 All of these arguments are persuasive to varying degrees when considered in isolation. The application judge did not have that luxury, however. He was required to consider the circumstances of the restructuring as a whole, including the reality that many of the financial institutions were not only acting as Dealers or brokers of the ABCP Notes (with the impugned releases relating to the financial institutions in these capacities, for the most part) but also as Asset and Liquidity Providers (with the financial institutions making significant contributions to the restructuring in these capacities).

117 In insolvency restructuring proceedings almost everyone loses something. To the extent that creditors are required to compromise their claims, it can always be proclaimed that their rights are being unfairly confiscated and that they are being called upon to make the equivalent of a further financial contribution to the compromise or arrangement. Judges have observed on a number of occasions that CCAA proceedings involve "a balancing of prejudices," inasmuch as everyone is adversely affected in some fashion.

118 Here, the debtor corporations being restructured represent the issuers of the more than $32 billion in non-bank sponsored ABCP Notes. The proposed compromise and arrangement affects that entire segment of the ABCP market and the financial markets as a whole. In that respect, the application judge was correct in adverting to the importance of the restructuring to the resolution of the ABCP liquidity crisis and to the need to restore confidence in the financial system in Canada. He was required to consider and balance the interests of all Noteholders, not just the interests of the appellants, whose notes represent only about 3% of that total. That is what he did.

119 The application judge noted at para. 126 that the Plan represented "a reasonable balance between benefit to all Noteholders and enhanced recovery for those who can make out specific claims in fraud" within the fraud carve-out provisions of the releases. He also recognized at para.

134 that:

> No Plan of this size and complexity could be expected to satisfy all affected by it. The size of the majority who have approved it is testament to its overall fairness. No plan to address a crisis of this magnitude can work perfect equity among all stakeholders.

120 In my view we ought not to interfere with his decision that the Plan is fair and reasonable in all the circumstances.

D. DISPOSITION

121 For the foregoing reasons, I would grant leave to appeal from the decision of Justice Campbell, but dismiss the appeal.

R.A. BLAIR J.A.
J.I. LASKIN J.A.:-- I agree.
E.A. CRONK J.A.:-- I agree.

* * * * *

SCHEDULE "A" - CONDUITS

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

* * * * *

SCHEDULE "B" - APPLICANTS

ATB Financial

Caisse de Dépôt et Placement du Québec

Canaccord Capital Corporation

Canada Post Corporation

Credit Union Central of Alberta Limited

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank Financial Inc./National Bank of Canada

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

* * * * *

SCHEDULE "A" - COUNSEL

1) Benjamin Zarnett and Frederick L. Myers for the Pan-Canadian Investors Committee.
2) Aubrey E. Kauffman and Stuart Brotman for 4446372 Canada Inc. and 6932819 Canada Inc.
3) Peter F.C. Howard and Samaneh Hosseini for Bank of America N.A.; Citibank N.A.; Citibank Canada, in its capacity as Credit Derivative Swap Counterparty and not in any other capacity; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA, National Association; Merrill Lynch International; Merill Lynch Capital Services, Inc.; Swiss Re Financial Products Corporation; and UBS AG.
4) Kenneth T. Rosenberg, Lily Harmer and Max Starnino for Jura Energy Corporation and Redcorp Ventures Ltd.
5) Craig J. Hill and Sam P. Rappos for the Monitors (ABCP Appeals).
6) Jeffrey C. Carhart and Joseph Marin for Ad Hoc Committee and Pricewaterhouse Coopers Inc., in its capacity as Financial Advisor.
7) Mario J. Forte for Caisse de Dépôt et Placement du Québec.
8) John B. Laskin for National Bank Financial Inc. and National Bank of Canada.
9) Thomas McRae and Arthur O. Jacques for Ad Hoc Retail Creditors Committee (Brian Hunter, et al).
10) Howard Shapray, Q.C. and Stephen Fitterman for Ivanhoe Mines Ltd.
11) Kevin P. McElcheran and Heather L. Meredith for Canadian Banks, BMO, CIBC RBC, Bank of Nova Scotia and T.D. Bank.
12) Jeffrey S. Leon for CIBC Mellon Trust Company, Computershare Trust Company of Canada and BNY Trust Company of Canada, as Indenture Trustees.
13) Usman Sheikh for Coventree Capital Inc.
14) Allan Sternberg and Sam R. Sasso for Brookfield Asset Management and Partners Ltd. and Hy Bloom Inc. and Cardacian Mortgage Services Inc.
15) Neil C. Saxe for Dominion Bond Rating Service.
16) James A. Woods, Sebastien Richemont and Marie-Anne Paquette for Air

Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal, Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Agence Métropolitaine de Transport (AMT), Giro Inc., Vêtements de sports RGR Inc., 131519 Canada Inc., Tecsys Inc., New Gold Inc. and Jazz Air LP.

17) Scott A. Turner for Webtech Wireless Inc., Wynn Capital Corporation Inc., West Energy Ltd., Sabre Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., and Standard Energy Ltd.

18) R. Graham Phoenix for Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., Quanto Financial Corporation and Metcalfe & Mansfield Capital Corp.

cp/e/ln/qlkxl/qllkb/qlltl/qlrxg/qlhcs/qlcas/qlhcs/qlhcs

1 Section 5.1 of the CCAA specifically authorizes the granting of releases to directors in certain circumstances.

2 Justice Georgina R. Jackson and Dr. Janis P. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Vancouver: Thomson Carswell, 2007).

3 Citing Gibbs J.A. in *Chef Ready Foods, supra*, at pp. 319-320.

4 The Legislative Debates at the time the CCAA was introduced in Parliament in April 1933 make it clear that the CCAA is patterned after the predecessor provisions of s. 425 of the *Companies Act 1985* (U.K.): see *House of Commons Debates (Hansard), supra*.

5 See *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 192; *Ontario Business Corporations Act*, R.S.O. 1990, c. B.16, s. 182.

6 A majority in number representing two-thirds in value of the creditors (s. 6).

7 *Steinberg* was originally reported in French: [1993] R.J.Q. 1684 (C.A.). All paragraph references to *Steinberg* in this judgment are from the unofficial English translation available

at 1993 CarswellQue 2055.

8 Reed Dickerson, *The Interpretation and Application of Statutes* (1975) at pp. 234-235, cited in Bryan A. Garner, ed., Black's Law Dictionary, 8th ed. (West Group, St. Paul, Minn., 2004) at 621.

Indexed as:

Blue Range Resources 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 Blue Range Resources Corporation
Between
Enron Canada Corp. and the Creditor's Committee, appellants (appellants), and
National Oil-Well Canada Ltd. et al., respondents (respondents)

[2000] A.J. No. 1232

2000 ABCA 285

193 D.L.R. (4th) 314

[2001] 2 W.W.R. 477

87 Alta. L.R. (3d) 352

271 A.R. 138

100 A.C.W.S. (3d) 956

Dockets: 99-18564, 18565, 18566, 18567, 18568, 18569,

18570, 18571 and 18802

Alberta Court of Appeal
Calgary, Alberta

Russell, Sulatycky and Wittmann JJ.A.

Heard: June 15, 2000.
Judgment: filed October 24, 2000.

(42 paras.)

On appeal from the decision of LoVecchio J. Dated the 9th day of November, 1999.

Counsel:

A. Robert Anderson and Scott J. Burrell, for Enron Canada Corp. and the Creditors' Committee.
S. Collins, for TransAlta Utilities Corporation.
D.W. Dear, for Rigel Oil & Gas Ltd.
D. Mann, for Barrington Petroleum Ltd. and PetroCanada Oil & Gas.
K.E. Staroszik, for Founders Energy Ltd.
J.N. Thom, for National-Oilwell Canada Ltd. and Campbell's Industrial Supply Ltd.

REASONS FOR JUDGMENT RESERVED

The judgment of the Court was delivered by

WITTMANN J.A.:--

Introduction

1 The Companies' Creditors Arrangement Act, R.S.A. 1985, c. C-36, as amended ("CCAA"), permits the compromise and resolution of claims of creditors against an insolvent corporation. In this appeal, as part of the ongoing resolution of the insolvency of Blue Range Resources Corporation ("Blue Range"), this Court has been asked to state the applicable criteria in considering whether to allow late claimants to file claims after a stipulated date in an order ("claims bar order").

2 In his decision below, the chambers judge determined that in the circumstances of this case it was appropriate to allow the respondents ("late claimants") to file their claims thus entitling them to participate in the CCAA distribution.

Facts

3 Blue Range sought and received court protection from its creditors under the CCAA on March 2, 1999. The claims procedure established by PriceWaterhouse Coopers Inc. ("the Monitor"), and approved by the court in a claims bar order, fixed a date of May 7, 1999 at 5:00 p.m. by which all claims were to be filed. Due to difficulties in obtaining the appropriate records, the date was extended in a second order to June 15, 1999 at 5:00 p.m., for the joint venture partners. The relevant orders stated that claims not proven in accordance with the set procedures "shall be deemed forever barred" (A.B.P. 01, A.B.P. 06). Under this procedure $270,000,000 in claims were filed.

4 The respondent creditors in this appeal fall into two categories: first, those who did not file their

Notices of Claim before the relevant dates in the claims bar orders, and second, those who filed their initial claims in time but sought to amend their claims after the relevant dates. All of these creditors applied to the chambers judge for relief from the restriction of the date in the claims bar orders and to have their late or amended claims accepted for consideration by the Monitor.

5 The chambers judge allowed the late and amended claims to be filed. The appellants, Enron Capital Corp. ("Enron") and the Creditor's Committee, seek to have that decision overturned. I granted leave to appeal on January 14, 2000 on the following question:

> What criteria in the circumstances of these cases should the Court use to exercise its discretion in deciding whether to allow late claimants to file claims which, if proven, may be recognized, notwithstanding a previous claims bar order containing a claims bar date which would otherwise bar the claim of the late claimants, and applying the criteria to each case, what is the result? (A.B.928).

Judgment Below

6 The chambers judge found that the applicable section of the CCAA, s. 12(2)(iii) did not mandate a claims procedure. He stated that preserving certainty in the CCAA process was not a sufficient reason to deny the late claimants a second chance. In his view, taking a strict reading of the claims bar orders would have the effect of denying creditors, who have a logical explanation for their non- compliance with the order, any recovery. While the chambers judge noted that compromise is required by creditors in a CCAA proceeding, he did not think it fair that these late claimants be required to compromise 100 per cent of their legitimate claims. In addition, the chambers judge was of the view that process required flexibility and should avoid pitting creditors against one another.

7 Having decided that flexibility in the process was required, the chambers judge then considered an appropriate test for allowing the filing of late claims. Although encouraged by the appellants to adopt an approach similar to that contained in the United States Bankruptcy Code, Federal Rules of Bankruptcy Procedure, for Chapter 11 Reorganization Cases, ("U.S. Bankruptcy Rules") the chambers judge chose to incorporate the test in place under the Bankruptcy and Insolvency Act R.S.C. 1985 c. B-3 ("BIA"). Specifically, he found that because the situation of Blue Range was essentially a liquidation, the approach used in the BIA was appropriate. Under the BIA, late claims are permitted under almost any circumstance provided no injustice is done to other creditors. A late filing creditor under the BIA may only share in undistributed assets. Therefore, the chambers judge found that the creditors should be allowed to file late claims, or to amend existing claims late.

Standard of Review

8 It has been recently held by this court that decisions of a CCAA supervising judge should only be interfered with in clear cases. Deference to a CCAA supervising judge is generally appropriate where the questions before the court deal with management issues and are of necessity matters

which must be decided quickly. This issue was addressed by Macfarlane, J.A. in Pacific National Lease Holding Corp. (1992), 15 C.B.R. (3d) 265 (B.C.C.A.) (cited with approval by Hunt, J.A. in Luscar Ltd. v. Smoky River Coal Ltd., [1999] A.J. No. 676 (C.A.)) as follows at 272:

> ...I am of the view that this court should exercise its powers sparingly when it is asked to intervene with respect to questions which arise under the CCAA. The process of management which the Act has assigned to the trial court is an ongoing one. In this case a number of orders have been made...
>
> ...
>
> Orders depend on a careful and delicate balancing of a variety of interests and of problems. In that context appellate proceedings may well upset the balance, and delay or frustrate the process under the CCAA.

The chambers judge was exercising his discretion under the CCAA in granting an extension of the claims bar dates. However, the criteria upon which that discretion is to be exercised is a matter of legal principle, and therefore on that issue, the standard of review is correctness.

Analysis

9 As a preliminary matter I wish to comment on the nature of the order granted and the notices sent out to the individual creditors. The order dated April 6, 1999 stated in paragraph 2:

> Claims not proven in accordance with the procedures set out in Schedules "A" and "B" shall be deemed forever barred and may not thereafter be advanced as against Blue Range in Canada or elsewhere. (A.B.P. 01)

The first page of Schedule "A" stated in part:

> A Claims' Bar Date of 5:00 p.m. Calgary time on May 7, 1999 has been set by the Alberta Court of Queen's Bench. All claims received by the monitor or postmarked after the Claims' Bar Date will be <u>forever extinguished, barred and will not participate in any voting or distributions in the CCAA proceedings.</u>.
> [Emphasis added] (A.B.P. 03).

The language used in Schedule "A" goes beyond the text of the order. Although it may not be of practical significance, barring the right of a claimant to a remedy is fundamentally different from erasing the debt. The court under the CCAA has powers to compromise and determine, but only in

accordance with the process prescribed in the statute.

10 It was urged before the court in oral argument by counsel for the appellants that the purpose of the wording of the claims bar orders was to "smoke out" the creditors. I am dubious that the severe wording of the claims bar orders is effective to "smoke out" the creditor who may otherwise lie dormant. The objective of making certain that all legitimate creditors come forward on a timely basis has to be balanced against the integrity and respect for the court process and its orders. Courts should not make orders that are not intended to be enforced in accordance with their terms. All counsel conceded that the court had authority to allow late filing of claims, and that it was merely a matter of what criteria the court should use in exercising that power. It necessarily follows that a claims bar order and its schedule should not purport to "forever bar" a claim without a saving provision. That saving provision could be simply worded with a proviso such as "without leave of the court", which appears to be not only what was contemplated, but what in fact occurred here.

The Appropriate Criteria

11 The appellants advocated the adoption of the criteria under the U.S. Bankruptcy Rules, Chapter 11, while the respondents favoured either the application of the tests under the BIA or some blending of the two standards.

12 Rule 9006 of the U.S. Bankruptcy Rules deals with the extension of time in these circumstances. The relevant portion of the Rule states:

> 9006 (b)(1) ... when an act is required or allowed to be done at or within a specified period by these rules or by a notice given thereunder or by order of court, the court for cause shown may at any time in its discretion (1) with or without motion or notice order the period enlarged if the request is made before the expiration of the period originally prescribed or as extended by a previous order or (2) on motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect.

The key phrase in this section is "excusable neglect". In Pioneer Investment Services Company v. Brunswick Associates v. Brunswick Associates Limited Partnership et al. (1993), 507 U.S. 380, 113 S. Ct. 1489, the U.S. Supreme Court dealt with the interpretation of this phrase. In Pioneer, the creditor's attorney, due to disruptions in his legal practice and confusion over the form of notice, failed to file a Notice of Claim in time. The U.S. Supreme Court noted that excusable neglect may extend to "inadvertent delays" (at pg 391) and went on to identify the relevant considerations when determining whether or not a delay is excusable. The Court said at 395:

> Because Congress has provided no other guideposts for determining what sorts of neglect will be considered "excusable", we conclude that the determination is at bottom an equitable one, taking account of all relevant circumstances surrounding the party's omission. These include, as the Court of Appeals found,

> the danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith.

The American authorities also seem to reflect that the burden of meeting all of these elements, including showing the absence of prejudice, lies with the party seeking to file the late claim: e.g. In re Specialty Equipment Companies Inc., [1993] CA7-QL 1429, 159 B.R. 236.

13 The Canadian approach under the BIA has been somewhat different. Canadian courts have been willing to allow the filing of late or amended claims under the BIA when the claims are delayed due to inadvertence, (which would include negligence or neglect), or incomplete information being available to the creditors, see: Re Mount Jamie Mines (Quebec) Ltd. (1980), 110 D.L.R. (3d) 80 (Ont. S.C.). The Canadian standard under the BIA is, therefore, less arduous than that applied under the U.S. Bankruptcy Rules.

14 I accept that some guidance can be gained from the BIA approach to these types of cases but I find that some concerns remain. An inadvertence standard by itself might imply that there need be almost no explanation whatever for the failure to file a claim in time. In my view inadvertence could be an appropriate element of the standard if parties are able to show, in addition, that they acted in good faith and were not simply trying to delay or avoid participation in CCAA proceedings. But I also take some guidance from the U.S. Bankruptcy Rules standard because I agree that the length of delay and the potential prejudice to other parties must be considered. To this extent, I accept a blended approach, taking into consideration both the BIA and U.S. Bankruptcy Rules approaches, bolstered by the application of some of the concepts included in other areas, such as late reporting in insurance claims, and delay in the prosecution of a civil action.

15 In Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110 (B.C.S.C.), the applicant was an unsecured creditor of Alberta Pacific Terminals Ltd. ("APCL"). Transtec Canada Ltd. was indebted to the applicant and APCL had guaranteed the obligation. APCL sought protection under the CCAA. Through oversight, the applicant Lindsay was not sent the relevant CCAA materials by APCL and was not included in the CCAA proceedings. He did not, therefore, have the opportunity to vote on the plan of arrangement. It is clear, however, that Lindsay at some point during the CCAA proceedings became aware of them, and at various stages had his lawyers contact APCL's lawyers to inquire about the process. Despite this knowledge he did not pursue the matter. Lindsay then came to the court seeking permission to sue APCL as a guarantor, potentially recovering considerably more than those creditors who participated in the CCAA process.

16 After reviewing all of the facts, Huddart, J. found that "Lindsay (or solicitors on his behalf) made considered, deliberate, decisions not to notify Alberta-Pacific of his claim until after the approval order and then not until after the closing of the share purchase agreement" (para. 19). She then went on to conclude that Lindsay preferred not to participate in the CCAA process and chose

to take his chances later on.

17 In deciding how to exercise her discretion, Huddart, J. applied the following factors: "the extent of the creditor's actual knowledge and understanding of the proceedings; the economic effect on the creditor and debtor company; fairness to other creditors; the scheme and purpose of the CCAA and the terms of the plan" (para. 56). On these criteria, Huddart, J. found that it would not be equitable to allow Lindsay to pursue a claim as he was well aware of what was going on in the CCAA proceedings, chose not to participate, and his late action would cause serious prejudice both to the debtor company and to the other creditors.

18 While Lindsay is clearly distinguishable on its facts from the within appeal, the case does highlight the issues of the conduct of the late claimants and the potential prejudice to other creditors and the debtor. Lindsay was the classic creditor "lying in the weeds", waiting for the appropriate moment to pounce. He did not act in good faith and his conduct was potentially prejudicial to other creditors and the debtor company. By avoiding the CCAA proceedings, Lindsay was attempting to gain an advantage not available to other creditors.

19 There is further support for a blended approach in several other areas of the law where courts have had to deal with the impact of delays and late filings. In particular, I have considered the courts' treatment of delays in the prosecution of actions and the late filing of notices of claim to insurers.

20 In Lethbridge Motors Co. v. American Motors (Can.) Ltd. (1987), 53 Alta. L.R. (2d) 326 (C.A.) the court had to decide whether or not to allow an action to continue where no steps had been taken by the plaintiff for five years. In deciding that the action could continue, Laycraft, C.J.A. relied on the following test from the English Court of Appeal in Allen v. Sir Alfred McAlpine & Sons Ltd., [1968] 1 All E.R. 543 where Salmon L.J. said at 561:

> In order for the application to succeed the defendant must show:
>
> (i) that there has been inordinate delay. It would be highly undesirable and indeed impossible to attempt to lay down a tariff - so many years or more on one side of the line and a lesser period on the other. What is or is not inordinate delay must depend on the facts of each particular case. These vary infinitely from case to case, but it should not be too difficult to recognise inordinate delay when it occurs.
> (ii) that this inordinate delay is inexcusable. As a rule, until a credible excuse is made out, the natural inference would be that it is inexcusable.
> (iii) that the defendants are likely to be seriously prejudiced by the delay. This may be prejudice at the trial of issues between themselves and the plaintiff, or between each other, or between themselves and the third parties. In addition to any inference that may properly be drawn from the delay itself,

> prejudice can sometimes be directly proved. As a rule, the longer the delay, the greater the likelihood of serious prejudice at the trial.

Relying on this test, as well as additional refinements, the Court found that the fundamental rule was that it was "necessary for a defendant to show serious prejudice before the court will exercise its jurisdiction to strike out an action for want of prosecution" (at pg. 331). The onus of showing serious prejudice has now been substantially altered as the result of amendments to the Alberta Rules of Court in 1994. Rule 244(4) now states that proof of inordinate and inexcusable delay constitutes prima facie evidence of serious prejudice: Kuziw v. Kucheran Estate, [2000] A.J. No. 944, 2000 ABCA 226 (Online: Alberta Courts).

21 Similar questions can arise in an insurance context where an insured is required to file a proof of loss or other notice of claim within a certain time period under a contract of insurance. For example, s. 205 of the Insurance Act R.S.A. 1980, c. I-5 states:

> 205 [w]here there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to by done or omitted by the insured with respect to the loss and the consequent forfeiture or avoidance of the insurance in whole or in part and the Court considers it inequitable that the insurance should be forfeited or avoided on that ground, the Court may relieve against forfeiture or avoidance on such terms as it considers just.

22 Similar wording is also found in ss. 211 and 385 of the Insurance Act and similar legislation exists throughout the common law provinces.

23 When deciding whether to grant relief from forfeiture in an insurance context the Alberta courts have generally adopted a two part test, see: Hogan v. Kolisnyk (1983), 25 Alta L.R. (2d) 17 (Q.B.). In Hogan the court found it appropriate to look first at the conduct of the insured to determine whether the insured is guilty of fraud or wilful misconduct. Second, the court considered whether the insurer had been seriously prejudiced by the imperfect compliance with the statutory provision (at 35). The "noncomplying" party can show that there was no prejudice by showing that the innocent party had actual knowledge of the events in question and was thereby able to investigate the situation.

24 Considering whether the insurer has suffered any prejudice, the court in Hogan quoted from a decision of Stevenson, D.C.J. in Schoeler (W.) Trucking Ltd. v. Market Ins. Co. of Can. (1980), 9 Alta L.R. (2d) 232 at 237 where Stevenson, D.C.J. said "[t]he root of the question is whether or not it (the insurer) would have acted any differently if it had been given notice of the loss when it should have been given notice". In 312630 British Columbia Ltd. v. Alta. Surety Co. (1995), 10 B.C.L.R. (3d) 84 (C.A.) the B.C. Court of Appeal set out a more recent formulation of the test, namely whether the insurer by reason of the late notice had lost a realistic opportunity to do anything that it might otherwise have done.

25 These authorities arise in a clearly different context from that which I am dealing with in this case, but they demonstrate that there is a somewhat consistent approach in a variety of areas of the law when dealing with the impact of late notice or delays in particular processes.

26 Therefore, the appropriate criteria to apply to the late claimants is as follows:

1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?
2. What is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay?
3. If relevant prejudice is found can it be alleviated by attaching appropriate conditions to an order permitting late filing?
4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

27 In the context of the criteria, "inadvertent" includes carelessness, negligence, accident, and is unintentional. I will deal with the conduct of each of the respondents in turn below and then turn to a discussion of potential prejudice suffered by the appellants.

National-Oilwell Canada Ltd. ("National")

28 National, and National as the successor in interest to Dosco Supply, a division of Westburne Industrial Enterprises Ltd. ("Dosco") indicate that their claims were filed late due to the unexpected illness and resulting lengthy absence of their credit manager who was in charge of the Blue Range accounts receivable. National submitted the National and Dosco notices of claims on June 7, 1999 (AB V, pgs 538 and 542). National's claim is $58,211.00 and Dosco's claim is $390,369.13. National and Dosco clearly acted in good faith and provided the Notices of Claim as soon as the relevant personnel became aware of the situation.

Campbell's Industrial Supply Ltd. ("Campbell's")

29 Campbell's initial claim in the amount of $14,595.22 was filed prior to the date in the relevant claims bar order. Campbell's then amended its claim on June 25, 1999 and again on July 8, 1999 to $23,318.88. The claim was amended after the relevant date as a result of a representative from Blue Range informing Campbell's that its claim should include invoices sent to Trans Canada Midstream, Berkley Petroleum, Big Bear Exploration and Blue Range Resources Corporation (A.B. 495-496). In addition, there appears to have been some delay due to the Notices of Claim not being sent to the correct Campbell's office. Campbell's acted in good faith throughout and it is in fact arguable that any delay in the proper filing of its claims was actually due to errors on the part of Blue Range rather than its own doing.

TransAlta Utilities Corporation ("TransAlta")

30 TransAlta did not comply with the dates in the claims bar orders. It contends that it did not receive the claims package prior to the relevant dates. It is apparent from the evidence that the claims package was sent to TransAlta at its accounts receivable office, rather than the registered office for service (A.B. 432-434). TransAlta was permitted to file its total claim of $120,731.00 by order of the chambers judge dated September 7, 1999. There is no evidence that TransAlta was attempting to circumvent the CCAA process. On the contrary, as soon as the appropriate personnel became aware of the situation, TransAlta took the necessary steps to have its Notice of Claim filed.

Petro-Canada Oil and Gas ("PCOG")

31 PCOG filed extensive claims material with the Monitor prior to the relevant dates showing several unsecured claims. The Monitor's draft third interim report indicated that four of PCOG's claims should properly have been classified as secured. The mistake by PCOG was the result of a misapprehension of how operator's liens functioned under the CAPL Operating Procedures incorporated into the contracts giving rise to the claims. PCOG then sought to amend its claims and have them changed from unsecured to secured status (A.B. 554), on July 7, 1999. The change in status would result in claims of $137,981.30 being amended from unsecured to secured. There was no lack of good faith.

Barrington Petroleum Ltd. ("Barrington")

32 Barrington was acquired by Sunoma Energy Corp ("Sunoma") in about September, 1998. An affidavit filed by Sunoma's controller indicates that the financial records of Barrington were found to have been in complete disarray. Barrington's initial Notice of Claim in the amount of $223,940.06 was submitted prior to the relevant date. Barrington received a Notice of Dispute of Claim which approved the claim to the extent of $57,809.37, but disputed the remainder. On reviewing the issue, Barrington's controller determined that Blue Range was correct, but at the same time she identified additional invoices of which she had been unaware (A.B. 549-551). On discovering the additional invoices, Barrington then submitted an amended Notice of Claim on July 22, 1999 and an objection to the Notice of Dispute of Claim. Barrington acted in good faith.

Rigel Oil & Gas Ltd. ("Rigel")

33 The full amount of Rigel's Notice of Claim was $146,429.68. This Claim was filed prior to the relevant date and the amount was approved by Blue Range. After the relevant date, on August 12, 1999, Rigel moved to amend and to allege that, despite Blue Range's claims to the contrary, its claim was secured, rather than unsecured. The only issue for Rigel on appeal is if their claim is properly secured can it be accepted because it was not claimed as secured until August 12, 1999.

Halliburton Group Canada Inc. ("Haliburton")

34 Halliburton was in the process of attempting to collect on accounts receivable owed by Big Bear Exploration Ltd. through May and June, 1999. They subsequently became aware, after the

relevant date, that a claim in the amount of $11,309.90 was in fact against Blue Range, and should properly have been filed as a Notice of Claim in the CCAA proceedings (A.B. 497-499). On making this discovery, Halliburton wrote to the Monitor on July 14, and July 26, 1999 requesting that its claim be included in the CCAA proceeding. The Monitor disputed this claim as having been filed too late (A.B. 498). It appears that Halliburton acted in good faith.

Founders Energy Ltd. ("Founders")

35 Founders filed its claim prior to the relevant date, but, due to an oversight, claimed as an unsecured rather than a secured creditor. After filing its initial Notice of Claim, Founders received a Notice of Dispute from Blue Range. Within the 15 day appeal period, but outside the claims bar date, Founders then filed an amended Notice of Claim claiming a secured interest in the sum of $365,472.39, on July 26, 1999.

Prejudice

36 The timing of these proceedings is a key element in determining whether any prejudice will be suffered by either the debtor corporation or other creditors if the late and late amended claims are allowed. The total of all late and amended claims of the late claimants, secured and unsecured, is approximately $1,175,000. As set out above, in the initial claims bar order, the relevant date was 5:00 p.m. May 7, 1999. This date was extended for joint venture partners to 5:00 p.m. on June 15, 1999. The Plan of Arrangement, sponsored by Canadian Natural Resources Ltd. ("CNRL"), was voted on and passed on July 23, 1999. Status as a creditor, the classification as secured or unsecured, and the amount of a creditor's claim, are relevant to voting: s. 6 CCAA.

37 Enron and the Creditor's Committee claim that they would be prejudiced if the late claims were allowed because, had they known late claims might be permitted without rigorous criteria for allowance, they might have voted differently on the Plan of Arrangement. Enron in particular submits that it would have voted against the CNRL Plan of Arrangement, thus effectively vetoing the plan, if it had known that late claims would be allowed. This bald assertion after the fact was not sufficient to compel the chambers judge to find this would in fact have been Enron's response. Nowhere else in the evidence is there any indication that late claimants being allowed would have impacted the voting on the different proposed Plans of Arrangement. In addition, materiality is relevant to the issue of prejudice. The relationship of $1,175,000 (which is the total of late claims) to $270,000,000 (which is the total of claims filed within time) is .435 per cent.

38 Also, the contrary is indicated in the Third Interim Report of the Monitor where it is shown in Schedule D-1 (A.B. 269) that $2 million was held as an estimate of unsecured disputed claims. Therefore, when considering which Plan of Arrangement to vote for, Enron, and all of the creditors, would have been aware that $2 million could still be legitimately allowed as unsecured claims, and would have been able to assess that potential effect on the amount available for distribution.

39 Further, the late claimants were well known to the Monitor and all of the other creditors. The

evidence discloses that officials at Enron received an e-mail from the Monitor on May 18, 1999 indicating that there were several creditors who had filed late, after the first deadline of May 7, and the Monitor thought that even though they were late the court would likely allow them (A.B. 1040). Finally, all of the late claimants were on the distribution list as having potential claims. (A.B. 9-148). It cannot be said that these late claimants were lying in the weeds waiting to pounce. On the contrary, all parties were fully aware of who had potential claims, especially Enron and the Creditors Committee.

40 In a CCAA context, as in a BIA context, the fact that Enron and the other Creditors will receive less money if late and late amended claims are allowed is not prejudice relevant to this criterion. Re-organization under the CCAA involves compromise. Allowing all legitimate creditors to share in the available proceeds is an integral part of the process. A reduction in that share can not be characterized as prejudice: Re Cohen (1956), 36 C.B.R. 21 (Alta. C.A.) at 30-31. Further, I am in agreement with the test for prejudice used by the British Columbia Court of Appeal in 312630 British Columbia Ltd. It is: did the creditor(s) by reason of the late filings lose a realistic opportunity to do anything that they otherwise might have done? Enron and the other creditors were fully informed about the potential for late claims being permitted, and were specifically aware of the existence of the late claimants as creditors. I find, therefore, that Enron and the Creditors will not suffer any relevant prejudice should the late claims be permitted.

Summary of Criteria

41 In considering claims filed or amended after a claims bar date in a claims bar order, a CCAA supervising judge should proceed as follows:

1. Was the delay caused by inadvertence and if so, did the claimant act in good faith?
2. What is the effect of permitting the claim in terms of the existence and impact of any relevant prejudice caused by the delay?
3. If relevant prejudice is found can it be alleviated by attaching appropriate conditions to an order permitting late filing?
4. If relevant prejudice is found which cannot be alleviated, are there any other considerations which may nonetheless warrant an order permitting late filing?

Conclusion

42 Applying the criteria established, I find that the conclusion reached by the chambers judge ought not to be disturbed, and the late claims filed by the respondents should be permitted under the CCAA proceedings. The appeal is dismissed.

WITTMANN J.A.
RUSSELL J.A.:-- I concur.
SULATYCKY J.A.:-- I concur.

cp/i/qljpn/qlcas/qlsxs

1998 CarswellOnt 2758, [1998] I.L.R. I-3575, 40 O.R. (3d) 429, 22 C.P.C. (4th) 381, 5 C.C.L.I. (3d) 18, [1998] O.J. No. 2811

1998 CarswellOnt 2758, [**1998**] I.L.R. I-3575, 40 O.R. (3d) 429, 22 C.P.C. (4th) 381, 5 C.C.L.I. (3d) 18, [**1998**] O.J. No. 2811

Dabbs v. Sun Life Assurance Co. of Canada

Paul Dabbs, Plaintiff and Sun Life Assurance Company of Canada, Defendant

Ontario Court of Justice, General Division

Sharpe J.

Heard: May 4-5 and June 5, 1998
Judgment: July 3, 1998[FN*]
Docket: 96-CT-022862

Proceedings: set aside or quashed *Dabbs v. Sun Life Assurance Co. of Canada* (September 14, 1998), CA C30326, M22971, M23028 (Ont. C.A.)**Proceedings: refused leave to appeal *Dabbs v. Sun Life Assurance Co. of Canada* (October 22, 1998), 26855 (S.C.C.)**

Counsel: *Michael A. Eizenga*, *Michael J. Peerless* and *Charles M. Wright*, for the plaintiff.

H. Lorne Morphy and *Patricia D.S. Jackson*, for the defendant.

Michael Deverett, for three objectors.

Gary R. Will and *J. Douglas Barnett*, for eleven objectors.

Subject: Civil Practice and Procedure; Insurance

Practice --- Parties — Representative or class actions — General

Parties settled plaintiff's proposed class action — Parties moved for certification of action as class proceeding and approval of settlement — Plaintiff claimed that defendant misrepresented period for which premiums were payable with respect to "vanishing premium" life insurance policies — Plaintiff's statement of claim disclosed cause of action respecting common issue shared by identifiable class of plaintiffs — Class proceeding was most efficient manner to deal with potential claims of 141,000 class members in Ontario — No basis existed for denying certification — Agreement did not fail to provide for subclass of plaintiffs who had additional claim for further improprieties respecting sale of insurance policies — Right to opt out of settlement provided adequate protection to any class member who wished to pursue further or alternative claim against defendant — Action was certified as class proceeding.

Practice --- Disposition without trial — Settlement — General

Insured and insurer settled proposed class action for alleged misrepresentation in sale of life insurance policies — Parties moved for approval of settlement — Settlement merits approval where in all circumstances it is fair, reasonable and in best interests of those affected by it — Settlement was strongly recommended by experienced counsel — Same settlement agreement had been approved by courts of British Columbia and Quebec — Under settlement, class members had right to receive either "no proof" benefits or benefits determined according to summary claims resolution process — Alternatively, class members had right to opt out of settlement and sue on own behalf — Proposed settlement was approved.

Cases considered by *Sharpe J.*:

London & South Western Railway v. Blackmore (1870), L.R. 4 H.L. 610, 39 L.J. Ch. 713 (U.K. H.L.) — referred to

Podmore v. Sun Life Assurance Co. (January 16, 1998), Tannenbaum J. (Que. S.C.) — considered

Romanchuck v. Sun Life Assurance Co. (November 28, 1997), Brenner J. (B.C. S.C.) — considered

Statutes considered:

Class Proceedings Act, 1992, S.O. 1992, c. 6

Generally — pursuant to

s. 5 — referred to

s. 5(1) — considered

MOTION by plaintiff and defendant for certification of plaintiff's action as class proceeding and for approval of settlement agreement reached by parties.

***Sharpe J.*:**

1. Nature of Proceedings

1 This action is a proposed class proceeding pursuant to the *Class Proceedings Act 1992*, S.O. 1992, c. 6. The claim arises from the sale of so-called "vanishing premium" life insurance policies. The plaintiff alleges that in marketing these policies, the defendant Sun Life Assurance Company of Canada ("Sun Life") and its agents represented to purchasers that dividends to policy holders would pay the required premiums within a specified number of years. Sales illustrations projected a "premium offset date" after which no further premiums would be required. In fact, in the plaintiff's case and in a large number of similar cases, dividends have been lower than projected and policy holders have been or will be required to pay premiums for a longer period than the projected premium offset date. The defendant Sun Life has made it clear that it denies the allegations of misrepresentation.

2 Together with similar Quebec and British Columbia actions, this action was settled by written agreement, dated June 16, 1997. The settlement is subject to and conditional upon court approval in all three provinces. The settlement has been approved in Quebec and British Columbia. On this motion, the plaintiff and defendant seek

certification of the action as a class proceeding and approval of the settlement.

3 Following my earlier ruling on the procedure to be followed on this motion, released February 24, 1998, further material was filed by the plaintiff and by certain of the objectors. The motion was then heard over three days in accordance with the terms set out in my procedural ruling. I am now in a position to rule on certification and the request for approval of the settlement.

2. Certification

4 The test for certification is set out in the following terms in the *Class Proceedings Act*, s. 5:

> 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 action 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.

5 The defendant supports the motion for certification, but only on the condition that the settlement be approved at the same time. Subject to certain submissions relating to the subclass issue discussed below, the objectors focused their attention on the settlement and did not seriously contend that this was not a case for certification.

(a) Cause of Action

6 I am satisfied that the statement of claim discloses a cause of action. The plaintiff asserts claims on his own behalf and on behalf of a proposed class for alleged breach of contract and negligent misrepresentation arising out of the manner in which whole life participating insurance policies with a premium offset option were sold. The allegations in the action primarily concern the use of sales illustrations, combined with oral and written representations made by the defendant and its agents with respect to the date upon which dividends would be sufficient to fully pay up the policies. While it is clear from the position it has taken on this motion that the defendant would deny these allegations if the action were to proceed, the plaintiff does plead a tenable cause of ac-

tion.

(b) Identifiable Class

7 The plaintiff proposes that the class be defined as follows:

> all owners of Class Policies purchased in Ontario, or who are resident in Ontario on April 30, 1997 and whose Class Policy(ies) were purchased outside Quebec or British Columbia.
>
> "Class Policy" is defined as
>
> any participating whole life policy issued by Sun Life in Canada between January 1, 1980 and December 31, 1995 which is in force as of April 30, 1997 (a "Current Class Policy") or which has become a Lapsed Policy between January 1, 1990 and April 30, 1997 (a "Lapsed Class Policy"), except those policies in respect of which the owners have released Sun Life from claims related to premium offset or to the sale of the policies.

8 The proposed definition of the class does, I find, represent an identifiable class of two or more persons that would be represented by the representative plaintiff. It is common ground that there are approximately 141,000 members of the proposed class in Ontario and approximately 400,000 class members in Canada.

(c) Common Issue

9 I also find that the statement of claim does raise a common issue, namely the following:

> Did the use of illustrations and/or any representations, in writing or verbal, create an obligation on the part of Sun Life with respect to a specified offset date despite the terms of the policy itself and the terms of any illustration?

(d) Preferable Procedure

10 I find that a class proceeding is the preferable procedure for the resolution of the common issue. As already noted, there are approximately 141,000 class members in Ontario and approximately 400,000 class members in Canada. The litigation of these claims on an individual basis would be costly and time consuming. Indeed, if these claims had to be litigated on an individual basis, few members of the class would be able to present their claims because of the costs, risks and delays involved. I have no doubt that a class proceeding is the most efficient manner to deal with these claims from the perspective of both the litigants and the court, and that a class proceeding will result in increased access to justice.

(e) Representative Plaintiff

11 Mr. Dabbs filed an affidavit on this motion and was cross-examined before me. Mr. Dabbs impressed me as being an honest and informed lay person with a genuine perception of having been mislead by an agent as to the number of premiums he would have to pay. I am satisfied on the basis of all the evidence that he has made a sincere and genuine effort to represent the interests of the proposed class and that he has no conflict of interest with other members of the class. I find as well that the representative plaintiff has produced a proper plan for the resolution of this proceeding.

(f) Subclass

12 Mr. Deverett submitted that certification should be denied on the ground that the agreement failed to provide for a subclass for those who have claims for "twisting", a practice whereby a policy holder is improperly induced by an agent to replace an existing policy with a new policy of less value to the policy holder. In my view, there is no evidence that would indicate that there has been a significant problem with "twisting" among Sun Life policy holders. Class counsel did not ignore the issue. The statement of claim contains an allegation that would deal with twisting. However, Mr. Ritchie testified that from class counsel' s interviews with over 200 policy holders, there emerged no evidence of a systemic problem. In my view, in the absence of any evidence or reasonably supported belief that twisting may be a wide-spread problem among class members, there is no basis for denying certification on the ground that there is no subclass for "twisting". The right to opt out provides adequate protection to any class member who wishes to pursue a claim for "twisting".

3. Terms of the Settlement

13 The settlement agreement is a document of some considerable complexity, but it will facilitate analysis to provide a simplified explanation of it main features.

(a) Right to Opt Out

14 Under the terms of the settlement, all class members retain the right to opt out of the settlement and sue on their own behalf for whatever claim they wish to assert. The right to opt out arises at two stages. A class member may opt out immediately and have nothing to do with the settlement. There is also a right to opt out that arises in one area of the alternative claim resolution process, discussed in greater detail below.

(b) Global Benefits

15 The proposed settlement contains two types of benefits for class members. First are Global Benefits. These might be described as "no-proof" benefits. They are available to all class members without inquiry as to the nature of the representations that were made to the class member at the time he or she purchased the policy. All members of the class are automatically entitled to an annual dividend improvement of 50 basis points ($^{1}/_{2}$ %) higher than would otherwise apply for a period of three years. For a special category of policies known as "enhanced policies", there is a further benefit of a 25% reduction in the cost of term insurance for the enhanced term of such policy.

16 A member of the class may also elect the Optional Dividend Benefit. This is also a "no-proof" benefit, available without inquiry as to the nature of the representations that were made to the class member at the time he or she purchased the policy. This benefit entitles the policy holder to an annual dividend interest rate that is 75 basis points (3/4%) higher than would otherwise apply for the term of the policy. However, to obtain this benefit, the policy holder must waive the Special Maturity Dividend. The Special Maturity Dividend is not a right secured by any policy, but an enhancement the defendant has voluntarily provided to its policy holders. It represents an enhanced cash value or payment on death determined by the length of time the member has held the policy. To determine the relative values of the Optional Dividend Benefit and the Special Maturity Dividend the policy holder must give up, it is necessary to examine the policy holder's individual circumstances. The plaintiff and the defendant submit that in most cases, the value of the Optional Dividend Benefit will greatly exceed the value of the Special Maturity Dividend. I will return to the question of the value of the Optional Dividend Benefit below.

(c) Alternative Claims Resolution Process

17 The second type of benefit is that available through the Alternative Claims Resolution Process ("ACRP"). The ACRP provides a mechanism whereby a policy holder presents evidence of the nature of the actual misrepresentation made at the time of sale of the policy. A class member who elects to submit an ACRP claim is, subject to an exception described below, not entitled to receive the "no-proof" benefits just described. The ACRP provides for submission of a claim on the basis of affidavit from the policy holder and certain documentary evidence.

18 The settlement agreement contemplates that a policy holder who submits an ACRP claim will be placed in one of five categories. These are described in greater detail and with more precision in the agreement, but for present purposes, the following simplified definitions will suffice:

> *Category 1*: the member provides evidence showing that the defendant or its agent made a written representation that the policy would be fully paid-up after a specified number of premiums had been paid.
>
> *Category 2*: the member provides affidavit evidence that the defendant's agent made an oral representation that the policy would be fully paid-up after a specified number of premiums had been paid and the agent confirms that such representation was made.
>
> *Category 3*: the member provides affidavit evidence that the defendant's agent made an oral representation that the policy would be fully paid-up after a specified number of premiums had been paid but the agent neither confirms nor denies that such representation was made.
>
> *Category 4*: the member provides affidavit evidence that the defendant's agent made an oral representation that the policy would be fully paid-up after a specified number of premiums had been paid but the agent provides an affidavit denying that such representation was made.
>
> *Category 5*: the member provides affidavit evidence that the defendant's agent made an oral representation that the policy would be fully paid-up after a specified number of premiums had been paid and there is evidence that a written statement was provided at the time of sale which contradicts the member's version of the misrepresentation.

19 The rights and benefits attaching to these classifications is as follows. Category 1 and 2 claimants are entitled to the same premium offset entitlement that was represented to them. Category 3 claimants are entitled to a premium offset date which is half way from the premium offset date represented at the time of sale to the premium offset date shown as applicable on the first policy anniversary date after March 1, 1997. Category 4 and 5 claimants are entitled to no relief. However, Category 4 claimants have two options available after their claims have been classified as falling into Category 4. First, they have the right to opt out of the settlement entirely, thereby preserving any common law action right they may have. Second, Category 4 claimants have the right to re-elect and take either of the "no-proof" benefits described above.

20 The settlement agreement provides for a summary and mechanical process whereby claims are to be assessed and classified. The ACRP does not allow for viva voce evidence, nor does it permit a right to cross-examine and or include any right to make oral representations. The defendant Sun Life is required to establish a Claims Administration Facility which bears primary responsibility for determining the claims. The Claims Administration Facility is, however, subject to audit by class counsel and rejected claims are subject to review by a

Review Panel consisting of a lawyer designated by Sun Life and a designated member of settlement class counsel. In the event of disagreement between the members of the review panel, there is further review by the "Designate", defined as a retired judge or comparable individual.

21 The agreement requires the parties to provide to the court for approval a list of statements which are to be considered to constitute clear and unqualified guarantees as contemplated for Category 1 and 2 claims. To protect the integrity of the ACRP, the lists are filed with the court under seal, but I have reviewed them. I find that they represent a useful, fair and reasonable collection of the sort of statement that would meet the standard required under the agreement.

22 Sun Life is also required to provide a toll free telephone information line on which class members may make inquiries and obtain policy status information. Class counsel are required to monitor that "hot line" to ensure that appropriate information is given to class members. I note as well that class members who opt for the ACRP are entitled to access to the Sun Life file. Counsel for Sun Life stated to the court that before having to decide whether to accept the Global Benefits, elect the Opitional Dividend Benefit or pursue a claim under the Alternative Resolution Process, a class member would be able to obtain from Sun Life a print-out setting out information as to the class member's policy that would include the value of the Special Maturity Benefit.

(d) Value of the Optional Dividend Benefit

23 The value of the "Optional Dividend Benefit" is of considerable significance. It is available to all policy holders on a "no-proof" basis and as it provides the fall-back position available to those policy holders who swear that a misrepresentation was made but who are denied any relief under the ACRP when met with a sworn denial by the agent.

24 I asked for further evidence of the value of this benefit. The plaintiff answered this request with a further affidavit from an actuary who had been retained to provide an expert opinion on the overall worth of the settlement. It is apparent that the actuary's opinion is based upon background information with respect to policies, dividends and benefits provided by the defendant. While neither of the groups of objectors showed any concern about the value of the Optional Dividend Benefit until I raised the point, both counsel submitted that there should be a more searching inquiry into the background information that had been provided to Mr. Huff. The defendant takes the position that this information is of a confidential nature and that if it were to be made a matter of public record, the defendant would suffer thereby. Upon Mr. Huff depositing with the Registrar of the Court copies of the material and information he had been provided by the defendant, I reserved my decision on the appropriate course to follow.

25 My ruling on this point is that the question I asked has been answered by Mr. Huff's evidence and that without looking at the material provided by the defendant to Mr. Huff, I have been provided sufficient information to permit me to assess the fairness of this settlement. I reach this conclusion for the following reasons. First, Mr. Huff impressed me as a reliable witness who took his role as an independent expert seriously. He did not exaggerate or use the witness stand as a platform to advocate the cause of the party that retained him. His evidence was measured and balanced. He indicated that by its very nature, virtually all of the information he needed to formulate his opinion had to come from the defendant. There is simply no independent source for the number and types of policies, the rights attached to those policies and the formulae for calculation of benefits. To the extent possible, he was able to verify that the information provided by the defendant was internally consistent and the necessary actuarial calculations were tested.

26 I was urged by the objectors represented by Mr. Deverett to question the reliability of data supplied by the defendant because of an adverse credibility finding made against a senior officer of the defendant by another judge of this court in another action. In my view, it would be entirely inappropriate to accept such a submission. Each case falls to be decided on its own merits and on the evidence presented and the information at issue here is not the same as the evidence rejected in that other proceeding.

27 I am satisfied that an honest and significant effort has been made to respond to the question I asked. Mr. Huff and his associates devoted over 100 hours of professional time, 50 hours of paraprofessional time and 30 hours of clerical time, the greater part of which was related to the verification of offset dates. No further review is required. I would add that inherent in the approval of a settlement is the need to assess issues on a less than complete factual record. To require proof of all relevant facts to the standard required at trial would defeat the very notion of a settlement where the parties ask the court to approve an arrangement reached on a less than perfect record.

28 Mr. Huff's evidence is that over 90% of policy holders would achieve offset reductions of between 30% and 70% through the Optional Dividend Benefit. The weighted average reduction for policies he tested with meaningful offset reductions (ie. excluding those where the current offset was the same as that indicated at the time of issue) was 56%. It is apparent that these are averages and that to assess the situation of any individual policy holder, it would be necessary to consider the particulars of that individuals situation. Mr. Huff confirmed that the examples provided by Sun Life in the Question and Answer booklet provided to Class members are accurate.

(e) Lapsed Policies

29 The agreement also makes provision for lapsed policies. The holder of a lapsed policy who is able to provide evidence of insurability is entitled to a new policy similar to the lapsed policy with a 50% reduction in the first annual premium. The holder of a lapsed policy may also apply under the ACRP. If the member's claim is classified as Category 1,2 or 3, the policy may be reinstated without evidence of insurability upon payment of past due premiums, loans and interest.

4. Analysis of the Proposed Settlement

(a) The standard for approval

30 In my previous ruling I indicated that the standard to be met by the parties seeking approval of the settlement is whether in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it. A settlement of the kind under consideration here will affect a large number of individuals who are not before the court, and I am required to scrutinize the proposed settlement closely to ensure that it does not sell short the potential rights of those unrepresented parties. I agree with the thrust of Professor Watson's comments in "Is the Price Still Right? Class Proceedings in Ontario", a paper delivered at a CIAJ Conference in Toronto, October, 1997, that class action settlements "must be seriously scrutinized by judges" and that they should be "viewed with some suspicion". On the other hand, all settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs of litigation.

31 I have had the benefit of three full days of cross-examination of deponents on affidavits filed in support

of the settlement and submissions by counsel representing the parties and the objectors. I have received answers to certain questions I posed to the parties. After considerations of the points that have been made both in favour of and against approval of the settlement, for the reasons that follow, I have reached the conclusion that this settlement should be approved.

(b) Recommendation of Class Counsel

32 The fact that this settlement is strongly recommended by experienced class counsel is certainly a factor in its favour. The recommendation of class counsel is clearly not dispositive as it is obvious that class counsel have a significant financial interest in having the settlement approved. Still, the recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line. Moreover, in the case at bar, the settlement was not the result of a solo effort. As there were proceedings brought in British Columbia and Quebec as well, there was a team of class counsel from three different provinces. Moreover, class counsel also sought and obtained the advise of counsel from the United States who have experience in "vanishing premium" litigation.

(c) Risks of Proceeding to Trial

33 While the plaintiff presents an arguable case, there is no doubt that there is a risk that if the case went to trial, the common issue would be resolved against the class. Misrepresentation is often difficult to prove. Here, the standard sales illustration which forms the basis of most claims contains an explicit waiver which the members of the class would have to overcome. While the specific terms vary, typical language is: "This illustration assumes a continuation of the current scale of dividends and Special Maturity Dividends (SMD). Dividends may be higher or lower; they will be based on Sun Life's interest, expense, and mortality experience." The policies themselves typically contain language indicating that the premium is payable throughout the term of the policy: "Total Premiums payable by owner due [Month, Day and Year] and yearly thereafter while life insured lives." It is certainly possible that the defendant might persuade a court that such language provided class members with a clear statement that the dividends might or might not be sufficient to fulfill the hoped for result of the illustration. In addition to the legal and factual risks are certain practical concerns. The case would be factually, legally and procedurally complex. It would almost certainly take several years to get to trial and to then exhaust appeals.

(d) Fairness of the ACRP

34 The ACRP is at the core of this agreement. It plainly does not offer the procedural guarantees of a trial as there is no right to cross-examine, present oral evidence or to make oral submissions. On the other hand, there would be no point to the settlement if it did not provide for some form of summary resolution of claims. The provision of a cost-free process to claimants who would otherwise be forced to abandon their claims or bear the costs of litigation represents a significant benefit.

35 In my view, there can be little doubt that the ACRP offers a fair and reasonable resolution of claims falling in Categories 1 and 2 which afford the claimant precisely the offset date that was represented. I would also find it difficult to question the fairness of the result of a Category 3 claim where the claimant is given half-way relief on the basis of nothing more that the claimants own sworn statement that an oral representation was made. Similarly, I see no reason to question the fairness of a Category 5 claim where there is evidence that a written statement was provided at the time of sale which contradicts the claimant's version of the misrepresentation. It is only fair that there be some control on the extent to which a class member can secure a benefit in the strength of

his or her own affidavit. I note here that in answer to a question I posed, it was stated to the court that it was not intended that language of the explicit waiver in the standard sales illustration quoted above would be sufficient to bring the claim within Category 5.

36 The contentious issue is the fairness of Category 4. Mr. Will focused his attention on this point and submitted that, in effect, the agent was given a veto over the rights of the policy holder. It was his submission that there should be some control or constraint on the extent to which agents could defeat a claim by simple denial. The right to confront and cross-examine the agent could be granted, or there could be a points system that would discount agent denials where the same agent denied more than one claim.

37 In my view, there are a number of factors which have to be considered here. First is the fact that the agent must make the denial on oath. This means that the agent who lies is subject to the threat of perjury. Second, it is not apparent that all agents will perceive it to be in their interest to favour the interests of Sun Life over their clients. Third are the very significant options that remain to a class member whose claim is denied by the agent. The class member has, at that point, the right to opt out and sue the defendant with full knowledge of the case he or she will have to meet. In that sense, the class member loses nothing because of the settlement but gains advance discovery of the case to be met. The class member also has the very significant right to abandon the ACRP and elect the "no-proof" benefits which, as noted, will frequently result in achieving half-way relief. In my view, when considered in light of the balance of the settlement, it cannot be said that the situation of the Category 4 claimants renders this settlement unfair.

38 It is my view, that considered as a whole, the ACRP does provide for an efficient and fair process.

(e) Approval in British Columbia and Quebec

39 Another factor which favours approval of the settlement is that the same agreement has been approved by the courts of British Columbia and Quebec. In the companion case in British Columbia, *Romanchuck v. Sun Life Assurance Co.* (Nov. 28, 1997), Brenner J. (B.C. S.C.) Brenner J. found that:

> ... the settlement is reasonable, fair and adequate. A considerable degree of creativity has been demonstrated by the parties in putting in place, among other things, a form of alternative dispute resolution to allow a cost effective method of resolving the claims in this case...

In the Quebec case, *Podmore v. Sun Life Assurance Co.* (January 16, 1998), Tannenbaum J. (Que. S.C.) Tannenbaum J. of the Quebec Superior Court found that the agreement was "raisonnable, équitable, approprié et dans le meilleur intérêt du groupe visé."

(f) Absence of Statement of Defence and Discovery

40 This settlement was reached at a very early stage of the proceedings. No statement of defence was filed and there has been no discovery. The position of the defendant has not been put formally on the record and has been known to class counsel only through the settlement process. In my view, this is not a reason for refusing approval. It is clearly not the law that a settlement requiring court approval cannot be made at such an early stage of the proceedings. Moreover, I am satisfied that class counsel did adequately consider the position of the defendant. There is evidence before me that before recommending the settlement, class counsel interviewed hundreds of potential class members and a number of Sun Life agents. I am satisfied that a serious and diligent effort has been made to determine the facts. This is by no means the first "vanishing premium" case litigated in

North America and class counsel took advice from others with experience in the area.

(g) Exclusion of Other Possible Claims

41 I have already dealt with the matter of "twisting" in relation to certification. It is unnecessary to add anything here except that the settlement preserves the right of any class member to opt out and pursue any such claim.

42 Mr. Deverett also suggested that the failure of the Sun Life policies to perform as indicated in the standard sales illustration might be the fault of Sun Life itself as it has the unfettered right to determine the dividends that are to be paid. Again, I find that the evidence before me fails to show that there is any serious prospect that this is a potentially valid source for a claim by class members. Sun Life does business in a competitive market. The failure of life insurance policies of the kind at issue here to perform was not restricted to Sun Life. There was an industry wide problem which has been linked to collapse of unusually high interest rates of the 1980's and which produced a number of actions in North America against a long list of insurance companies.

43 A related issue concerns the question of how Sun Life, a mutual insurance company, would pay for the benefits to be conferred upon the policy holders. While that issue was not dealt with in the agreement itself, Mr. Ritchie testified that an understanding was reached during the negotiation of the settlement that future dividend scales would not be affected. That understanding was confirmed by a letter to Mr. Ritchie dated August 29, 1997 from counsel for Sun Life stating:

> I confirm the information provided during the negotiation process.
>
> Sun Life has specified that future dividend scales will be determined as if the settlement had never taken place. No attempt to recoup the costs of the settlement will be made in any manner affecting the existing participating policy holders (including Class Members).

44 That undertaking was confirmed by counsel for Sun Life before me at this hearing. In light of possible demutualization by Sun Life, a further letter from Sun Life's counsel to Mr Ritchie dated May 1, 1998 repeats the above undertaking and states:

> Given the possibility of demutualization, Sun Life has instructed us to advise that the statements made earlier are still true, with the (obvious) clarification that the costs of the agreement may have an impact on the value of the company, which value will be distributed to all eligible policyholders in the event that demutualization proceeds.

45 Another point made in relation to the prospect of other potential claims is that the terms of the release to be given to Sun Life under the agreement are broad. Sun Life and its agents are to be released "from any liability or damages for representations, omissions or other conduct ... that occurred during the purchase or sale of any Settled Class Policy, or in connection with the offering of Global Benefits, the Optional Dividend Benefit, or other benefits or resolutions pursuant to the Agreement." A release in these terms consequent upon a settlement is not unusual or unexpected, and in any event, is subject to being interpreted in accordance with recognized legal principles. It is well established that a release must be interpreted with reference to the context in which it was drafted and that a release will not be construed as applying to facts not known to the claimant at the time the release was drafted: *London & South Western Railway v. Blackmore* (1870), L.R. 4 H.L. 610 (U.K. H.L.). These principles, together with the right of any policy holder who now believes he or she has a claim against Sun Life

that is not embraced by the settlement to opt out, provide an adequate answer to this objection.

(h) Analysis of the Proposed Settlement - Conclusion

46 I find that the plaintiff and the defendant have satisfied the burden of demonstrating that the proposed settlement is fair, reasonable and in the best interests of those affected by it. The Global Benefits afford significant relief to class members on a "no-proof" basis. The ACRP provides for a summary but fair disposition of claims advanced on the basis of representations that were made.

4. Conclusion

47 For these reasons, there shall be an order for the relief requested in paragraphs (a) to (i) of the Notice of Motion appointing Paul Dabbs as a representative plaintiff, certifying this action as class proceeding, approving the proposed settlement and for the further related orders requested.

48 In my February 24, 1998 ruling, I made reference to the issue of costs. Any party who wishes to claim costs shall serve and file a concise written brief within 20 days of the release of these reasons outlining the claim that is made and the basis for the claim. Reply submissions are to be made 10 days thereafter. A date for a hearing of any such claims will be arranged. Failing any such submissions, there shall be no order as to costs of this motion.

49 I will remain seized of this matter for the purpose of any further approvals that are required, including the approval of the arbitration award relating to the fees and disbursements of class counsel.

Motion granted.

FN* Judgment set aside/quashed (1998), 165 D.L.R. (4th) 482, 113 O.A.C. 307, [1999] I.L.R. I-3269, 41 O.R. (3d) 97 (C.A.); leave to appeal refused (October 22, 1998), Doc. 26855 (S.C.C.).

END OF DOCUMENT

Indexed as:

Dabbs v. Sun Life Assurance Co. of Canada

Between
Paul Dabbs, plaintiff, and
Sun Life Assurance Company of Canada, defendant

[1998] O.J. No. 1598

Court File No. 96-CT-022862

Ontario Court of Justice (General Division)

Sharpe J.

Heard: February 5, 1998.
Judgment: February 24, 1998.

(14 pp.)

Practice -- Persons who can sue and be sued -- Individuals and corporations, status or standing -- Class or representative actions, for damages -- Settlements -- Court approval.

Ruling as to procedural issues with respect to a motion for settlement approval of a class action suit involving a claim for damages against an insurer for breach of contract. The claim was settled by an agreement. Fourteen members of the proposed class filed objections to the settlement. The issues were the onus for approval of the agreement, the role of the court and factors to be considered in the approval of the agreement, procedures for and scope of the objection to the agreement and costs.

HELD: The parties proposing the settlement had the onus of showing that it should be approved. The role of the court was to find that the settlement was fair, reasonable and in the best interests of all those affected by it. The factors to be considered were the likelihood of recovery, the amount and nature of discovery evidence, the settlement terms, counsel's recommendations, the future expense of litigation, the number of objectors, the nature of objections and the presence of good faith. The objectors had the right to adduce evidence by way of affidavit but had no right to oral discovery or production of documents. They were subject to the discretion of the court to impose appropriate terms as to costs.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 242(2).

Class Proceedings Act, 1992, ss. 12, 14, 29, 32(1).

Ontario Rules of Civil Procedure, Rule 7.08(1).

Counsel:

Michael A. Elzenga and Charles M. Wright, for the plaintiff.
H. Lorne Morphy and Patricia D.S. Jackson, for the defendant.
Michael Deverett, for 3 objectors.
Gary R. Will and J. Douglas Barnett, for 11 objectors.

SHARPE J.:--

1. NATURE OF PROCEEDINGS

1 In this action, commenced pursuant to the Class Proceedings Act 1992, the plaintiff asserts claims for alleged breach of contract and negligent misrepresentation arising out of the manner in which whole life participating insurance policies with a premium offset option were sold. Similar actions were commenced in Quebec and in British Columbia. Before the defendant filed a statement of defence and before certification as a class proceeding, this action, together with the Quebec and British Columbia actions, was settled by written agreement, dated June 16, 1997, setting out detailed and complex terms. The settlement is subject to and conditional upon court approval in all three provinces.

2 Winkler J. approved a form of notice of motion for a certification/authorization and agreement approval to be sent to members of the proposed Ontario class. Similar orders were made in Quebec and British Columbia. The notice stated that members of the class who wished to participate in the hearing for approval of the settlement were required to file a written statement of objection and notice of appearance by a specified date. Fourteen members of the proposed Ontario class filed objections. Three are represented by Mr. Deverett and eleven by Messrs. Will and Barnett. At the opening of this hearing, Mr. Deverett indicated that one of the objectors he represents wished to withdraw from further participation.

3 On August 28, 1997 Winkler J. directed that there be a hearing to determine certain procedural issues, namely:

(a) Standing to object;
(b) Procedures for and scope of objection;
(c) The role of the court in approval of the agreement;
(d) Onus for approval of the agreement;
(e) Factors to be considered by the court for approval of the agreement;
(f) Cost consequences.

4 The issue of standing was determined by Winkler J. and it was contemplated that the motion to determine the remaining procedural issues would be heard on September 4, 1997. It did not proceed on that date as the Deverett objectors requested an adjournment. The Deverett objectors then brought a motion to set aside Winkler J.'s earlier order regarding the notice of motion for certification/authorization, to declare the plaintiff's counsel to be in a conflict of interest, and for other relief, including an order that those objectors be given immunity from costs and be awarded interim costs. While the costs issue remains outstanding, other aspects of the motion were dismissed by Winkler J. An application for leave to appeal from that order was dismissed by O'Driscoll J. on January 22, 1998.

5 I have now heard full argument on the outstanding procedural issues specified by Winkler J.'s August 29, 1997 direction. For convenience of analysis, I propose to deal with them in the following order:

(a) Onus for approval of the agreement;
(b) The role of the court in approval of the agreement;
(c) Factors to be considered by the court for approval of the agreement;
(d) Procedures for and scope of objection;
(e) Cost consequences

6 I wish to emphasize at the outset that what follows is intended only to provide a procedural framework for the hearing of this motion. It would be entirely inappropriate to attempt to determine in the context of one case a process appropriate for all cases. My ruling has been determined on the basis of the submissions I have heard and is intended to do no more than provide guidance to the parties and objectors in the present case.

2. ANALYSIS

(a) Onus for approval of the agreement

7 It is common ground that the parties proposing the settlement bear the onus of satisfying the court that it ought to be approved.

(b) The role of the court in approval of the agreement

8 There are two matters to be determined by the court: (1) should the action be certified as a class

proceeding and, if the answer is yes, (2) should the settlement be approved. While the role of the court with respect to certification is well defined by the Class Proceedings Act, 1992, the same cannot be said of the approval of settlements. Section 29 provides that "[a] settlement of a class proceeding is not binding unless approved by the court" but the Act provides no statutory guidelines that are to be followed.

9 Experience from other situations in which the court is required to approve settlements does, however, provide guidance. Court approval is required in situations where there are parties under disability (see Rule 7.08(1)). Court approval is also required in other circumstances where there are affected parties not before the court (see Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 242(2) dealing with derivative actions). The standard in these situations is essentially the same and is equally applicable here: the court must find that in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it.

10 It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3. As a practical matter, it is within the power of the court to indicate areas of concern and afford the parties the opportunity to answer and address those concerns with changes to the settlement; see eg Bowling v. Pfizer Inc. 143 F.R.D. 141 (1992), I would observe, however, that the fact that the settlement has already been approved in Quebec and British Columbia would have to be considered as a factor making changes unlikely in this case.

11 With respect to specific objections raised by the objectors, there is an additional factor to be kept in mind. The role of the court is to determine whether the settlement is fair, reasonable and in the best interests of the class as a whole, not whether it meets the demands of a particular class member. As approval is sought at the same time as certification, even if the settlement is approved, class members will be afforded the right to opt out. There is, accordingly an element control that may be exercised to alleviate matters of particular concern to individual class members.

12 Various definitions of "reasonableness" were offered in argument. The word suggests that there is a range within which the settlement must fall that makes some allowance for differences of view, as an American court put it "a range which recognizes the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion". (Newman v. Stein 464 F. (2d) 689 (1972) at 693).

(c) Factors to be considered by the court for approval of the agreement

13 A leading American text, Newberg on Class Actions, (3rd ed), para. 11.43 offers the following useful list of criteria:

1. Likelihood of recovery, or likelihood of success
2. Amount and nature of discovery evidence
3. Settlement terms and conditions

4. Recommendation and experience of counsel
5. Future expense and likely duration of litigation
6. Recommendation of neutral parties if any
7. Number of objectors and nature of objections
8. The presence of good faith and the absence of collusion

14 I also find the following passage from the judgment of Callaghan A.C.J.H.C. in Sparling v. Southam Inc. (1988), 66 O.R. (2d) 225 at 230-1 to be most helpful. Callaghan A.C.J.H.C. was considering approval of a settlement in a derivative action, but his comments are equally applicable to the approval of settlements of class action:

> In approaching this matter, I believe it should be observed at the outset that the courts consistently favour the settlement of lawsuits in general. To put it another way, t here is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial court system.
>
> In deciding whether or not to approve a proposed settlement under s. 235(2) of the Act, the court must be satisfied that the proposal is fair and reasonable to all shareholders. In considering these matters, the court must recognize that settlements are by their very nature compromises, which need not and usually do not satisfy every single concern of all parties affected. Acceptable settlements may fall within a broad range of upper and lower limits.
>
> In cases such as this, it is not the court's function to substitute its judgment for that of the parties who negotiate the settlement. Nor is it the court's function to litigate the merits of the action. I would also state that it is not the function of the court as simply rubber-stamp the proposal.
>
> The court must consider the nature of the claims that were advanced in the action, the nature of the defences to those claims that were advanced in the pleadings, and the benefits accruing and lost to the parties as a result of the settlement.
>
> ...
>
> The matter was aptly put in two American cases that were cited to me in the

course of argument. In a decision of the Federal Third Circuit Court in Yonge v. Katz, 447 F. (2d) 431 (1971), it is stated:

> It is not necessary in order to determine whether an agreement of settlement and compromise shall be approved that the court try the case which is before it for settlement. Such procedures would emasculate the very purpose for which settlements are made. The court is only called upon to consider and weigh the nature of the claim, the possible defences, the situation of the parties, and the exercise of business judgment in determining whether the proposed settlement is reasonable.

In another case cited by all parties in these proceedings, Greenspun v. Bogan, 492 F. (2d) 375 at p. 381 (1974), it is stated:

> ... any settlement is the result of a compromise - each party surrendering something in order to prevent unprofitable litigation, and the risks and costs inherent in taking litigation to completion. A district court, in reviewing a settlement proposal, need not engage in a trial of the merits, for the purpose of settlement is precisely to avoid such a trial. See United Founders Life Ins. Co. v. Consumer's National Life Inc. Co., 447 F. (2d) 647 (7th Cir. 1971); Florida Trailer & Equipment Co. v. Deal, 284 F. (2d) 567, 571 (5th Cir. 1960). It is only when one side is so obviously correct in its assertions of law and fact that it would be clearly unreasonable to require it to compromise in the extent of the settlement, that to approve the settlement would be an abuse of discretion. (Emphasis added)

15 It is apparent that the court cannot exercise its function without evidence. The court is entitled to insist on sufficient evidence to permit the judge to exercise an objective, impartial and independent assessment of the fairness of the settlement in all the circumstances.

16 In the arguments presented by the proponents of the settlement, considerable emphasis is placed on the opinion of senior counsel that the settlement is fair and reasonable as an important factor. While I agree that the opinion of counsel is evidence worthy of consideration, it is only one factor to be considered. It does not relieve the parties proposing the settlement of the obligation to provide sufficient information to permit the court to exercise its function of independent approval. On the other hand, the court must be mindful of the fact that as the consequence of not approving the settlement is that the litigation may well continue, there are inherent constraints on the extent to which the parties can be expected to make complete disclosure of the strengths and weaknesses of their case.

(d) Procedures for and scope of objection

17 The Class Proceedings Act, 1992, s. 12 confers a general discretion on the court with respect to the conduct of class proceedings:

> 12. The court, on the motion or a party or class member, may make an order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate.

18 Section 14 provides for the participation of class members in the following terms:

> 14(1) In order to ensure the fair and adequate representation of the interests of the claims or any subclass or for any other appropriate reason, the court may, at any time in a class proceeding, permit one or more class members to participate in the proceeding.
>
> (2) Participation under subsection (1) shall be in whatever manner and on whatever terms, including terms as to costs, the court considers appropriate.

19 As already noted, the order of Winkler J. required class members who wished to object to the settlement to file written objections. It remains to determine the procedural and other rights objectors have in relation to the approval process.

20 In general, the procedural rights of all participate in the approval process must reflect the nature of the process itself and the special role of the court. The matter cannot be viewed in strictly adversarial terms. The plaintiff and the defendant find themselves in common cause, seeking approval of the settlement. The objectors have their own specific concerns which, upon examination, may or may not be reflective of the interests of the class as a whole.

21 In view of the fact that the purpose of the exercise is to ensure that the interests of the unrepresented class members are protected, the court is called upon to play a more active role than is called for in strictly adversarial proceedings. It is important that the court itself remain firmly in control of the process and that the matter not be treated as if it were a dispute to be resolved between the proponents of the settlement on the one side and the objectors on the other.

(i) Objectors' right to adduce evidence

22 I can see no reason why the objectors should not have the right to adduce evidence. However, given the interests of the objectors and the nature of the process, the right to adduce evidence is not at large. Any evidence adduced by the objectors must be relevant to the points they have raised by way of objection. It must also be adduced in a timely fashion. I direct that any evidence be adduced

by way of affidavit filed at least 30 days prior to the date set for the hearing of this motion.

(ii) Objectors' right to discovery

23 Under the Rules of Court, the right to oral discovery and production of documents is restricted to parties to an action. The objectors are not parties to the action, and accordingly have no right to oral discovery or production of documents.

24 On the other hand, s. 14(2) of the Act does provide that participation "shall be in whatever manner and on whatever terms ... the court considers appropriate." On behalf of the objectors he represents, Mr. Deverett sought the right to conduct essentially a "no holds barred" discovery of the parties to the action. He submitted that as no discovery had been conducted, it was impossible to assess the merits of the case and the settlement without one. In my view, this submission misses the whole point of the settlement approval exercise. The very purpose of the settlement at an early stage of the proceedings is to avoid the cost and delay involved in discovery and other pre-trial procedures. If Mr. Deverett is right, then a class action could almost never be settled without discovery, for if the parties did not conduct one, an objector could insist upon doing so as a precondition of settlement. This would create a powerful disincentive to early settlements by the parties and would run counter to the general policy of the law which strongly favours early resolution of disputes. On the other hand, the lack of discovery is a factor the court may take into account in assessing the fairness of the settlement. However, the remedy in a case where the court concludes that the settlement cannot be approved without a discovery is to refuse to approve the settlement and not to have one conducted by an objector. Given the very different in approach to discovery in the United States, I do not find the American authorities cited by the objectors on this point to be persuasive.

25 The objectors represented by Mr. Will seek production of certain specific documents relevant to their claims. This request has to be assessed in the light of the settlement agreement itself. An important element of the settlement agreement is a process to resolve individual claims. One aspect of that process will entitled these objectors to production of documents. The process will also permit them to opt out of the settlement after they receive production. In my view, in light of the process contemplated by the settlement agreement, these objectors are not entitled to insist upon production of documents at this stage. The point of the approval process is to determine whether the settlement is fair, reasonable and in the best interests of those affected by it. The issue for the court, then, is to assess whether the process contemplated by the settlement agreement is a fair one. I fail to see what relevance documents pertaining to the claims of these objections have at this stage or how they would assist the court in determining whether the settlement and the process it specifies is a fair one.

26 Accordingly, in the circumstances of this case, I find that it is not appropriate to grant the objectors the right to oral or documentary discovery.

(iii) Right to cross-examine

27 The objectors also seek a general right to cross-examine on the affidavits filed in support of approval of the settlement. There is not inherent right to cross-examine: see eg. Kevork v. The Queen, [1984] 2 F.C. 753. On the other hand, it is important that there be some way for the court to ensure that evidence on contentious points can be probed and tested. As I have already stated, I view the approval process as one which the court must control and in which the court must take an active role. In keeping with that principle, and in view of the extremely open-ended request made by the Deverett objectors, I direct as follows:

(1) that any cross-examination of deponents shall take place viva voce before the court on the dates set for the hearing of the certification/approval motion;
(2) that any party or objector who wishes to cross-examine a deponent serve and file at least 10 days prior to the motion a written outline of the matters upon which cross-examination is requested;
(3) that the nature and extent of cross-examination shall, subject to the discretion of the court, only be in an area indicated by the written outline and shall be subject to the discretion of the court to exclude such cross-examination which may be exercised either before or during the hearing of the motion;
(4) that any deponent for which cross-examination is requested shall be available to attend court on the days the motion is to be heard as if under summons;
(5) that in any event, Mr. Ritchie be in attendance for the motion;
(6) that the right of the court to question witnesses shall remain within the sole discretion of the court and shall not be in any way affected by para (2).

(e) Costs consequences

28 The Deverett objectors seek an order that they not be subject to any order as to costs and that they be awarded interim costs. It was suggested, in the alternative, by Mr. Will that I specify in advance the circumstances which would or would not lead to an adverse costs order.

29 In my view, no such orders or directives should be made. Nothing has been shown that would bring this case within the category of "very exceptional cases" contemplated by Organ v. Barnett (1992), 11 O.R. (3d) 210 as justifying an award of interim costs to ensure that the objectors are able to continue their participation. Section 32(1) of the Act, which provides that class members are not liable for costs except with respect to the determination of their own claims, does not apply. That provision contemplates the usual situation where a class member takes no active step in the proceedings. The objectors are subject to the discretion conferred by s. 14(2), which expressly preserves the right of the court to impose appropriate terms as to costs.

30 It is important that, as one means of controlling the process, the court retain its discretion with respect to the costs of this process. I hardly need add that my discretion is to be exercised in accordance with an established body of law dealing with cost orders. That body of law recognizes the right of the court to award costs to compensate for or sanction inappropriate behaviour by a litigant. It also recognizes that in certain cases, departure from the ordinary rule that an unsuccessful pay the costs of the winner may be appropriate: see eg. Mahar v. Rogers Cablesystems Ltd. (1995), 25 O.R. (3d) 690.

CONCLUSION

31 If there are further procedural issues which arise prior to the hearing of the motion, I may be spoken to.

SHARPE J.

qp/mii

MIKE DOBINA, Plaintiff, -against- WEATHERFORD INTERNATIONAL LTD., et al., Defendants.

11 Civ. 1646 (LAK)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2012 U.S. Dist. LEXIS 160663; Fed. Sec. L. Rep. (CCH) P97,081

November 7, 2012, Decided
November 7, 2012, Filed

PRIOR HISTORY: In re Weatherford Int'l Secs. Litig., 2011 U.S. Dist. LEXIS 72569 (S.D.N.Y., July 6, 2011)

CASE SUMMARY:

OVERVIEW: In a 15 U.S.C.S. 78j(b) action, plaintiff did not adequately allege defendant corporate officers' deliveries of personally-held company shares back to the company a day before a financial restatement were "sales of stock" that resulted in profits, avoided losses, or reduced their overall holdings and this precluded a strong inference of scienter.

OUTCOME: Motions granted in part and denied in part.

CORE TERMS: scienter, audit, accounting, motive, tax rate, internal quotation marks omitted, tax expenses, reporting, restatement, acquisition, auditor, requisite, earnings, recklessness, red flags, understatement, certifications, financial statements, analyst, weakness, stock, false statements, stock price, circumstantial evidence, misstatement, particularity, magnitude, reckless, disclosure, effectiveness

LexisNexis(R) Headnotes

Civil Procedure > Pleading & Practice > Defenses, Demurrers & Objections > Failures to State Claims

[HN1] In deciding a motion to dismiss under Fed. R. Civ. P. 12(b)(6), a court must accept all factual allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor. In order to survive such a motion, the complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.' A claim is facially plausible when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the

defendant is liable for the misconduct alleged.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Express Liabilities > Misleading Statements > False & Misleading Statements
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
[HN2] To state a claim under § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b), a plaintiff must allege facts sufficient to establish that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff.

Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements > Fraud Claims
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements
[HN3] A complaint asserting a § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b), claim must satisfy also the heightened pleading standards of Fed. R. Civ. P. 9(b) and the Private Securities Litigation Reform Act of 1995. Fed. R. Civ. P. 9(b); 15 U.S.C.S. § 78u--4(b). Under Rule 9(b), averments of fraud must be stated with particularity and a plaintiff must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Deceptive & Manipulative Devices
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Recklessness
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements
[HN4] In addition, the Private Securities Litigation Reform Act (PSLRA) requires a complaint to state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind. 15 U.S.C.S. § 78u--4(b)(2)(A). The requisite state of mind is an intent to "deceive, manipulate, or defraud." In the United States Court of Appeals for the Second Circuit, allegations of recklessness -- an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it -- are sufficient.

Civil Procedure > Pleading & Practice > Pleadings > Heightened Pleading Requirements > Fraud Claims
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements

[HN5] In evaluating whether a complaint alleges facts giving rise to a strong inference of scienter, courts must consider all the facts alleged, inferences favoring plaintiffs rationally drawn from the facts, and plausible, nonculpable explanations for the defendant's conduct. The inference of scienter must be more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent. Generally, the plaintiffs must allege facts sufficient to show that each defendant personally knew of, or participated in, the fraud. That is, the plaintiff must allege that each defendant had the requisite scienter.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors

[HN6] A securities fraud complaint may satisfy the scienter requirement by alleging facts to show either (1) that defendants had the motive and opportunity to commit the fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity

[HN7] In order sufficiently to allege motive and opportunity in the securities fraud context, plaintiffs must allege that defendants benefitted in some concrete and personal way from the purported fraud. Our Circuit has made clear that goals possessed by virtually all corporate insiders are insufficient to allege motive for § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b), purposes. Such common goals include the desire to maintain a high credit rating for the corporation or otherwise sustain the appearance of corporate profitability or the success of an investment, or the desire to maintain a high stock price in order to increase executive compensation.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors

[HN8] If plaintiffs have not alleged motive and opportunity sufficiently, they may rely upon the strong circumstantial evidence prong, though the strength of the circumstantial allegations must be correspondingly greater if there is no motive. A complaint alleges strong circumstantial evidence of scienter when it alleges that defendants (1) benefitted in a concrete and personal way from the purported fraud, (2) engaged in deliberately illegal behavior, (3) knew facts or had access to information suggesting that their public statements were not accurate, or (4) failed to check information they had a duty to monitor.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors

[HN9] Discretionary bonuses tied to performance targets and their large compensation packages, are possessed by virtually all corporate insiders and thus are insufficient to give rise to the requisite

strong inference of scienter in the securities fraud context. Similarly unavailing are allegations that fraud helped the company meet earnings targets or sustain the appearance of profitability.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN10] The United States Court of Appeals for the Second Circuit has recognized that individual stock sales by corporate insiders will provide the requisite motive on a securities fraud claim.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN11] While artificial inflation of stock prices in order to acquire another company. in some circumstances may be sufficient for scienter, the desire to achieve the most lucrative acquisition proposal can be attributed to virtually every company seeking to be acquired or to acquire another and therefore generally is insufficient. Whether an interest in acquisitions is sufficient is an extremely contextual inquiry that demands an allegation of a unique connection between the fraud and the acquisition. The United States Court of Appeals for the Second Circuit has provided little guidance as to what this unique connection must be, but has suggested that it is sufficient when the misstatements directly relate to the acquisition. This requirement demands more than alleging simply that the company acquired companies during the class period with the use of stock.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN12] Rothman now must be read in the context of ECA, which emphasizes the importance of the unique connection between the fraud and the acquisition.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
[HN13] There is an important reason to apply exacting scrutiny to any claim of motive through company acquisitions. A plaintiff who alleges motive and opportunity necessarily has satisfied the pleading requirements for scienter, even without any allegation that a statement that later proved to have been false was made with an indication of knowledge or recklessness. This helps explain why the United States Court of Appeals for the Second Circuit refuses to consider allegations of even lavish executive compensation as sufficiently alleging motive despite the fact that one certainly could imagine that a number of executives might commit fraud in order to maintain their positions and therefore their considerable annual pay packages. The point is not whether such pay packages provide, in at least some sense of the word, motive to commit fraud, but rather, whether the mere fact that an executive is paid well provides a motive sufficient to permit a case to go to discovery without any further allegations that would support an inference of scienter.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of

Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN14] The United States Court of Appeals for the Second Circuit has concluded, and the Private Securities Litigation Reform Act has reinforced, that relying on motives surrounding lavish executive compensation packages possessed by virtually all corporate insiders would be improper because it would require virtually every company in the United States that experiences a downturn in stock price. to defend securities fraud actions.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Recklessness
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN15] In the securities fraud context, the requisite scienter can be alleged with facts showing either (1) that defendants had the motive and opportunity to commit fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN16] While an acquisition program funded by stock issuances in a certain sense might provide a motive to inflate the stock price, it is not sufficient to allege scienter.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN17] In a case in which a company is a target of acquisition, any intent to defraud the acquirer cannot be conflated with an intent to defraud the shareholders because achieving a superior merger benefits all shareholders.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN18] The United States District Court for the Southern District of New York has recognized how the subjectivity of statements in the securities fraud context bears on whether a plaintiff adequately has alleged scienter. But subjectivity will not completely immunize a statement from review under § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b). Indeed, a plaintiff can plead a claim adequately based even on a statement of opinion if it alleges facts sufficient to permit a conclusion that the defendant either did not in fact hold that opinion or knew that it had no reasonable basis for it.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors

[HN19] Where a statement is made repeatedly regarding an issue of specific personal interest to the officers, the allegations will more readily give rise to the requisite strong inference of scienter.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Recklessness
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN20] To plead scienter adequately, a plaintiff needs to allege facts plausibly giving rise to an inference of recklessness, an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant, or so obvious that the defendant must have been aware of it.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN21] In the context of a securities fraud claim recklessness inquiry, the United States Court of Appeals for the Second Circuit has held that where plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accounting Irregularities
[HN22] Simply put, weak accounting controls may pave the way for fraud. They do not themselves constitute fraud.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > General Overview
[HN23] The United States Court of Appeals for the Second Circuit has held that the magnitude, at least in certain circumstances, can be relevant to the scienter inquiry. To the extent that the invalid tax assets creates a large footprint on a companies finances without any supporting documentation, the size of the error may provide some support for scienter. When the magnitude of an error is relevant to scienter depends on the circumstances.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN24] In the securities fraud context, it is clear that the size of the fraud alone does not create an inference of scienter.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Heightened Pleading Requirements
[HN25] The core operations theory adopted by several courts in the United States District Court for the Southern District of New York states that knowledge of the falsity of a company's financial statements can be imputed to key officers who should have known of facts relating to the core

operations of their company that would have led them to the realization that the company's financial statements were false when issued. As a number of courts have noted, however, it remains an open question whether the theory has survived the passage of the Private Securities Litigation Reform Act.

Evidence > Inferences & Presumptions > Inferences
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN26] The fact that the court may make an inference does not mean that such an inference necessarily would be the most compelling under Tellabs. The court is required to consider plausible, nonculpable explanations for the defendant's conduct and, in order to sustain the complaint, must conclude that the inference of scienter is at least as compelling as any opposing inference one could draw from the facts alleged.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Motive & Opportunity
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN27] That the auditor collected fees from the company it audited does not sufficiently allege motive in a 15 U.S.C.S. § 78j(b) case, as it would defy common sense to hold that the motive element. would be satisfied merely by alleging the receipt of normal compensation for professional services rendered. General allegations that the defendants acted in their economic self-interest are not enough.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN28] Alleging a close relationship without more does not allow the court to infer scienter in a securities fraud action.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Recklessness
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN29] In conducting an inquiry, a demanding standard is imposed by the United States Court of Appeals for the Second Circuit to plead auditor scienter in a securities fraud case. In particular, for recklessness on the part of a non-fiduciary accountant to satisfy securities fraud scienter, such recklessness must be conduct that is highly unreasonable, representing an extreme departure from the standards of ordinary care and approximating an actual intent to aid in the fraud being

perpetrated by the audited company. Moreover, the Second Circuit has said that the failure of a non-fiduciary accounting firm to identify problems with the defendant-company's internal controls and accounting practices does not constitute reckless conduct sufficient for § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b), liability.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accounting Irregularities
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN30] Auditor scienter can be established by a showing of shoddy accounting practices amounting at best to a pretended audit, or of grounds supporting a representation so flimsy as to lead to the conclusion that there was no genuine belief back of it. This is because, although the United States Court of Appeals for the Second Circuit requires approximate intent, the plaintiff need not allege that the auditor actually wanted the fraud to happen; rather, it is sufficient to consider what could the defendant reasonably foresee as a potential result of his action. Where the auditor is not an accounting dilettante and knows well that its opinions and certifications are afforded great weight, it is sufficient for a plaintiff to allege and prove that a defendant could have foreseen the consequences of his action but forged ahead nonetheless.

Civil Procedure > Summary Judgment > Standards > General Overview
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN31] At summary judgment stage mere failure to uncover the accounting fraud is insufficient to prove auditor scienter in the securities fraud context.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accounting Irregularities
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN32] Typically, auditor scienter in the United States Court of Appeals for the Second Circuit turns on alleging that the auditor repeatedly failed to scrutinize serious signs of fraud. Such allegations of red flags, when coupled with allegations of accounting violations, may permit a complaint to survive a motion to dismiss. But an unseen red flag cannot be heeded and flags are not red merely because the plaintiff calls them red. Rather, the red flags, taken collectively, must demonstrate obvious signs of fraud, or that the danger of fraud was so obvious that the defendant must have been aware of it. The inquiry is whether all of the facts alleged, taken collectively, give

rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accountants & Auditors
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accounting Irregularities
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN33] Where statements by an auditor are couched as opinions, the United States District Court for the Southern District of New York has recognized that the bar is raised even higher to allege the requisite scienter in a securities fraud case. In particular, to allege that an opinion is false (and a fortiori, to allege that it is false with scienter), the complaint must set forth facts sufficient to warrant a finding that the auditor did not actually hold the opinion it expressed or that it knew that it had no reasonable basis for holding it.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Accounting Irregularities
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Recklessness
Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN34] The United States Court of Appeals for the Second Circuit has said that the failure of a non-fiduciary accounting firm to identify problems with the defendant-company's internal controls and accounting practices does not constitute reckless conduct sufficient for § 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.S. 78j(b), liability.

Securities Law > Liability > Secondary Liability > Controlling Persons > Elements of Proof
[HN35] Section 20(a) (15 U.S.C.S. § 78t(a)) of the Securities Exchange Act makes liable those who directly or indirectly control a person who is liable for a primary violation of the statute. As the United States District Court for the Southern District of New York has held, a plaintiff need not plead culpable participation by the control person in order to state a legally sufficient claim. Nor need the allegations of control be pleaded with particularity.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
[HN36] A motion to supplement a complaint pursuant to Fed. R. Civ. P. 15(d) is governed by the same standard as a motion to amend under Rule 15(a). It differs only in that it refers to a request to add allegations about an event or events that occurred after the original pleading was filed, as compared to a motion to amend, which covers events that occurred before the filing of the pleading but which were not included in the complaint.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview

[HN37] Under Fed. R. Civ. P. 15(d), on motion and reasonable notice, the court may, on just terms, permit a party to serve a supplemental pleading setting out any transaction, occurrence, or event that happened after the date of the pleading to be supplemented.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
[HN38] A motion to supplement the pleading generally should be permitted when the supplemental facts connect it to the original pleading. Such a motion should not be granted, however, where it would cause undue delay, undue prejudice to the party to be served with the proposed pleading, or would be futile.

Securities Law > Liability > Securities Exchange Act of 1934 Actions > Implied Private Rights of Action > Elements of Proof > Scienter > Relevant Factors
[HN39] In the securities fraud context, officer resignations do not support inference of scienter absent highly unusual or suspicious circumstances. It would hardly be unusual or suspicious that two executives would be removed as a result of a significant restatement, even assuming it was an honest mistake.

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For Weatherford International Ltd., Bernard J. Duroc-Danner, Andrew P. Becnel, Jessica Abarca, and Charles E. Geer, Jr., Defendants: Robert J. Malionek, Kevin H. Metz, Peter A. Wald, Sarah A. Greenfield, LATHAM & WATKINS, LLP.

For Ernst & Young LLP, Defendant: Stanley J. Parzen, MAYER BROWN LLP.

JUDGES: Lewis A. Kaplan, United States District Judge.

OPINION BY: Lewis A. Kaplan

OPINION

MEMORANDUM OPINION

LEWIS A. KAPLAN, *District Judge*.

This action arises out of statements regarding the internal controls and accounting practices of Weatherford International Ltd. ("Weatherford" or the "Company"), after Weatherford announced in 2011 that it had understated its tax expenses from 2007 through 2010 by over $500 million. Lead plaintiff American Federation of Musicians and Employer's Pension Fund ("AFME") alleges that Weatherford and certain of its officers, as well as its auditor Ernst & Young LLP ("Ernst & Young" or "E & Y"), violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the

"Exchange **[*2]** Act")[1] and Rule 10b-5 thereunder[2] by knowingly issuing materially false statements regarding the Company's tax accounting for the relevant time period and omitting to state facts necessary to make the statements that were made not misleading.

1 *See* 15 U.S.C. §§ 78j(b), 78t.

2 *See* 17 C.F.R. § 240.10b--5.

This matter is now before the Court on defendants' motions to dismiss the complaint for failure to state a claim and on AFME's motion for leave to supplement the amended complaint (the "AC").

Facts

I. Parties

A. Lead Plaintiff

AFME is "one of the largest pension funds in the entertainment industry," with "over $1 billion dollars in assets under management."[3] It purchased Weatherford common stock during the class period.[4]

3 DI 12, at 8.

4 *See* AC ¶ 38. The class period is defined as April 25, 2007 (when the Company's first quarter 2007 financial results were released) through March 1, 2011. *See* DI 12, at 2.

B. Defendants

The defendants are the Company, Ernst & Young, and several individuals associated with the Company (the "Individual Defendants").[5]

5 Weatherford and the Individual Defendants are referred to collectively as the "Weatherford Defendants."

Weatherford is an "international provider of equipment **[*3]** and services used in the drilling,

completion and production of oil and natural gas wells."[6] Ernst & Young is a certified public accounting firm that Weatherford hired to provide independent audits, accounting and management consulting services, tax services, and review of Weatherford's SEC filings.[7]

6 AC ¶ 39.

7 *Id*. ¶ 40.

The Individual Defendants are Ms. Jessica Abarca and Messrs. Bernard Duroc-Danner, Andrew Becnel, and Charles Geer, Jr.[8] Duroc-Danner is Weatherford's chief executive officer, president, and chairman.[9] Becnel was the Company's senior vice president and chief financial officer.[10] Geer was Weatherford's vice president and principal accounting officer.[11] Abarca was the Company's chief accounting officer and vice president of accounting.[12]

8 *See id*. ¶ 1.

9 *See id*. ¶ 42. Duroc-Danner has been chief executive officer, president, and chairman since 1998. *See id*. He signed Weatherford's 2007, 2008, and 2009 Form 10-Ks, as well as its first, second and third quarter Form 10-Qs for 2007, its first, second, and third quarter Form 10-Qs for 2008, its first, second, and third quarter Form 10-Qs for 2009, and its first, second, and third quarter Form 10-Qs for 2010. *See id*. ¶ 43. He signed **[*4]** also a June 9, 2009 Form 8-K, and participated in "every earnings conference call with analysts during the Class Period." *Id*.

10 *See id*. ¶ 44. Becnel became vice president of finance in 2005, and chief financial officer in 2006. *See id*. He signed Weatherford's 2007, 2008, and 2009 Form 10-Ks, a 2009 Form 10-K/A, a March 1, 2011 Form 12b-25, "Forms 10-Q for ever quarter covered by the Restatement," and "Current Reports on Forms 8-K covered by the Restatement." *Id*. ¶ 45. He is alleged also to have "participated on every conference call with analysts during the Class Period." *Id*.

11 *See id*. ¶ 46. His alleged "sudden departure from the Company was announced on March 16, 2011." *Id*. ¶ 1. He signed Weatherford's second quarter Form 10-Q for 2010, as well as a Form 10-Q/A for this same quarter in 2010, and its third quarter Form 10-Q for 2010. *Id*. ¶ 46. "Geer also participated in the Company's March 2, 2011 'material weakness' conference call with analysts." *Id*.

12 *See id*. ¶ 47. Abarca signed Weatherford's 2007, 2008, and 2009 Form 10-Ks, as well as its

first, second, and third quarter Form 10-Qs for 2007, its first, second, and third quarter Form 10-Qs for 2008, its first, second, and third quarter **[*5]** Form 10-Qs for 2009, and its first quarter 10-Q for 2010. *See id.*

II. The Amended Complaint

The AC focuses on Weatherford's alleged understatement of tax expenses in its financial statements for the years 2007, 2008, 2009, and the first three quarters of 2010.[13] It alleges that, through "a simple and crude tax accounting fraud," the Company's effective tax rate dropped "sharply" in 2007 and that the Company reported "artificially low and rapidly declining effective tax rates--one of the lowest, if not the lowest, in the industry" through the rest of the class period.[14]

13 *See id.* ¶ 24.

14 *Id.* ¶¶ 5-7.

According to the AC, the lower rate was of particular interest to analysts and investors. The Weatherford Defendants are alleged to have "closely monitored Weatherford's effective income tax rate, and specifically touted it in numerous SEC filings and analyst conference calls."[15] For example, when asked during an April 2007 call about the surprisingly low tax rate, Becnel stated "'[y]es, that was good work from our tax group in terms of planning.'"[16] The Company's 2008 and 2009 annual reports stated that "the decreases in the Company's effective tax rates were 'due to benefits realized from the **[*6]** refinement of our international tax structure and changes in our geographic earnings mix.'"[17] As a result of the lower tax rates, a number of analysts upgraded their earnings estimates for Weatherford, with one July 2007 report stating that its higher estimates were "'primarily a function of a lower effective tax rate.'"[18]

15 *Id.* ¶ 8; *see id.* ¶¶ 73-76.

16 *Id.*

17 *Id.* ¶ 17.

18 *Id.* ¶ 10; *see id.* ¶¶ 73-76.

This apparently lower rate proved illusory. On March 1, 2011, the Company announced that it

would restate its earnings for 2007 through the third quarter of 2010. It stated that it had identified in February 2011 a "'material weakness in internal control over financial reporting for income taxes.'"[19] In particular, it said that the "Company's processes, procedures, and controls related to financial reporting were not effective to ensure that amounts related to current taxes payable, certain deferred tax assets and liabilities, reserves for uncertain tax positions, the current and deferred income tax expense and related footnote disclosures were accurate."[20]

19 *Id*. ¶ 135. As the Company explained elsewhere, "'[m]aterial weakness is a term of art. It is a deficiency or combination of deficiencies **[*7]** in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the financial statements would not be prevented or detected on a timely basis.'" *Id*. ¶ 136 (alterations omitted).

20 *Id*. ¶ 134.

According to the statement, the Company conducted additional testing after identifying the material weakness and, in the process, identified tax receivable balances for which, as the Company later explained to the SEC, "documentary support was not available."[21] The Company stated that it subsequently determined that those receivables had been recorded in error due to "a tax benefit incorrectly being applied to the elimination of intercompany dividends."[22] It said that the "error manifested itself in 2007 and went undetected in that year and each subsequent year."[23] It clarified that it had not erred in its actual cash payment of taxes to the Internal Revenue Service, but rather in its accounting for tax expense in its financial statements.[24] The Company ultimately concluded that it had understated its 2007-2010 tax expense by approximately $500 million--$460 million due to these intercompany transactions and $40 million relating to foreign tax **[*8]** assets.[25] Thus, the Company's tax expense actually was $1.2 billion rather than the previously-reported $700 million.[26] A March 8, 2011 annual report provided restated financial information and included an opinion by Ernst & Young, which stated that Weatherford had "'not maintained effective internal control over financial reporting as of December 31, 2010.'"[27] The AC alleges that Weatherford's stock price declined nearly 11 percent on the day following the announcement, thereby eliminating $1.8 billion from Weatherford's market capitalization.[28]

21 DI 68, Ex. 8 at 2.

22 *Id.; see* AC ¶ 137 (quoting Becnel's statements on March 2, 2011 conference call that the error arose from "'tax-affecting'" an inter-company transaction at a 35% level rather than at a 0% effective tax rate, thereby leading to the creation of a "'substantial tax asset'").

23 DI 68, Ex. 9 at 2.

24 *See id*.

25 *See id*.

26 DI 68, Ex. 9 at 5.

27 AC ¶ 140.

28 *See id*. ¶ 24.

The AC asserts claims under Sections 10(b) and 20(a) of the Exchange Act and Rule 10b--5 thereunder. It alleges that the Weatherford Defendants committed securities fraud through false statements and omissions falling into two principal categories: (1) those arising directly **[*9]** from the understatement of tax expense and (2) those pertaining to Weatherford's maintenance of internal controls over its financial reporting. In addition, the AC alleges that Ernst & Young committed securities fraud when it provided, throughout the class period, (1) its unqualified opinion regarding the fair presentation of Weatherford's financial position and its compliance with generally accepted accounting principles ("GAAP") (2) its unqualified opinion regarding the effectiveness of Weatherford's internal controls and (3) its statements that it complied with generally accepted auditing standards ("GAAS") in reaching these conclusions.

Discussion

I. Legal Standard

[HN1] In deciding a motion to dismiss under Rule 12(b)(6), a court must accept all factual allegations in the complaint as true and draw all reasonable inferences in the plaintiff's favor.[29] In order to survive such a motion, the complaint "'must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.'"[30] A claim is facially plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct **[*10]** alleged."[31]

29 *See Anschutz Corp. v. Merrill Lynch & Co*., 690 F.3d 98, 107 (2d Cir. 2012).

30 *Id*. (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009)).

31 *Iqbal*, 556 U.S. at 678.

[HN2] To state a claim under Section 10(b) of the Exchange Act, a plaintiff must allege facts sufficient "to establish that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with *scienter*, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff."[32]

32 *ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co.*, 553 F.3d 187, 197 (2d Cir. 2009) [hereinafter "*ECA*"] (internal quotation marks omitted).

[HN3] A complaint asserting a Section 10(b) claim must satisfy also the heightened pleading standards of Rule 9(b) and the Private Securities Litigation Reform Act of 1995 ("PSLRA").[33] Under Rule 9(b), "averments of fraud [must] be stated with particularity" and a plaintiff must "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent."[34]

33 *See* FED. R. CIV. P. 9(b); **[*11]** 15 U.S.C. § 78u--4(b).

34 *Anschutz*, 690 F.3d at 108 (internal quotation marks and alterations omitted); *see also* 15 U.S.C. § 78u--4(b)(1) (providing that "the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed").

[HN4] In addition, the PSLRA requires a complaint to "state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind."[35] The requisite state of mind is an intent to "'deceive, manipulate, or defraud.'"[36] In this circuit, allegations of recklessness -- "an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it" -- are sufficient.[37]

35 15 U.S.C. § 78u--4(b)(2)(A); *accord Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007).

36 *ECA*, 553 F.3d at 198 (quoting *Tellabs*, 551 U.S. at 313).

37 *Id.* (internal quotation marks and alterations omitted).

[HN5] In evaluating **[*12]** whether a complaint alleges facts giving rise to a "strong inference of *scienter*," courts must consider all the facts alleged, inferences favoring plaintiffs rationally drawn from the facts, and "plausible, nonculpable explanations for the defendant's conduct."[38] The "inference of *scienter* must be 'more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.'"[39] Generally, the plaintiffs must allege facts sufficient to show that each defendant "personally knew of, or participated in, the fraud."[40] That is, the plaintiff must allege that each defendant had the requisite *scienter*.[41]

38 *Tellabs*, 551 U.S. at 324.

39 *ECA*, 553 F.3d at 198 (quoting *Tellabs*, 551 U.S. at 314).

40 *Mills v. Polar Molecular Corp*., 12 F.3d 1170, 1175 (2d Cir. 1993) (emphasis omitted).

41 *See In re BISYS Sec. Litig*., 397 F. Supp. 2d 430, 440 (S.D.N.Y. 2005) (hereinafter "*BISYS*").

[HN6] A complaint may satisfy the *scienter* requirement "by alleging facts to show either (1) that defendants had the motive and opportunity to commit the fraud, or (2) strong circumstantial evidence of conscious misbehavior or recklessness."[42]

42 *ECA*, 553 F.3d at 198.

[HN7] In order sufficiently **[*13]** to allege "motive and opportunity," plaintiffs must allege that defendants "benefitted in some concrete and personal way from the purported fraud."[43] Our Circuit has made clear that goals "possessed by virtually all corporate insiders" are insufficient to allege motive for Section 10(b) purposes.[44] Such common goals include "the desire to maintain a high credit rating for the corporation or otherwise sustain the appearance of corporate profitability or the success of an investment, or the desire to maintain a high stock price in order to increase executive compensation."[45]

43 *Id*. (internal quotation marks omitted).

44 *South Cherry Street, LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009) (internal quotation marks omitted).

45 *Id*.

[HN8] If plaintiffs have not alleged motive and opportunity sufficiently, they may rely upon the "strong circumstantial evidence" prong, "though the strength of the circumstantial allegations must be correspondingly greater if there is no motive."[46] A complaint alleges strong circumstantial evidence of *scienter* when it alleges that defendants (1) "benefitted in a concrete and personal way from the purported fraud," (2) "engaged in deliberately illegal behavior," **[*14]** (3) "knew facts or had access to information suggesting that their public statements were not accurate," or (4) "failed to check information they had a duty to monitor."[47]

46 *ECA*, 553 F.3d at 199 (internal quotation marks omitted).

47 *Id.; Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000); *see Teamsters Local 445 Freight Division Pension Fund v. Dynex Capital, Inc*., 531 F.3d 190, 194 (2d Cir. 2008) [hereinafter ("*Teamsters*")].

II. Analysis

A. Weatherford Defendants

1. Motive and Opportunity

AFME contends that the AC adequately pleads that the Weatherford Defendants had both a motive and the opportunity to commit fraud. The contention is unavailing.

The AC points first to the Individual Defendants' discretionary bonuses tied to performance targets and their large compensation packages.[48] [HN9] Such motives, however, are "possessed by virtually all corporate insiders" and thus are insufficient to give rise to the requisite strong inference of *scienter*.[49] Similarly unavailing are the AC's allegations that the fraud helped the Company meet earnings targets or sustain the appearance of profitability.[50]

48 *See* AC ¶¶ 22--23, 151--58.

49 *South Cherry Street*, 573 F.3d at 109 (internal quotation marks omitted).

50 *See* **[*15]** AC ¶¶ 10, 11, 28; *South Cherry Street*, 573 F.3d at 109.

[HN10] The Second Circuit has recognized that individual stock sales by corporate insiders will provide the requisite motive.[51] But the AC fails to allege that any such sales occurred here. It states only that certain of the individual defendants--Duroc-Danner and Becnel--"delivered tens of thousands of their personally-held Weatherford shares back to Weatherford" one day before the Company announced that it would be issuing the financial restatement.[52] It noticeably does not state, however, that either Duroc-Danner or Becnel actually sold stock at that time. The inadequacy of the pleading is highlighted by the defendants' assertion that these were "shareholder-approved[] tax withholding transactions in which the executives surrendered a portion of their stock grants (but retained [and acquired] a much larger part) on the dates those grants vested in order to cover their withholding obligations."[53] AFME's briefing does not earnestly contest defendants' assertion and states only that resolving this argument would be "improvident at this early stage."[54] But the Court need not determine whether defendants' proffered explanation is correct **[*16]** or accurate. The basic point is that plaintiff has failed adequately to allege that these deliveries were sales of stock, that they resulted in profits or avoided losses, or even that they had the net effect of reducing defendants' overall holdings in Weatherford stock. The lack of such allegations precludes any strong inference of *scienter* based on these deliveries.

51 *See ECA*, 553 F.3d at 198.

52 AC ¶ 23; *see id*. ¶ 158.

53 DI 69, at 9 n.9.

54 DI 71, at 25.

In light of the inadequacy of these grounds for motive, AFME focuses principally on its theory that the fraud inflated Weatherford's stock price and thus permitted it to fund its "aggressive growth strategy" while avoiding becoming an acquisition target in its own right.[55] The AC points to a "sampling" of seven acquisitions Weatherford conducted from 2007 through 2009 and further refers to Weatherford's 2009 annual report, which stated that the Company funded its 2008 and 2009 acquisitions through the issuance of $287 million in stock.[56]

55 AC ¶ 67 (internal quotation marks omitted); *see id*. ¶¶ 30 n.6, 68-70, 163-64.

56 *Id*. ¶ 164.

The theory is rejected easily with regard to the Individual Defendants because plaintiff "nowhere allege[s] that **[*17]** defendants engaged in these transactions to secure personal gain" as opposed to carrying out their "financial responsibilities to the Company."[57] Moreover, "[e]ven if the complaint is read to say that defendants artificially inflated [Weatherford's] stock price to increase their personal compensation (by undertaking the cited transactions or otherwise), the complaint would still fail to allege the requisite motive" because such an incentive is common to all insiders.[58]

57 *Rombach v. Chang*, 355 F.3d 164, 177 (2d Cir. 2004) (internal quotation marks omitted). The only allegations in the AC coming close to such a charge are those of a confidential witness, CW1, who purportedly stated that in order to "earn brownie points," Becnel "bent accounting rules when Weatherford went on an acquisition spree." AC ¶ 56 (internal quotation marks omitted). In the absence of other facts supporting the relevant point, a complaint must describe confidential witnesses "with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Novak*, 216 F.3d at 314. The complaint's description of CW1 simply as a "Senior Financial **[*18]** Executive," AC ¶ 54, provides an insufficient basis to conclude that CW1 would be privy to Becnel's inner motivations. *See BISYS*, 397 F. Supp. 2d at 442 (deeming inadequate similarly general descriptions of various confidential witnesses).

58 *Rombach*, 355 F.3d at 177; *see BISYS*, 397 F. Supp. 2d at 446 (rejecting motive based on acquisition spree as to individual defendants for same reason).

More challenging is the question of whether the corporate defendant--Weatherford itself--may be inferred to have had the requisite motive due to its interest in acquiring other companies. [HN11] While "artificial inflation of stock prices in order to acquire another company . . . 'in some circumstances' [may] be sufficient for scienter,"[59] the "desire to achieve the most lucrative acquisition proposal can be attributed to virtually every company seeking to be acquired or to acquire another" and therefore generally is insufficient.[60] Whether an interest in acquisitions is sufficient is an "extremely contextual" inquiry that demands an allegation of a "unique connection between the fraud and the acquisition."[61]

59 *ECA*, 553 F.3d at 201 n.6 (quoting *Rothman v. Gregor*, 220 F.3d 81, 92-94 (2d Cir. 2000)).

60 *Id*. at 201 **[*19]** (internal quotation marks omitted) (citing *Kalnit v. Eichler*, 264 F.3d 131, 141 (2d Cir. 2001)).

61 *Id*. at 201 n.6 (internal quotation marks omitted).

The Circuit has provided little guidance as to what this "unique connection" must be, but has suggested that it is sufficient when the "misstatements directly relat[e] to the acquisition."[62] The Court concludes that this requirement demands more than alleging simply that the Company acquired companies during the class period with the use of stock.[63]

62 *See id*. (citing *Cohen v. Koenig*, 25 F.3d 1168, 1170-71, 1173-74 (2d Cir. 1994)); *see also Rothman*, 220 F.3d at 93 (relying on *In re Time Warner Inc. Sec. Litig*., 9 F.3d 259, 262, 270 (2d Cir. 1993), in which our Circuit addressed misstatement that directly concerned company's search for strategic partners and its nondisclosure of its consideration of alternative stock offering).

63 The Court recognizes that in *Rothman v. Gregor*, 220 F.3d 81, our Circuit observed that a stock-based acquisition contemporaneous with, but apparently otherwise unrelated to, the misstatements "reenforce[d] the adequacy of the complaint's allegation of *scienter*." *Id*. at 94. But *Rothman* already had concluded that the **[*20]** *scienter* element was alleged adequately through sufficient circumstantial evidence of recklessness. Moreover, [HN12] *Rothman* now must be read in the context of *ECA*, which emphasizes the importance of the "unique connection" between the fraud and the acquisition.

ECA undermines also plaintiff's reliance on a prior decision, *In re Interpublic Securities Litigation*, No. 02 Civ 6527, 2003 U.S. Dist. LEXIS 8844, 2003 WL 21250682 (S.D.N.Y. May 29, 2003), for the proposition that a sustained growth-by-acquisition strategy not otherwise connected to an alleged fraud provides sufficient motive.

[HN13] There is an important reason to apply exacting scrutiny to any claim of motive through company acquisitions. A plaintiff who alleges motive and opportunity necessarily has satisfied the pleading requirements for *scienter*, even without any allegation that a statement that later proved to have been false was made with an indication of knowledge or recklessness.[64] This helps explain why our Circuit refuses to consider allegations of even lavish executive compensation as sufficiently alleging motive despite the fact that one certainly could imagine that a number of executives might commit fraud in order to maintain their positions and therefore **[*21]** their considerable annual pay packages. The point is not whether such pay packages provide, in at least some sense of the word, "motive" to commit fraud, but rather, whether the mere fact that an executive is paid well provides a motive sufficient to permit a case to go to discovery without any further allegations that would support an inference of *scienter*. [HN14] Our Circuit has concluded, and the PSLRA has reinforced, that relying on such motives "possessed by virtually all corporate

insiders"[65] would be improper because it would require "virtually every company in the United States that experiences a downturn in stock price . . . to defend securities fraud actions."[66]

64 *See ECA*, 553 F.3d at 198 (recognizing that [HN15] the requisite scienter can be alleged with facts showing "*either* (1) that defendants had the motive and opportunity to commit fraud, *or* (2) strong circumstantial evidence of conscious misbehavior or recklessness" (emphasis added)).

65 *South Cherry Street*, 573 F.3d at 109 (internal quotation marks omitted).

66 *ECA*, 553 F.3d at 201 (internal quotation marks omitted).

Likewise, [HN16] while an acquisition program funded by stock issuances in a certain sense might provide a "motive" to inflate **[*22]** the stock price, it is not sufficient to allege *scienter*. Accepting AFME's position would allow a plaintiff to proceed to discovery whenever it can allege that a company that is growing through the issuance of equity made a statement that ultimately proved to have been materially false but helped to raise the company's share price. That conclusion is inconsistent with the PSLRA and our Circuit's requirements of a "unique connection" between the fraud and the acquisition, and this Court declines to accept it.[67]

67 The Court notes a potential further ground for finding motive insufficient here--any such motive to raise the stock price in order to fund acquisitions more cheaply would inure to the benefit of all shareholders, and thus would not demonstrate intent to defraud Weatherford shareholders. *See Kalnit*, 264 F.3d at 141 (observing, [HN17] in case in which company was target of acquisition, that "any intent to defraud [the acquirer] cannot be conflated with an intent to defraud the shareholders" because "achieving a superior merger benefitted all shareholders"); *cf. ECA*, 553 F.3d at 203 ("Even if [defendant] was actively engaged in duping other institutions for the purposes of gaining at the **[*23]** expense of those institutions, it would not constitute a motive for [the defendant] to defraud its own investors.").

Kalnit and *ECA* appear to be in some tension with *Rothman* on this point, because it would seem that any time an inflated stock price permits cheaper acquisition proposals, the lower price paid would inure to the benefit of all shareholders. Because the allegations are insufficient for other reasons, the Court need not resolve any apparent tension among these cases.

2. Circumstantial Evidence of Recklessness

As discussed above, plaintiff alleges two different kinds of false statements by the Weatherford Defendants: (1) those relating to the quality of Weatherford's internal controls and (2) those relating to the understated tax expense.[68]

68 The AC and plaintiff's briefing leaves somewhat unclear whether plaintiff alleges a third category of false statements regarding the Company's projected capital expenditures ("capex"). *Compare* AC ¶ 18 (alleging that "[a]nother adverse consequence of Weatherford's lack of internal controls related to the Company's capital expenditures . . . which far exceeded its stated budgets" and alleging that the Company repeatedly revised its capex **[*24]** projections) *with* DI 71, at 24 n.21 (plaintiff's opposition brief contending that it has not "'abandoned' its capex allegations"). The Court does not understand the AC's few paragraphs discussing capex statements to set forth an independent Section 10(b) claim on this ground. In any event, the Court agrees with the Weatherford Defendants that any such claim should be dismissed because plaintiff fails to allege the false statements with particularity and fails to raise any inference that the projections were made with the requisite *scienter*.

a. Internal Controls

In every Form 10-Q and 10-K filed during the class period, certain defendants made statements regarding the effectiveness of Weatherford's internal controls. In particular, Duroc-Danner and Becnel individually certified that they were "'responsible for establishing and maintaining disclosure controls and procedures . . . and internal control for financial reporting'" for Weatherford and have, among other things, "'[d]esigned such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial **[*25]** reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles'" and "'disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors . . . [a]ll significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information.'"[69] These attestations continued quarterly as late as November 1, 2010, in Weatherford's 10-Q for the third quarter of 2010.[70]

69 AC ¶ 142. The Company itself made statements also in each report about the effectiveness of its internal controls, relying on the certifications of Duroc-Danner and Becnel. In

particular, it stated,

> "[W]e carried out an evaluation, under the supervision and with the participation of management, including [Becnel] and [Duroc-Danner], of the effectiveness of our disclosure controls and procedures . . . . Based upon that evaluation, our CEO and CFO have concluded our disclosure **[*26]** controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that information relating to us . . . required to be disclosed is accumulated and communicated to management, including the CEO and CFO, to allow timely decisions regarding required disclosure."

DI 65, Ex. 15 at 39.

70 *See* DI 65, Ex. 17.

By contrast, the Company's March 2011 restatement identifying the "material weakness" detailed significant gaps in its internal controls as follows:

> "The Company's processes, procedures and controls related to financial reporting were not effective to ensure that amounts related to current taxes payable, certain deferred tax assets and liabilities, reserves for uncertain tax positions, the current and deferred income tax expense and related footnote disclosures were accurate. Specifically, our processes and procedures were not designed to provide for adequate and timely identification and review of various income **[*27]** tax calculations, reconciliations, and related supporting documentation required to apply our accounting policies for income taxes in accordance with US GAAP.
>
> "The principal factors contributing to the material weakness were: 1) inadequate staffing and technical expertise within the company related to taxes, 2) ineffective review and approval practices relating to taxes, 3) inadequate processes to effectively reconcile income tax accounts and 4) inadequate controls over the preparation of quarterly tax provisions."[71]

71 DI 68, Ex. 4.

Although the March 2011 restatement specifically stated only that Weatherford's internal control over financial reporting for income taxes was not effective "as of December 31, 2010"[72] (i.e., the end of that particular reporting period), in light of the Company's attestations through the class period that its internal controls had not changed[73] and the fact that the $500 million tax expense understatement persisted from 2007 through 2010, one reasonably may infer that Weatherford's internal controls in fact were inadequate throughout the class period.

72 *Id*.

73 *See, e.g.*, DI 65, Ex. 15 at 39.

The question, of course, is whether the AC adequately pleads that Becnel **[*28]** and Duroc-Danner made their certifications either knowing they were false or with reckless disregard for their truth.[74] The Court is mindful of the fact that the certifications involve a certain amount of subjectivity, e.g., regarding whether Weatherford's internal controls provide "'reasonable assurance'" about the reliability of financial reporting.[75] [HN18] This Court previously has recognized how the subjectivity of statements in the securities fraud context bears on whether a plaintiff adequately has alleged *scienter*.[76] But subjectivity will not completely immunize a statement from review under Section 10(b). Indeed, a plaintiff can plead a claim adequately based even on a statement of opinion if it alleges facts sufficient to "permit a conclusion that [the defendant] either did not in fact hold that opinion or knew that it had no reasonable basis for it."[77]

74 *See South Cherry Street*, 573 F.3d at 109.

75 AC ¶ 142.

76 *See In re Lehman Bros. Sec. and ERISA Litig.*, 799 F. Supp. 2d 258, 300-03 (S.D.N.Y. 2011) [hereinafter "*Lehman*"].

77 *Id*. at 302.

The Court concludes that AFME has alleged *scienter* adequately with regard to Becnel's statements about internal controls. In reaching this conclusion, **[*29]** the Court relies on several key factors.

First, the personal participation of Becnel in designing and evaluating the internal controls is relevant to the inquiry. The certifications state that Becnel, along with Duroc-Danner, was "'responsible for establishing and maintaining'" those controls and "'designed'" or caused such controls to be designed under his supervision.[78] Moreover, Becnel participated in and supervised each of the Company's quarterly evaluations of its internal controls.[79] [HN19] Where a statement is made repeatedly regarding an issue of specific personal interest to the officers, the allegations will more readily give rise to the requisite strong inference of *scienter*.[80]

78 AC ¶ 142.

79 *See, e.g..*, DI 65, Ex. 15 at 39.

80 *See Plymouth Cnty..Ret. Ass'n v. Schroeder*, 576 F. Supp. 2d 360, 382-83 (E.D.N.Y. 2008) (supporting finding of *scienter* with allegations that directors were personally involved in transactions at issue); *Buxbaum v. Deutsch Bank A.G.*, No. 98 Civ. 8460, 2000 U.S. Dist. LEXIS 5838, 2000 WL 33912712, *19 (S.D.N.Y. Mar. 7, 2000) (similar).

Second, the discrepancies between the admissions of the March 2011 restatement and the repeated certifications that continued from the beginning of the class **[*30]** period until as late as November 2010 are stark. In March 2011, the Company admitted "inadequate staffing and technical expertise," "ineffective review and approval practices," "inadequate processes to effectively reconcile income tax accounts" and "inadequate controls over the preparation of quarterly tax provisions."[81] Given Becnel's personal participation in designing and evaluating the internal controls, he presumably had extensive knowledge about precisely these matters. The inference that he lacked a reasonable basis for his certifications is plausible in the circumstances.

81 DI 68, Ex. 4.

Third, the AC alleges that Becnel was aware of at least some problems with internal controls in the tax department during the class period. The AC refers to CW2, a "senior-level audit executive" who worked in Weatherford's internal audit department from approximately 2000 to 2010.[82] CW2 allegedly states that taxes "were 'always an area of concern'" and a "'constant' issue." CW2 reported that taxes were the only department with unexplained audit delays that "'genuinely concerned'" CW2. He or she allegedly informed Abarca and Becnel about these delays, but they are said to have believed "'that **[*31]** is just the nature of taxes and the Tax Department.'" Moreover, "[a]ccording to CW2, on several occasions, Tax Department audits turned up multiple control deficiencies, including at least one 'significant deficiency' in 2009, that were expressly raised with Becnel, Abarca, and the Audit Committee."[83] All deficiencies were entered into "Exception Logs" which were summarized and presented in Audit Committee meetings that Becnel and Abarca regularly attended.[84] CW2 stated that one of the reasons for his/her departure from Weatherford was increasing concern that "the Tax Department issues were not being addressed," and CW2 was "not surprised to learn of Weatherford's Restatement."[85]

82 AC ¶ 57. The Court is not persuaded by defendants' contention that the AC insufficiently describes CW2 in order for these allegations to be considered. The complaint's description of CW2 as a senior-level executive in the internal audit department during most of the class

period and its allegation that CW2 attended recurring quarterly Audit Committee meetings supports the probability that he or she would have been aware of problems regarding Weatherford's internal controls in taxation. *See BISYS*, 397 F. Supp. 2d at 442 **[*32]** (holding adequate similarly specific descriptions of various confidential witnesses).

83 AC ¶ 58.

84 *Id*.

85 *Id*. ¶ 59.

Finally, to the extent the Tax Department posed unique issues, the fact that taxes were "key to measuring [Weatherford's] financial performance and [were] a subject about which investors and analysts often inquired" further "reinforces the inference of *scienter*."[86]

86 *New Orleans Emps. Ret. Sys. v. Celestica, Inc*., 455 F. App'x 10, 14 (2d Cir. 2012) (summary order).

Defendants' opening brief paid almost no attention to the internal controls statements, contending principally that the alleged statements of CW2 regarding internal audit delays are not relevant. The Court is unpersuaded. Given that part of Weatherford's challenged statements regarded the effectiveness of internal controls to allow "timely"[87] decisions regarding disclosure and that part of the ultimately revealed problem was that Weatherford's "processes and procedures were not designed to provide for adequate and *timely* identification and review,"[88] one reasonably may infer that Becnel's certifications were recklessly made in light of the audit delays raised by CW2 and dismissed by Becnel. Moreover, the defendants' **[*33]** awareness of delays that might have been indicative of the "inadequate staffing and technical expertise" and dismissal of issues that pertained solely to the Tax Department may be also indicative of recklessness.

87 DI 65, Ex. 15 at 39.

88 DI 68, Ex. 4.

Defendants challenge also CW2's alleged statements about control deficiencies on the ground that the AC does not allege that those deficiencies related in any way to the $500 million restatement. But that is entirely beside the point when determining whether Becnel's general statements

regarding internal controls--which were separate from its understatement of tax expense--were made recklessly. The AC's allegations permit the conclusion that Becnel knew about but failed to resolve meaningful control deficiencies at times when Becnel was certifying that the internal controls were effective. While discovery ultimately may undermine the probative value of the supposed deficiencies referenced by CW2, the complaint is sufficient in this respect to survive a motion to dismiss.

In short, in light of the personal involvement of Becnel in designing and evaluating Weatherford's internal controls, the stark realities about the inadequacies of the internal **[*34]** controls that were revealed in the March 2011 restatement, the audit delays and control deficiencies expressly raised to him during the class period, and the fact that the Tax Department uniquely was experiencing problems even while he knew that its functions were of specific importance to the Company, the AC sufficiently alleges *scienter* with regard to his statements.[89] The inference that his certifications were made with reckless disregard for the truth is at least as compelling as any opposing, nonculpable inference.[90]

89 *See In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370 392-95 (S.D.N.Y. 2007) (concluding that complaint adequately alleged *scienter* with respect to company's internal controls certifications).

90 The authorities relied on by defendants in its reply do not undermine this conclusion. In *Coronel v. Quanta Capital Holdings*, No. 07 Civ. 1405, 2009 U.S. Dist. LEXIS 6633, 2009 WL 174656 (S.D.N.Y. Jan. 26, 2009), the court rejected only the plaintiffs' use of internal control weakness as a basis for inferring *scienter* regarding the filing of false earnings statements, not as an independently actionable securities fraud claim. Moreover, it relied on the fact that the company's control weaknesses **[*35]** did not lead to any financial restatements. That is not this case.

Similarly unavailing is *In re Interpublic Securities Litigation*, 2003 U.S. Dist. LEXIS 8844, 2003 WL 21250682. In concluding that the plaintiffs did not adequately plead *scienter*, the court relied on the fact that the company had never admitted that it failed to have the proper procedures in place, a far cry from this case. Nor was there any indication that executives in *Interpublic* had received any information about internal control problems while the company was certifying that the controls were adequate.

The Court concludes further that the AC adequately alleges *scienter* with regard to Weatherford.[91] While the above allegations are sufficient to give rise to the requisite strong inference of *scienter* as to Becnel, the Court concludes that the AC does not sufficiently allege *scienter* with respect to any of the other individual defendants. Although Abarca was present also at the Audit Committee

meetings, the AC does not allege with particularity her role in designing the internal controls. The AC is insufficient also with respect to Duroc-Danner because it fails to allege that he was aware of any issues with internal controls at all during the **[*36]** class period. The AC contains no allegations about Geer on this issue whatsoever.

91 *See Teamsters*, 531 F.3d at 195 ("[T]he most straightforward way to raise [a strong inference of *scienter*] for a corporate defendant will be to plead it for an individual defendant.").

b. Understatement of Tax Expense

Next, the AC alleges false statements that relate specifically to the understatement of tax expense, including the Company's reports on Forms 10-K and 10-Q. It alleges that these reports "materially overstated the Company's net income, net earnings, effective income tax rate and purported growth."[92] Relatedly, because the company's accounting for the tax receivables, which resulted in the understatement of tax expense, did not conform to GAAP, the AC alleges that the Weatherford defendants falsely asserted that the Company's financial results were prepared in accordance with GAAP.[93] This category of false statements finally includes numerous statements made in conference calls by the Weatherford defendants indicating that their positive financial results were due to successful strategies and competitive tax advantages rather than "improper manipulation of the Company's income tax expense."[94]

92 AC **[*37]** ¶ 77.

93 *See id.*

94 *Id.*

To the extent plaintiff appears to allege an intentional scheme whereby defendants "crudely manipulated the Company's effective tax rate expense by a few percentage points each quarter and fiscal year to generate enough earnings to meet or beat the Company's targets in key periods," its allegations are insufficient.[95] The complaint is entirely devoid of factual allegations that could make plausible, let alone compelling, the inference that defendants actively manipulated the tax receivable asset in order to beat Wall Street estimates or otherwise inflate earnings by a desired amount. Nor does the AC provide a sufficient basis to support even its allegations that the fictitious tax asset was intentionally introduced by defendants onto Weatherford's books.[96]

95 *Id* ¶ 65.

96 *Id*. ¶ 5 (alleging that "the Insider Defendants devised a competitive edge that its rivals could not match, a simple and crude tax accounting fraud designed to inflate Weatherford's net income and net [earnings per share] to create an overall false facade of financial success during an otherwise very difficult period for the Company").

But that is not the end of the story. Plaintiff need not make such **[*38]** grandiose allegations [HN20] to plead *scienter* adequately. Rather, plaintiff needs to allege facts plausibly giving rise to an inference of recklessness, "an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[97]

97 *ECA*, 553 F.3d at 198 (internal quotation marks and alterations omitted).

Plaintiff puts forward several bases on which to found such an inference of recklessness, including (1) the magnitude of the restatement, (2) the focus of defendants and investors on the effective tax rate, (3) the quality of internal controls, and (4) access to information.[98]

98 To the extent plaintiff relies on CW1 from the AC for another basis to allege *scienter*, *see* AC ¶¶ 54-56, this Court above has already concluded CW1 was not sufficiently described to be deemed credible.

The Court is not persuaded by the AC's attempt to allege *scienter* regarding the understatement of tax expense based on an access to information theory.[99] [HN21] Our Circuit has held that "'where plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing **[*39]** this information.'"[100] The allegations of the AC do not go beyond a "broad reference to raw data" that the Circuit has concluded is insufficient to allege access to information as a basis for *scienter*.[101] Although AFME points to the assertions of CW3 that Weatherford maintained a monthly spreadsheet detailing intercompany receivables and payables, the AC notably stops short of actually alleging that the spreadsheet contained sufficient information to demonstrate that the tax expenses were in error.[102] Nor does the AC allege that any of the defendants actually were provided this spreadsheet.[103]

99 AC ¶¶ 48-53.

100 *Teamsters*, 531 F.3d at 196 (quoting *Novak*, 216 F.3d at 309) (alterations omitted).

101 *Id*.

102 AC ¶ 60.

103 *Id*.

Similarly unpersuasive is the alleged lack of internal controls. While Weatherford's poor internal controls may give rise to liability with respect to the defendants' statements *about* internal controls, the weak internal controls provide little if any circumstantial support that the statements that the understated tax expense were made with *scienter*. [HN22] Simply put, "[w]eak accounting controls may pave the way for fraud. They do not themselves constitute fraud."[104]

104 *BISYS*, 397 F. Supp. 2d at 450.

This **[*40]** leaves plaintiff's central points--that the magnitude of the understatement and the defendants' and investors' considerable focus on Weatherford's tax rates demonstrate that the defendants were at least reckless with regard to the truth of their statements.

[HN23] The Second Circuit has held that the magnitude, at least in certain circumstances, can be relevant to the *scienter* inquiry.[105] To the extent that the invalid tax assets created a large footprint on Weatherford's finances without any supporting documentation, the size of the error may provide some support for *scienter*.[106] Moreover, these assets reduced Weatherford's stated tax expense enormously--Weatherford's stated expense from 2007-2010 was 21 percent, but after the restatement it proved actually to have been 34 percent.[107] How substantial that understatement was to Weatherford's prospects and outlook is highlighted by the many analyst conference calls and SEC filings in which defendants touted their lower tax rates. As the AC alleges, analysts showed considerable interest to defendants in even a few percentage point change in the effective tax rate.[108] Moreover, the defendants often provided specific guidance about the effective **[*41]** tax rate they expected to achieve, down to the percentage point, in analyst calls along with their reasons behind that belief, generally owing to "'tax planning'" and the Company's "'geographic earnings mix.'"[109] The AC further notes that the difference between the reported tax rate and the actual tax rate would often be even more significant in specific quarters. For example, in the third quarter of 2010, the

Company reported a 5 percent tax rate, which ultimately was restated to 35 percent.[110] Other quarters saw significant tax benefits, when the restated tax rate was a meaningful net cost.[111]

105 *See Rothman*, 220 F.3d at 92 (invoking magnitude of write-off to render less credible inference advanced by defendants and thus to conclude that plaintiff adequately alleged *scienter*); *In re Scholastic Corp. Securities Litigation*, 252 F.3d 63, 76-77 (2d Cir. 2001) (similar); *see also Defer LP v. Raymond James Financial, Inc*., 654 F. Supp. 2d 204, 219 (S.D.N.Y. 2009) (recognizing that "the magnitude of the alleged fraud does provide some circumstantial evidence of *scienter*" (internal quotation marks omitted)).

106 When the magnitude of an error is relevant to *scienter* depends on the circumstances. **[*42]** For example, if a widget manufacturer announces that it will be writing off significant inventory assets due to a previously undisclosed defect in a particular model of widgets, the size of the restatement may say very little, if anything, about *scienter* regarding the failure to disclose the defect earlier. The probability that corporate officers would have discovered the defect earlier might be unaffected by whether the inventory was worth $10 million or $100 million.

Conversely, if a widget manufacturer states repeatedly that it had annual sales of $100 million when in actuality its sales were only $10 million, the magnitude of that error should provide some support for an inference of *scienter*, because such a significant discrepancy would be unlikely to go unnoticed.

107 AC ¶ 5.

108 *Id*. ¶ 74 (analyst noting he was surprised by the lower rate of 24% versus an expected 27%, and Becnel stating "'[y]es, that was good work from our tax group in terms of planning. We had some benefits that rolled in that will appreciate over the -- that we will recognize over the rest of the year in terms of those planning implementations. And also it will depend . . . on where we are making our money. But **[*43]** we feel very good about that.").

109 *Id*. ¶ 88; *see id*. ¶ 107 (when asked about the reasons for a lower 15.5 percent rate--which ultimately proved to be a 32 percent rate after the restatement--Becnel stating "'That we can answer. If you look at distribution of earnings by geographic segment and the different rates both what I would call the statutory versus effective rates that we have been able to achieve and incremental tax planning that we undertook during the quarter in connection with our move to Geneva, all of those helped. Obviously we feel a lot more confident about putting our thumb on exactly where we will be by the end of the year in terms of earnings given the prognosis that [Duroc-Danner] just went through, and so I feel a lot more confident in that [tax] rate than where we were heading into Q1'").

110 *See id*. ¶ 127.

111 *See id*. ¶¶ 116, 122.

Nevertheless, [HN24] "it is clear that the size of the fraud alone does not create an inference of *scienter*,"[112] and what is noticeably missing from the AC is any allegation that the Weatherford defendants had any contemporaneous basis to believe that the information they related was incorrect that would be sufficient to allege the requisite "conscious **[*44]** recklessness."[113] In an attempt to bridge the gap in this regard, plaintiff relies considerably on the "core operations" theory adopted by several courts in this district. [HN25] That theory states that "[k]nowledge of the falsity of a company's financial statements can be imputed to key officers who should have known of facts relating to the core operations of their company that would have led them to the realization that the company's financial statements were false when issued."[114] The theory finds its roots in *Cosmas v. Hassett*, a case in which knowledge about new Chinese import restrictions was imputed to corporate officers when sales to China constituted a "significant part of [the company's] business."[115] As a number of courts have noted, however, it remains an open question whether the theory has survived the passage of the PSLRA.[116]

112 *BISYS*, 397 F. Supp. 2d at 447 (internal quotation marks omitted).

113 *South Cherry Street*, 573 F.3d at 109 (internal quotation marks omitted).

114 *In re Atlas Air Worldwide Holdings, Inc. Sec. Litig*., 324 F. Supp. 2d 474, 490 (S.D.N.Y. 2004).

115 886 F.2d 8, 13 (2d Cir. 1989).

116 *See Bd. of Trustees of City of Ft. Lauderdale Gen. Emps. Ret. Sys. v. Mechel OAO*, 811 F. Supp. 2d 853, 871 (S.D.N.Y. 2011) **[*45]** (surveying caselaw in the district) *aff'd Frederick v. Mechel OAO*, 475 F. App'x 353, 356 (2d Cir. 2012) (summary order) ("*Cosmas* was decided prior to the enactment of the PSLRA, and we have not yet expressly addressed whether, and in what form, the core operations doctrine survives as a viable theory of *scienter*").

That debate need not be settled here. The Court assumes, in light of the importance of tax rates to Weatherford's financials, that the proper determination of these rates constituted "core operations" that would have permitted a plausible inference that the defendants knew about the falsity or knew facts that made the risk of such falsity obvious.

[HN26] But the fact that the Court *may* make such an inference does not mean that such an inference necessarily would be the most compelling under *Tellabs*. The Court is required to consider "plausible, nonculpable explanations for the defendant's conduct" and, in order to sustain the complaint, must conclude that the inference of *scienter* is "at least as compelling as any opposing inference one could draw from the facts alleged."[117] Here, the allegations of the AC support the plausible inference that the Company made an error in its tax **[*46]** accounting treatment in 2007 that persisted on its books, compounding over time, and leading to incorrect financial reporting that propagated up to management. That is, it is a plausible inference that management's statements about the Company's tax expense were "the result of merely careless mistakes at the management level based on false information fed it from below."[118] In the absence of any allegations of suspicious circumstances or of knowledge of facts that made the risk of such error obvious, the Court concludes that this nonculpable inference is more compelling than the inference proffered by AFME. Thus, the AC fails adequately to allege *scienter* with regard to the understatement of tax expense.

117 *Tellabs*, 551 U.S. at 324.

118 *Teamsters*, 531 F.3d at 197 (internal quotation marks omitted). Note that this category of statements is distinguishable in this regard from the statements about internal controls. While the inference is quite compelling here that the error simply originated at a lower level and percolated up to management, that inference is much less plausible with respect to internal controls that were or should have been designed by upper management.

B. Ernst & Young

AFME **[*47]** challenges three categories of statements made by Ernst & Young in reports appended to each of Weatherford's annual 10-K reports for 2007, 2008, and 2009: (1) its statements regarding the effectiveness of Weatherford's internal controls,[119] (2) its statements regarding Weatherford's compliance with GAAP,[120] and (3) its statements regarding its own compliance with the auditing standards of the PCAOB, which has adopted GAAS, in arriving at its opinions about Weatherford's internal controls[121] and GAAP compliance.[122]

119 *See, e.g.*, 2009 10-K, DI 68, Ex. 7 at 39 ("In our opinion, Weatherford International Ltd. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009 based on the COSO criteria [laying out standards for evaluating internal controls].").

120 *See, e.g., id*. at 40 ("In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Weatherford International Ltd. and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December **[*48]** 31, 2009, in conformity with U.S. generally accepted accounting principles.").

121 *See, e.g., id*. at 39 ("We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.").

122 *See, e.g., id*. at 40 ("We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence **[*49]** supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.").

With regard to the third category, E & Y's statements about GAAS compliance, the AC points to several General Standards ("GS"), interpretive Statements on Auditing Standards ("AU"), and Standards of Fieldwork that allegedly are part of GAAS and that E & Y allegedly violated.[123] AFME focuses particularly on GAAS standards regarding the gathering of sufficient evidential matter. In particular, AU Section 326 provides that the auditor "'should be thorough in his or her search for evidential matter,'"[124] and AU Section 110 states that "'[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.'"[125]

123 *See* AC ¶ 202 n.15 (indicating allegations of violations of GS Nos. 1-3 and Standards of Field Work Nos. 2-3).

124 *Id*. ¶ 206.

125 *Id*. **[*50]** ¶ 207.

AFME contends that each of these three categories of statements was false and that E & Y made such false statements with the requisite *scienter*.

1. Motive and Opportunity

Plaintiff first posits that it sufficiently has alleged facts giving rise to a strong inference of *scienter* under the motive and opportunity approach on three types of allegations. The first regard the fees that Ernst & Young received from Weatherford.[126] The second are based on supposed close ties between the two entities -- the AC focuses particularly on former employees of Ernst & Young who later worked for Weatherford, including individual defendant Abarca.[127] The third set of allegations focus on administrative sanctions and discipline that Ernst & Young and its employees have faced in other, independent circumstances.[128] None of these allegations suffices.

126 *See id*. ¶¶ 201, 218, 220.

127 *See id*. ¶¶ 220-26.

128 *See id*. ¶¶ 227-28.

The AC alleges only that Ernst & Young "generated over $30 million in aggregate fees" from Weatherford during the class period.[129] It nowhere alleges that these fees were not commensurate with work performed or otherwise were paid inappropriately. [HN27] This does not sufficiently allege motive, **[*51]** as "[i]t would defy common sense to hold that the motive element . . . would be satisfied merely by alleging the receipt of normal compensation for professional services rendered."[130]

129 *Id*. ¶ 218.

130 *Friedman v. Ariz. World Nurseries*, 730 F. Supp. 521, 532 (S.D.N.Y. 1990), *aff'd* 927 F.2d 594 (2d Cir. 1991); *see Ganino v. Citizen Utilities Co*., 228 F.3d 154, 170 (2d Cir. 2000) ("General allegations that the defendants acted in their economic self-interest are not enough.").

The "revolving door" allegations are similarly unsuccessful. The Court assumes for present purposes that there was, in fact, a "steady stream" of Weatherford employees and executives with "close personal ties" to Ernst & Young.[131] Even so, the AC fails to allege why this gave Ernst &

Young a motive to commit the alleged fraud. The Weatherford employees whose departure dates from Ernst & Young are given are alleged to have left the auditor in 1996 and 2000,[132] some seven years before the class period. In any event, the AC fails to allege why the fact that certain Weatherford employees once worked for Ernst & Young has any bearing on either party's motive or opportunity to commit the fraud alleged in this case. Simply **[*52]** listing common employees of both companies, without more, is not enough.[133]

131 AC ¶ 220.

132 *See id*. ¶¶ 221, 222.

133 *See Vogel v. Sands Bros. & Co*., 126 F. Supp. 2d 730, 743 (S.D.N.Y. 2001) (holding that [HN28] alleging a "close relationship" without more did not allow the court to infer *scienter*).

Finally, the AC provides two paragraphs of allegations of prior wrongs it asserts Ernst & Young committed.[134] These prior sanctions and disciplinary measures--which occurred in circumstances entirely independent of the circumstances of this case--have no bearing on whether Ernst & Young had a motive to perpetuate fraud in this case.

134 *See* AC ¶¶ 227, 228.

2. Circumstantial Evidence of Recklessness

Alternatively, AFME contends that it has alleged the requisite *scienter* through sufficient circumstantial evidence of conscious misbehavior or recklessness.

[HN29] In conducting this inquiry, the Court is mindful of the "demanding" standard imposed by this Circuit to plead auditor *scienter* in a securities fraud case.[135] In particular, for "recklessness on the part of a non-fiduciary accountant to satisfy securities fraud *scienter,* such recklessness must be conduct that is highly unreasonable, representing an extreme departure **[*53]** from the standards of ordinary care" and "approximat[ing] an actual intent to aid in the fraud being perpetrated by the audited company."[136] Moreover, our Circuit has said that "the failure of a non-fiduciary accounting firm to identify problems with the defendant-company's internal controls and accounting practices does not constitute reckless conduct sufficient for § 10(b) liability."[137]

135 *Lehman*, 799 F. Supp. 2d at 302 (internal quotation marks omitted).

136 *Rothman*, 220 F.3d at 98 (internal quotation marks omitted); *accord South Cherry Street*, 573 F.3d at 110. This said, [HN30] auditor "'*scienter* can be established by a showing of shoddy accounting practices amounting at best to a pretended audit, or of grounds supporting a representation so flimsy as to lead to the conclusion that there was no genuine belief back of it.'" *Rothman*, 220 F.3d at 98 (quoting *McLean v. Alexander*, 599 F.2d 1190, 1198 (3d Cir. 1979)). This is because, although the Circuit requires approximate "intent," the plaintiff need not allege that the auditor actually "wanted" the fraud to happen; rather, it is sufficient to consider "what could the defendant reasonably foresee as a potential result of his action." *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 221 (2d Cir. 2000) **[*54]** (internal quotation marks omitted). Thus, because "E & Y is not an accounting dilettante" and "knows well that its opinions and certifications are afforded great weight . . . . it is sufficient for a plaintiff to allege and prove that a defendant could have foreseen the consequences of his action but forged ahead nonetheless." *Id.; accord Gould v. Winstar Communications, Inc.*, 692 F.3d 148, 158 (2d Cir. 2012).

137 *Novak*, 216 F.3d at 309; *see Gould*, 692 F.3d at 159 (suggesting [HN31] at summary judgment stage that "mere failure to uncover the accounting fraud" is insufficient).

[HN32] Typically, auditor *scienter* in this Circuit turns on alleging that the auditor "repeatedly failed to scrutinize serious signs of fraud."[138] Such allegations of "red flags," when coupled with allegations of accounting violations, may permit a complaint to survive a motion to dismiss.[139] But "an unseen red flag cannot be heeded" and "flags are not red merely because the plaintiff calls them red."[140] Rather, the red flags, taken collectively, must demonstrate "obvious signs of fraud, or that the danger of fraud was so obvious that [the defendant] must have been aware of it."[141]

138 *Gould*, 692 F.3d at 160.

139 *Stephenson v. PricewaterhouseCoopers, LLP*, 768 F. Supp. 2d 562, 573 (S.D.N.Y. 2011).

140 *Id.*

141 *South Cherry Street*, 573 F.3d at 112; **[*55]** *see Tellabs*, 551 U.S. at 322-23 ("The inquiry . . . is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of *scienter*, not whether any individual allegation, scrutinized in isolation, meets that standard" (emphasis in original)).

Moreover, [HN33] where, as here, statements by an auditor are couched as opinions, this Court has

previously recognized that the bar is raised even higher to allege the requisite *scienter*. In particular, to allege that an opinion is false (and *a fortiori*, to allege that it is false with *scienter*), the complaint must "set forth facts sufficient to warrant a finding that the auditor did not actually hold the opinion it expressed or that it knew that it had no reasonable basis for holding it."[142]

142 *Lehman*, 799 F. Supp. 2d at 303.

The Court takes each category of alleged misstatements in turn.

a. GAAP Compliance

AFME relies on what it characterizes as nine red flags to support an inference of *scienter* regarding E & Y's opinions about Weatherford's GAAP compliance: (1) the sudden drop in Weatherford's tax rate in 2007, (2) the magnitude of the error as ultimately revealed in 2010, (3) the frequency and consistency of the tax entries, (4) **[*56]** the fact that Weatherford's apparent tax rate was much lower than that of its rivals and permitted Weatherford to beat earnings forecasts, (5) the fact that E & Y received fees for "non-U.S. tax compliance, planning and U.S./non-U.S. tax related consultation," (6) Weatherford's prior history of accounting improprieties, (7) the discrepancy between Weatherford's cash tax rate and reported tax rate, (8) E & Y's access to a spreadsheet containing intercompany reconciliations and (9) the discrepancy between E & Y's representations about internal controls and Weatherford's March 2011 admissions.[143] The Court is not persuaded that these allegations are sufficient to satisfy the demanding standard for pleading *scienter* as against an auditor.

143 AC ¶ 213.

First, several of these were not red flags at all. That E & Y received fees from Weatherford for U.S. "tax related consultation" says substantially nothing about what E & Y would have known from 2007-2010 about this particular aspect of Weatherford's taxes beyond its general role as auditor. Nor is Weatherford's March 2011 revelation of its poor internal controls a red flag that would have been seen by E & Y in 2007-2010.

Second, at least one **[*57]** of these purported red flags is insufficiently connected to E & Y. The AC fails to allege that E & Y knew about Weatherford's competitors' tax rates or that the tax rates were responsible for beating earnings forecasts.

Third, some of these red flags just are not sufficiently colorful. As discussed previously, the AC fails to explain with particularity whether and how the spreadsheet providing "intercompany

reconciliations" would have revealed the understatement of tax expense.[144] Nor does Weatherford's general history of one-time accounting charges provide any meaningful grounds to contend that E & Y was reckless for failing to uncover this particular misstatement.

144 The AC contains also many more general statements about E & Y's "access" due to its longstanding role as an auditor of Weatherford since 2001, non-audit work, frequent conversations with management, etc. *See* AC ¶ 209. "None of these allegations shows anything more than that [E & Y] was [Weatherford's] auditor, a fact which is wholly insufficient to show [E & Y's] *scienter*." *In re Doral Fin Corp. Sec. Litig.*, 563 F. Supp. 2d 461, 466 (S.D.N.Y. 2008).

Finally, to the extent that the supposed red flag merely constituted better **[*58]** performance by Weatherford, the Circuit has rejected the notion that a rapid increase in profitability is a sign of fraud sufficient to plead *scienter*.[145]

145 *See Chill v. Gen. Elec. Co.*, 101 F.3d 263, 269-70 (2d Cir.1996)

The remaining purported red flags amount not so much to any meaningful contemporaneous knowledge that E & Y had showing the existence of any misstatements, but rather that the size and nature of the fraud was such that E & Y should have found it. That is, the AC is "replete with allegations that [E & Y] would have learned the truth as to those aspects of [Weatherford's taxes] if [E & Y] had performed the due diligence it promised."[146] This is not enough.

146 *South Cherry Street*, 573 F.3d at 112 (internal quotation marks omitted). Moreover, E & Y's opinion letter makes clear that its audit operates on a "test basis" and therefore did not analyze every single transaction. DI 68, Ex. 7 at 40. Thus, AFME's allegation that E & Y failed to uncover the error is insufficient to allege that the audit was improperly conducted.

b. Internal Controls

The allegations regarding internal controls fare no better. The only purported red flag that AFME alleges regarding internal controls **[*59]** is the tension between E & Y's opinion that the internal controls were effective and Weatherford's subsequent conclusion that they were not. But that is not

a red flag because Weatherford's conclusion was made known only after E & Y's representations. Unlike in the case of Becnel, the AC contains no allegations suggesting that E & Y ever had been made aware of issues with internal tax controls.

AFME's stronger argument is that, in light of the considerable deficiencies in internal controls revealed by the Company, any reasonable audit following the criteria that E & Y affirmed that it had used would have revealed the deficiencies. But the AC's allegations in this regard are only conclusory, providing no factual detail as to how application of the criteria would necessarily have uncovered the problems with internal controls.[147] The Court thus concludes that the more compelling inference is that the audit was no more than negligent, if indeed it was that, in failing to identify the problems.[148]

147 *See* AC ¶ 216 ("The COSO criteria provide a detailed roadmap for auditors, including the identification of red flags, appropriate policies and procedures and comprehensive audit planning and review **[*60]** of internal controls necessary for reliable financial reporting. Accordingly, if Ernst & Young conducted the audit it claimed it had pursuant to COSO, it had actual knowledge that the Company had virtually no internal controls over financial reporting for taxes, as Weatherford admitted in the Restatement. If Ernst & Young did not conduct a COSO audit, as it represented to investors that it had during the Class Period, its certifications were knowingly false.")

148 The Court further recognizes that [HN34] the Circuit has said that "the failure of a non-fiduciary accounting firm to identify problems with the defendant-company's internal controls and accounting practices does not constitute reckless conduct sufficient for § 10(b) liability." *Novak*, 216 F.3d at 309 (citing *Decker v. Massey-Ferguson, Ltd.*, 681 F.2d 111, 120 (2d Cir. 1982)). Plaintiff contends that the principle is inapposite since the passage of the Sarbanes-Oxley Act which mandates specific reviews and certifications regarding internal controls. The Court need not rely on the broad principle enunciated by *Novak* and *Decker* to conclude that plaintiff has failed to allege any reckless conduct here.

c. GAAS Compliance

Finally, E & Y's **[*61]** statements regarding its compliance with GAAS is disposed easily. Whether in alleging that E & Y violated its duties of "due professional care," "professional skepticism," or gathering sufficient evidential matter, or otherwise, the claims fall for essentially the same reasons as described above. Indeed, the burden is doubly high in this context; not only must AFME allege that E & Y failed to do an adequate audit, but it must allege also that E & Y was at least reckless in believing that its audit was adequate. There is nothing in the AC that even begins to suggest anything about E & Y's state of mind with regard to how it conducted the audit, and thus the claim

fails.

C. Section 20(a)

[HN35] Section 20(a) of the Exchange Act makes liable those who directly or indirectly control a person who is liable for a primary violation of the statute.[149] As this Court previously has held, a plaintiff need not plead culpable participation by the control person in order to state a legally sufficient claim.[150] Nor need the allegations of control be pleaded with particularity.[151]

149 *See* 15 U.S.C. § 78t(a).

150 *See In re Parmalat Sec. Litig.*, 497 F. Supp. 2d 526, 532 n.42 (S.D.N.Y. 2007); *BISYS*, 397 F. Supp. 2d at 450.

151 *Id.*

The **[*62]** Court concludes that in addition to stating a claim against Becnel and Weatherford as primary violators, the AC states a claim against Duroc-Danner, Abarca, and Geer under Section 20(a). As chief executive officer, Duroc-Danner clearly had "the power to direct or cause the direction of the management and policies" of Weatherford.[152] The same is true for Abarca and Geer, who were Weatherford's chief accounting officer and principal accounting officer, respectively, and signed some of the statements at issue.[153]

152 *S.E.C. v. First Jersey Sec. Inc.*, 101 F.3d 1450, 1472-73 (2d Cir. 1996) (internal quotation marks omitted).

153 *See* AC ¶¶ 46-47.

D. Motion to Supplement

AFME moves to supplement the complaint to add factual content that purportedly came to light only after the filing of the amended complaint.

[HN36] A motion to supplement a complaint pursuant to Rule 15(d) is governed by the same standard as a motion to amend under Rule 15(a).[154] It differs only in that it refers to a request to add allegations about an event or events that occurred after the original pleading was filed, as compared to a motion to amend, which covers events that occurred before the filing of the pleading but which were **[*63]** not included in the complaint.[155]

154 *See Quaratino v. Tiffany & Co.*, 71 F.3d 58, 66 (2d Cir. 1995); *Instinet Inc. v. Ariel (UK) Ltd.*, No. 08 Civ. 7141, 2011 U.S. Dist. LEXIS 109349, 2011 WL 4444086, at *2 n.1 (S.D.N.Y. Sept. 26, 2011).

155 *See* [HN37] FED. R. CIV. P. 15(d) ("On motion and reasonable notice, the court may, on just terms, permit a party to serve a supplemental pleading setting out any transaction, occurrence, or event that happened after the date of the pleading to be supplemented.").

[HN38] A motion to supplement generally should be "permitted when the supplemental facts connect it to the original pleading."[156] Such a motion should not be granted, however, where it would cause "undue delay, . . . undue prejudice to the party to be served with the proposed pleading, or [would be] futil[e]."[157]

156 *Quaratino*, 71 F.3d at 66.

157 *Id*.

At a hearing before this Court on January 17, 2012, counsel for lead plaintiff AFME indicated that they preferred to "go forward"[158] with the amended complaint as drafted, and declined the opportunity offered by this Court to amend their complaint. Lead Plaintiff has twice attempted to add to the allegations of the AC since this date, first requesting to amend and then filing a motion to supplement **[*64]** it, both in spite of the fact that they are seeking to alter the very complaint on which they unequivocally elected to stand.[159]

158 DI 83, at 2.

159 *See* DI 86; DI 89.

Be that as it may, AFME asserts that its present motion to supplement the AC should be granted because events have occurred after the date the AC was filed that add substantively to the allegations asserted therein.[160] AFME seeks to supplement with allegations regarding (1) the "remov[al]" of Becnel, as well as the Company's vice president of tax, (2) a U.S. Department of Justice investigation that was announced on March 15, 2012, and which the motion asserts is

looking "into the facts alleged in the [AC]," and (3) a second financial restatement issued by the Company in 2012, which "admitted tax misstatements . . . [of] another $185 million."[161] In addition, AFME asks the Court to take judicial notice of related materials.

160 As certain of the defendants note, it appears that plaintiff's supplemental amended complaint contains also changes that are not simply alterations reflecting events that "happened after" the AC was filed. *See* DI 94, at 6 n.2.

161 DI 90, at 4, 8.

The motion is denied as futile. None of the proposed additions **[*65]** in any way affects the resolution of this case. First, that Becnel and another executive were removed well over a year after a restatement in which the Company was forced to acknowledge, at a minimum, a $500 million mistake, is not probative of *scienter*.[162] Second, while the existence of government investigations may sometimes be probative of *scienter* with regard to post-investigation conduct, there is no basis to conclude that a DOJ investigation initiated over a year after the events in question is probative of anything.[163] Finally, the 2012 restatement appears to have increased the size of the losses, but changes nothing of substance with regard to the claims in this case.

162 *See Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 598 (S.D.N.Y. 2011) (finding that [HN39] officer resignations did not support inference of scienter absent "highly unusual or suspicious circumstances"). It would hardly be unusual or suspicious that two executives would be removed as a result of this significant restatement, even assuming it was an honest mistake.

163 *See Teamsters Allied Benefit Funds v. McGraw*, No. 09 Civ 140, 2010 WL 882883, at *11 (S.D.N.Y. Mar. 11, 2010) (noting that government investigations only **[*66]** allege scienter for misconduct occurring after the investigation).

Conclusion

Accordingly, Ernst & Young's motion to dismiss the AC [DI 63] is granted. The Weatherford Defendants' motion to dismiss the AC [DI 67] is granted in all respects, except that it is denied with respect to (1) the Section 10(b) claims against Becnel and Weatherford regarding statements about the quality of internal controls and (2) corresponding Section 20(a) claims against Duroc-Danner, Abarca, and Geer. AFME's motion for leave to supplement the complaint [DI 90] is denied, and its

requests for judicial notice [DI 90; DI 101] are denied as moot.

SO ORDERED.

Dated: November 7, 2012

/s/ Lewis A. Kaplan

Lewis A. Kaplan

United States District Judge

Supreme Court of the United States
DURA PHARMACEUTICALS, INC., et al., Petitioners,
v.
Michael BROUDO et al.

No. 03-932.
Argued Jan. 12, 2005.
Decided April 19, 2005.

Background: Purchasers of stock in pharmaceutical company brought securities fraud action against company and certain managers and directors, alleging that defendants' false statements regarding expected future Food and Drug Administration (FDA) approval of a new asthmatic spray device artificially inflated price of stock. The United States District Court for the Southern District of California, 2000 WL 33176043,M. James Lorenz, J., dismissed without prejudice, and following filing of amended complaint dismissed with prejudice. Purchaser appealed. The Court of Appeals, 339 F.3d 933, reversed and remanded. Certiorari was granted.

Holdings: The Supreme Court, Justice Breyer, held that:
(1) an investor may not establish loss causation by alleging that security price was inflated because of misrepresentation, and
(2) investors' allegations were insufficient to state fraud claim.

Reversed and remanded.

West Headnotes

[1] Securities Regulation 349B 60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

An investor claiming securities fraud under the Securities Exchange Act cannot satisfy the requirement of proving that the fraud caused an economic loss simply by alleging in the complaint, and subsequently establishing, that the price of the security on the date of purchase was inflated because of the misrepresentation. Securities Exchange Act of 1934, § 21D(b)(4), as amended, 15 U.S.C.A. § 78u-4(b)(4).

[2] Securities Regulation 349B 60.53

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.53 k. Misrepresentation. Most Cited Cases

Investors' allegations that they paid artificially inflated prices for securities of pharmaceutical company, due to false statements regarding expected future Food and Drug Administration (FDA) approval of a new asthmatic spray device, and suffered damages, implying that the investors' loss consisted of the artificially inflated purchase price, were insufficient to state securities fraud claim under Securities Exchange Act; investors failed to claim that share price fell significantly after truth became known. Securities Exchange Act of 1934, § 21D(b)(4), as amended, 15 U.S.C.A. § 78u-4(b)(4).

*****1628 *336** *Syllabus* [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

Respondents filed a securities fraud class action, alleging that petitioners, Dura Pharmaceuticals, Inc., and some of its managers and directors (hereinafter Dura), made, *inter alia*, misrepresentations about future Food and Drug Administration approval of a new asthmatic spray device, leading respondents to purchase Dura securities at an artificially inflated price. In dismissing, the District Court found that the complaint failed adequately to allege "loss causation"-*i.e.*, a causal connection between the spray device misrepresentation and the economic loss, 15 U.S.C. § 78u-4(b)(4). The Ninth Circuit reversed, finding that a plaintiff can satisfy the loss causation requirement simply by alleging that a security's price at the time of purchase was inflated because of the misrepresentation.

Held:

1. An inflated purchase price will not by itself constitute or proximately cause the relevant economic loss needed to allege and prove "loss causation." The basic elements of a private securities fraud action-which resembles a common-law tort action for deceit and misrepresentation-include, as relevant here, economic loss and "loss causation." The Ninth Circuit erred in following an inflated purchase price approach to showing causation and loss. First, as a matter of pure logic, the moment the transaction takes place, the plaintiff has suffered no loss because the inflated purchase price is offset by ownership of a share that possesses equivalent value at that instant. And the logical link between the inflated purchase price and any later economic loss is not invariably strong, since other factors may affect the price. Thus, the most logic alone permits this Court to say is that the inflated purchase price suggests that misrepresentation "touches upon" a later economic loss, as the Ninth Circuit found. However, to touch upon a loss is not to *cause* a loss, as 15 U.S.C. § 78u-4(b)(4) requires. The Ninth Circuit's holding also is not supported by precedent. The common-law deceit and misrepresentation actions that private securities fraud actions resemble require a plaintiff to show not only that had he known the truth he would not have acted, but also that he suffered actual economic loss. Nor can the holding below be reconciled with the views of other Courts ***337** of Appeals, which have rejected the inflated purchase price approach to showing loss causation. Finally, the Ninth Circuit's approach is inconsistent with an important securities law objective. The securities laws make clear Congress' intent to permit private securities fraud actions only where plaintiffs adequately allege and prove the ****1629** traditional elements of cause and loss, but the Ninth Circuit's approach would allow recovery where a misrepresentation leads to an inflated purchase price, but does not proximately cause any economic loss. Pp. 1630-1634.

2. Respondents' complaint was legally insufficient in respect to its allegation of "loss causation." While Federal Rule of Civil Procedure 8(a)(2) requires only a "short and plain statement of the claim showing that the pleader is entitled to relief," and while the Court assumes that neither the Rules nor the securities statutes place any further requirement in respect to the pleading, the "short and plain statement" must give the defendant "fair notice of what the plaintiff's claim is and the grounds upon which it rests," *Conley v. Gibson*, 355 U.S. 41, 47, 78 S.Ct. 99, 2 L.Ed.2d 80. The complaint here contains only respondents' allegation that their loss consisted of artificially inflated purchase prices. However, as this Court has concluded here, such a price is not itself a relevant economic loss. And the complaint nowhere else provides Dura with notice of what the relevant loss might be or of what the causal connection might be between that loss and the misrepresentation. Ordinary pleading rules are not meant to impose a great burden on a plaintiff, but it should not prove burdensome for a plaintiff suffering economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. Allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause would bring about the very sort of harm the securities statutes seek to avoid, namely, the abusive practice of filing law-

suits with only a faint hope that discovery might lead to some plausible cause of action. Pp. 1634-1635.

339 F.3d 933, reversed and remanded.

BREYER, J., delivered the opinion for a unanimous Court.

Thomas G. Hungar, for United States as amicus curiae, by special leave of the Court, supporting the petitioners.

Patrick J. Coughlin, on briefs, Sanford Svetcov, Eric Alan Isaacson, Joseph D. Daley, Alan Schulman, Myron Moskovitz, Daniel S. Sommers, and Paul R. Hoeber, for respondents.

William F. Sullivan, Counsel of Record, Christopher H. McGrath, Tracey L. DeLange, Paul, Hastings, Janofsky & Walker, LLP, San Diego, CA, Attorneys for Petitioners.

For U.S. Supreme Court briefs, see:2004 WL 2075752 (Pet.Brief)2004 WL 2988614 (Reply.Brief)

Justice BREYER delivered the opinion of the Court.

***338** A private plaintiff who claims securities fraud must prove that the defendant's fraud caused an economic loss. 109 Stat. 747, 15 U.S.C. § 78u-4(b)(4). We consider a Ninth Circuit holding that a plaintiff can satisfy this requirement-a requirement that courts call "loss causation"-simply by alleging in the complaint and subsequently establishing that "the price" of the security "*on the date of purchase* was inflated because of the misrepresentation." 339 F.3d 933, 938 (9th Cir.2003) (internal quotation marks omitted). In our view, the Ninth Circuit is wrong, both in respect to what a plaintiff must prove and in respect to what the plaintiffs' complaint here must allege.

***339** I

Respondents are individuals who bought stock in Dura Pharmaceuticals, Inc., on the public securities market between April 15, 1997, and February 24, 1998. They have brought this securities fraud class action Daniel S. Sommers, and Paul R. Hoeber, for respondents.against Dura and some of ****1630** its managers and directors (hereinafter Dura) in federal court. In respect to the question before us, their detailed amended (181 paragraph) complaint makes substantially the following allegations:

(1) Before and during the purchase period, Dura (or its officials) made false statements concerning both Dura's drug profits and future Food and Drug Administration (FDA) approval of a new asthmatic spray device. See, *e.g.*, App. 45a, 55a, 89a.

(2) In respect to drug profits, Dura falsely claimed that it expected that its drug sales would prove profitable. See, *e.g.*, *id.*, at 66a-69a.

(3) In respect to the asthmatic spray device, Dura falsely claimed that it expected the FDA would soon grant its approval. See, *e.g.*, *id.*, at 89a-90a, 103a-104a.

(4) On the last day of the purchase period, February 24, 1998, Dura announced that its earnings would be lower than expected, principally due to slow drug sales. *Id.*, at 51a.

(5) The next day Dura's shares lost almost half their value (falling from about $39 per share to about $21). *Ibid.*

(6) About eight months later (in November 1998), Dura announced that the FDA would not approve Dura's new asthmatic spray device. *Id.*, at 110a.

(7) The next day Dura's share price temporarily fell but almost fully recovered within one week. *Id.*, at 156a.

Most importantly, the complaint says the following (and nothing significantly more than the following) about ***340** economic losses attributable to the spray device misstatement: "*In reliance on the*

integrity of the market, [the plaintiffs] ... paid artificially inflated prices for Dura securities" and the plaintiffs suffered "damage[s]" thereby. Id., at 139a (emphasis added).

The District Court dismissed the complaint. In respect to the plaintiffs' drug-profitability claim, it held that the complaint failed adequately to allege an appropriate state of mind, *i.e.*, that defendants had acted knowingly, or the like. In respect to the plaintiffs' spray device claim, it held that the complaint failed adequately to allege "loss causation."

The Court of Appeals for the Ninth Circuit reversed. In the portion of the court's decision now before us-the portion that concerns the spray device claim-the Circuit held that the complaint adequately alleged "loss causation." The Circuit wrote that "plaintiffs establish loss causation if they have shown that the price *on the date of purchase* was inflated because of the misrepresentation." 339 F.3d, at 938 (emphasis in original; internal quotation marks and citation omitted). It added that "the injury occurs at the time of the transaction." *Ibid.* Since the complaint pleaded "that the price at the time of purchase was overstated," and it sufficiently identified the cause, its allegations were legally sufficient. *Ibid.*

Because the Ninth Circuit's views about loss causation differ from those of other Circuits that have considered this issue, we granted Dura's petition for certiorari. Compare *ibid.* with, *e.g.*, *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 198 (C.A.2 2003); *Semerenko v. Cendant Corp.*, 223 F.3d 165, 185 (C.A.3 2000); *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1447-1448 (C.A.11 1997); cf. *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 685 (C.A.7 1990). We now reverse.

***341** II

Private federal securities fraud actions are based upon federal securities statutes and their implementing regulations. Section 10(b) of the Securities Exchange Act ****1631** of 1934 forbids (1) the "use or employ[ment] ... of any ... deceptive device," (2) "in connection with the purchase or sale of any security," and (3) "in contravention of" Securities and Exchange Commission "rules and regulations." 15 U.S.C. § 78j(b). Commission Rule 10b-5 forbids, among other things, the making of any "untrue statement of a material fact" or the omission of any material fact "necessary in order to make the statements made ... not misleading." 17 CFR § 240.10b-5 (2004).

The courts have implied from these statutes and Rule a private damages action, which resembles, but is not identical to, common-law tort actions for deceit and misrepresentation. See, *e.g.*, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730, 744, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 196, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). And Congress has imposed statutory requirements on that private action. *E.g.*, 15 U.S.C. § 78u-4(b)(4).

In cases involving publicly traded securities and purchases or sales in public securities markets, the action's basic elements include:

(1) *a material misrepresentation (or omission)*, see *Basic Inc. v. Levinson*, 485 U.S. 224, 231-232, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988);

(2) *scienter*, *i.e.*, a wrongful state of mind, see *Ernst & Ernst, supra*, at 197, 199, 96 S.Ct. 1375;

(3) *a connection with the purchase or sale of a security*, see *Blue Chip Stamps, supra*, at 730-731, 95 S.Ct. 1917;

(4) *reliance*, often referred to in cases involving public securities markets (fraud-on-the-market cases) as "transaction causation," see *Basic, supra*, at 248-249, 108 S.Ct. 978 (nonconclusively presuming that the price of a publicly ***342** traded share reflects a material misrepresentation and that plaintiffs have relied upon that misrepresentation as long as they would not have bought the share in its absence);

(5) *economic loss,* 15 U.S.C. § 78u-4(b)(4); and

(6) "*loss causation,*" *i.e.,* a causal connection between the material misrepresentation and the loss, *ibid.;* cf. T. Hazen, Law of Securities Regulation §§ 12.11[1], [3] (5th ed.2005).

Dura argues that the complaint's allegations are inadequate in respect to these last two elements.

A

[1] We begin with the Ninth Circuit's basic reason for finding the complaint adequate, namely, that at the end of the day plaintiffs need only "establish," *i.e.,* prove, that "the price *on the date of purchase* was inflated because of the misrepresentation." 339 F.3d, at 938 (internal quotation marks and citation omitted). In our view, this statement of the law is wrong. Normally, in cases such as this one (*i.e.,* fraud-on-the-market cases), an inflated purchase price will not itself constitute or proximately cause the relevant economic loss.

For one thing, as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss; the inflated purchase payment is offset by ownership of a share that *at that instant* possesses equivalent value. Moreover, the logical link between the inflated share purchase price and any later economic loss is not invariably strong. Shares are normally purchased with an eye toward a later sale. But if, say, the purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss. If the purchaser****1632** sells later after the truth makes its way into the marketplace, an initially inflated purchase price *might* mean a later loss. But that is far from inevitably so. When the ***343** purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price. (The same is true in respect to a claim that a share's higher price is lower than it would otherwise have been—a claim we do not consider here.) Other things being equal, the longer the time between purchase and sale, the more likely that this is so, *i.e.,* the more likely that other factors caused the loss.

Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. It may prove to be a necessary condition of any such loss, and in that sense one might say that the inflated purchase price suggests that the misrepresentation (using language the Ninth Circuit used) "touches upon" a later economic loss. *Ibid.* But, even if that is so, it is insufficient. To "touch upon" a loss is not to *cause* a loss, and it is the latter that the law requires. 15 U.S.C. § 78u-4(b)(4).

For another thing, the Ninth Circuit's holding lacks support in precedent. Judicially implied private securities fraud actions resemble in many (but not all) respects common-law deceit and misrepresentation actions. See *Blue Chip Stamps, supra,* at 744, 95 S.Ct. 1917; see also L. Loss & J. Seligman, Fundamentals of Securities Regulation 910-918 (5th ed.2004) (describing relationship to common-law deceit). The common law of deceit subjects a person who "fraudulently" makes a "misrepresentation" to liability "for pecuniary loss caused" to one who justifiably relies upon that misrepresentation. Restatement (Second) of Torts § 525, p. 55 (1976) (hereinafter Restatement of Torts); see also *Southern Development Co. v. Silva,* 125 U.S. 247, 250, 8 S.Ct. 881, 31 L.Ed. 678 (1888) (setting forth elements of fraudulent misrepresentation). And the common law has long insisted that a plaintiff in such a case show ***344** not only that had he known the truth he would not have acted but also that he suffered actual economic loss. See, *e.g., Pasley v. Freeman,* 3 T.R. 51, 65, 100 Eng. Rep. 450, 457 (1789) (if "no injury is occasioned by the lie, it is not actionable: but if it be attended with a damage, it then becomes the subject of an action"); *Freeman v. Venner,* 120 Mass. 424,

426 (1876) (a mortgagee cannot bring a tort action for damages stemming from a fraudulent note that a misrepresentation led him to execute unless and until the note has to be paid); see also M. Bigelow, Law of Torts 101 (8th ed.1907) (damage "must already have been suffered before the bringing of the suit"); 2 T. Cooley, Law of Torts § 348, p. 551 (4th ed.1932) (plaintiff must show that he "suffered damage" and that the "damage followed proximately the deception"); W. Keeton, D. Dobbs, R. Keeton, & D. Owen, Prosser and Keeton on Law of Torts § 110, p. 765 (5th ed.1984) (hereinafter Prosser and Keeton) (plaintiff "must have suffered substantial damage," not simply nominal damages, before "the cause of action can arise").

Given the common-law roots of the securities fraud action (and the common-law requirement that a plaintiff show actual damages), it is not surprising that other Courts of Appeals have rejected the Ninth Circuit's "inflated purchase price" approach to proving causation and loss. See, ****1633** *e.g.*, *Emergent Capital*, 343 F.3d, at 198 (inflation of purchase price alone cannot satisfy loss causation); *Semerenko*, 223 F.3d, at 185 (same); *Robbins*, 116 F.3d, at 1448 (same); cf. *Bastian*, 892 F.2d, at 685. Indeed, the Restatement of Torts, in setting forth the judicial consensus, says that a person who "misrepresents the financial condition of a corporation in order to sell its stock" becomes liable to a relying purchaser "for the loss" the purchaser sustains "when the facts ... become generally known" and "as a result" share value "depreciate[s]." § 548A, Comment *b*, at 107. Treatise writers, too, have emphasized the need to prove proximate causation. Prosser and Keeton § 110, at 767 (losses do "not ***345** afford any basis for recovery" if "brought about by business conditions or other factors").

We cannot reconcile the Ninth Circuit's "inflated purchase price" approach with these views of other courts. And the uniqueness of its perspective argues against the validity of its approach in a case like this one where we consider the contours of a judicially implied cause of action with roots in the common law.

Finally, the Ninth Circuit's approach overlooks an important securities law objective. The securities statutes seek to maintain public confidence in the marketplace. See *United States v. O'Hagan*, 521 U.S. 642, 658, 117 S.Ct. 2199, 138 L.Ed.2d 724 (1997). They do so by deterring fraud, in part, through the availability of private securities fraud actions. *Randall v. Loftsgaarden*, 478 U.S. 647, 664, 106 S.Ct. 3143, 92 L.Ed.2d 525 (1986). But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause. Cf. *Basic*, 485 U.S., at 252, 108 S.Ct. 978 (White, J., joined by O'CONNOR, J., concurring in part and dissenting in part) ("[A]llowing recovery in the face of affirmative evidence of nonreliance-would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result" (internal quotation marks and citations omitted)).

The statutory provision at issue here and the paragraphs that precede it emphasize this last mentioned objective. Private Securities Litigation Reform Act of 1995, 109 Stat. 737. The statute insists that securities fraud complaints "specify" each misleading statement; that they set forth the facts "on which [a] belief" that a statement is misleading was "formed"; and that they "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §§ 78u-4(b)(1), (2). And the statute expressly imposes on plaintiffs "the burden of proving" that the defendant's misrepresentations ***346** "caused the loss for which the plaintiff seeks to recover." § 78u-4(b)(4).

The statute thereby makes clear Congress' intent to permit private securities fraud actions for recovery where, but only where, plaintiffs adequately allege and prove the traditional elements of causa-

tion and loss. By way of contrast, the Ninth Circuit's approach would allow recovery where a misrepresentation leads to an inflated purchase price but nonetheless does not proximately cause any economic loss. That is to say, it would permit recovery where these two traditional elements in fact are missing.

In sum, we find the Ninth Circuit's approach inconsistent with the law's requirement that a plaintiff prove that the defendant's misrepresentation (or other fraudulent conduct) proximately caused the plaintiff's economic loss. We need ****1634** not, and do not, consider other proximate cause or loss-related questions.

B

[2] Our holding about plaintiffs' need to *prove* proximate causation and economic loss leads us also to conclude that the plaintiffs' complaint here failed adequately to *allege* these requirements. We concede that the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. Rule Civ. Proc. 8(a)(2). And we assume, at least for argument's sake, that neither the Rules nor the securities statutes impose any special further requirement in respect to the pleading of proximate causation or economic loss. But, even so, the "short and plain statement" must provide the defendant with "fair notice of what the plaintiff's claim is and the grounds upon which it rests." *Conley v. Gibson*, 355 U.S. 41, 47, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). The complaint before us fails this simple test.

As we have pointed out, the plaintiffs' lengthy complaint contains only one statement that we can fairly read as describing the loss caused by the defendants' "spray device" ***347** misrepresentations. That statement says that the plaintiffs "paid artificially inflated prices for Dura['s] securities" and suffered "damage[s]." App. 139a. The statement implies that the plaintiffs' loss consisted of the "artificially inflated" purchase "prices." The complaint's failure to claim that Dura's share price fell significantly after the truth became known suggests that the plaintiffs considered the allegation of purchase price inflation alone sufficient. The complaint contains nothing that suggests otherwise.

For reasons set forth in Part II-A, *supra*, however, the "artificially inflated purchase price" is not itself a relevant economic loss. And the complaint nowhere else provides the defendants with notice of what the relevant economic loss might be or of what the causal connection might be between that loss and the misrepresentation concerning Dura's "spray device."

We concede that ordinary pleading rules are not meant to impose a great burden upon a plaintiff. *Swierkiewicz v. Sorema N. A.*, 534 U.S. 506, 513-515, 122 S.Ct. 992, 152 L.Ed.2d 1 (2002). But it should not prove burdensome for a plaintiff who has suffered an economic loss to provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind. At the same time, allowing a plaintiff to forgo giving any indication of the economic loss and proximate cause that the plaintiff has in mind would bring about harm of the very sort the statutes seek to avoid. Cf. H.R. Conf. Rep. No. 104-369, p. 31 (1995), U.S.Code Cong. & Admin.News 1995, pp. 679, 730 (criticizing "abusive" practices including "the routine filing of lawsuits ... with only [a] faint hope that the discovery process might lead eventually to some plausible cause of action"). It would permit a plaintiff "with a largely groundless claim to simply take up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the [discovery] process will reveal relevant evidence." *Blue Chip Stamps*, 421 U.S., at 741, 95 S.Ct. 1917. Such a rule would tend to transform a private ***348** securities action into a partial downside insurance policy. See H.R. Conf. Rep. No. 104-369, at 31, U.S.Code Cong. & Admin.News 1995, pp. 679, 730; see also *Basic*, 485 U.S., at 252, 108 S.Ct. 978 (White, J., joined by O'CONNOR, J., concurring in part and dissenting in part).

For these reasons, we find the plaintiffs' complaint legally insufficient. We reverse the judgment of the Ninth Circuit, and we ****1635** remand the case for further proceedings consistent with this opinion.

It is so ordered.

U.S.,2005.
Dura Pharmaceuticals, Inc. v. Broudo
544 U.S. 336, 125 S.Ct. 1627, Blue Sky L. Rep. P 74,529, 161 L.Ed.2d 577, 73 USLW 4283, Fed. Sec. L. Rep. P 93,218, 05 Cal. Daily Op. Serv. 3273, 2005 Daily Journal D.A.R. 4419, 18 Fla. L. Weekly Fed. S 233

END OF DOCUMENT

Case Name:

Eidoo v. Infineon Technologies AG

PROCEEDINGS UNDER the Class Proceedings Act, 1992
Between
Khalid Eidoo and Cygnus Electronics Corporation,
Plaintiffs, and
Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc., Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc. Samsung Electronics Canada Inc., Micron Technology, Inc. Micron Semiconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc., Defendants
And between
Khalid Eidoo and Cygnus Electronics Corporation,
Plaintiffs, and
Hitachi Ltd., Hitachi America, Hitachi Electronic Devices (USA), Hitachi Canada Ltd., Mitsubishi Electronic Corporation, Mitsubishi Electric Sales Canada Inc., Mitsubishi Electric & Electronics USA, Inc., Nanya Technology Corporation, Nanya Technology Corporation USA, NEC Corporation, NEC Corporation of America, NEC Canada, Renesas Electronics Corporation fka NEC Electronics Corporation, Renesas Electronics America, Inc. fka NEC Electronics America, Inc., Renesas Electrionics Canada Ltd., Toshiba Corporation, Toshiba America Electronics Components Inc., Toshiba of Canada Limited, Winbond Electronics Corporation and Winbond Electronics Corporation America, Defendants

[2012] O.J. No. 6105

2012 ONSC 7299

Court File Nos. 05-CV-4340CP, 10-CV-15178CP

Ontario Superior Court of Justice

P.M. Perell J.

Heard: December 14, 2012.
Judgment: December 20, 2012.

(37 paras.)

Counsel:

Jonathan J. Foreman and *Rob Gain* for the Plaintiffs.

David Kent for Micron Technology, Inc. and Micron Semiconductor Products, Inc. o/a Crucial Technologies.

Eric Hoaken and *Emrys Davis* for NEC Corporation, NEC Corporation of America, NEC Canada, Renesas Electronics Corporation, and Renesas Electronics America, Inc.

Christine Kibly for Nanya Technology Corporation and Nanya Technology Corporation USA.

Eliot Kolers for Infineon Technologies AG, Infineon Technologies Corporation and Infineon Technologies North American Corporation.

Julie Parla for Hynix Semiconductor Inc., Hynix Semiconductor America Inc. and Hynix Semiconductor Manufacturing America, Inc.

Will Morrison for Samsung Electronics Co. Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., and Samsung Electronics Canada Inc.

Susan Friedman for Hitachi Ltd., Hitachi America, Ltd., Hitachi Canada, Ltd., Hitachi Electronic Devices (USA) and Renesas Electronics Canada, Ltd.

Zohaib Maladwals for Toshiba Corporation, Toshiba America Electronics Components Inc. and Toshiba of Canada Limited.

Dan Edmondstone for Winbond Electronics Corporation and Winbond Electronics Corporation America.

Christopher Naudie for Elpida Memory Inc.

REASONS FOR DECISION

1 **P.M. PERELL J.**:-- This is a motion for certification of two actions as class actions under the *Class Proceedings Act, 1992,* S.O. 1992 for settlement purposes and for related relief.

2 In light of a previous partial settlement of one of these actions, which settlement involved the Defendant Elpida Memory Inc., the ancillary relief includes an order that no further opt-out period is necessary and that the opt-out period has expired. The moving parties also seek an order that there be multi-jurisdictional hearings for the fairness hearing to approve the settlements.

3 For the reasons that follow, I grant this motion.

4 In the first of the proposed class actions under the *Class Proceedings Act, 1992*, Khalid Eidoo and Cygnus Electronics Corporation sue: Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc. Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., Micron Semidconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc. for: (a) breach of Part IV of the *Competition Act*, R.S.C. 1985, c. C-34; (b) civil conspiracy; and (c) tortious interference with economic interests.

5 In the second class action, Mr. Eidoo and Cygnus Electronics sue: Hitachi Ltd. Hitachi America, Hitachi Electronic Devices (USA), Hitachi Canada Ltd., Mitsubishi Electronics Corporation, Mitsubishi Electronic Sales Canada Inc., Mitsubishi Electric & Electronics USA, Inc., Nanya Technology Corporation, Nanya Technology Corporation USA, NEC Corporation, NEC Corporation of America, NEC Canada, Renesas Electronics Corporation fka NEC Electronics Corporation, Renesas Electronics America, Inc. fka NEC Electronics American Inc., Renesas Electronics Canada Ltd., Toshiba Corporation, Toshiba America Electronics Components Inc., Toshiba of Canada Limited, Winbond Electronics Corporation and Winbond Electronics Corporation America.

6 Both actions concern allegations that the Defendants conspired to fix prices in DRAM (dynamic random access memory) devices. The second action is, in effect, a device to add defendants as co-conspirators to the conspiracy alleged in the first class action.

7 Mr. Eidoo, is an individual who purchased DRAM and DRAM Products during the class period. Cygnus Electronics Corporation is an Ontario corporation carrying on business in the contract electronics manufacturing field. During the Class Period, it was a direct purchaser of DRAM and DRAM Product from several defendants.

8 There are parallel proceedings in British Columbia and Québec. Class Counsel in the various actions are cooperating in the various proceedings.

9 On April 4, 2006, at a case conference, the parties agreed to hold the Ontario proceeding in abeyance and to allow the B.C. Action to be advanced.

10 On November 12, 2009, [2009] B.C.J. No. 2239, the British Columbia Court of Appeal ruled in favour of the plaintiff and certified the B.C. Action as a class proceeding.

11 On June 3, 2010, the Defendants' application for leave to appeal the Decision of the British Columbia Court of Appeal to the Supreme Court of Canada was dismissed with costs. The subsequent application by certain non-settling defendants for reconsideration of the denial for leave was denied on May 17, 2012, [2010] S.C.C.A. No. 32.

12 On November 16, 2011, [2011] Q.J. No. 16771, the Quebec Action was authorized by the Quebec Court of Appeal. The defendants in the Quebec Action have appealed to the Supreme Court of Canada. That appeal was heard on October 17, 2012, [2012] S.C.C.A. No. 20, with the appeals of *Sun-Rype Products Ltd. v. Archer Daniels Midland Company*, 2011 BCCA 187 and *Pro-Sys Consultants Ltd. v. Microsoft Corporation*, 2011 BCCA 186. The Supreme Court has reserved judgment in all three appeals.

13 In 2011, the Plaintiffs entered into a settlement agreement with Elpida Memory, Inc. and Elpida Memory (USA), Inc. (the "Elpida Settlement"), and in March 2012, this Court certified this action as a class action for settlement purposes. See *Eidoo v. Infineon Technologies AG*, 2012 ONSC 1987.

14 It is important to note that in its certification order for the Elpida Settlement, the court provided the putative class members with a right to opt-out. The order in the Elpida Settlement provided that if the putative class member did opt out, then he or she could not participate in the Elpida settlement or future settlements. The order further provided that a person who did not opt-out could not opt out of the proceedings in the future. Thus, the Order stated:

> THIS COURT ORDERS that any Ontario Settlement Class Member who has validly opted out of the Ontario Proceeding is not bound by the Settlement Agreement and shall no longer participate or have the opportunity in the future to participate in the Ontario Proceeding.
>
> THIS COURT ORDERS that any Ontario Settlement Class Member who has not validly opted out of the Ontario Proceeding is bound by the Settlement Agreement and may not opt out of the Ontario Proceeding in the future.
>
> THIS COURT ORDERS AND DECLARES that, upon the Effective Date, each Ontario Settlement Class Member who has not validly opted out of the Ontario Proceeding shall consent and shall be deemed to have consented to the dismissal

as against the Releasees of any Other Actions he, she or it has commenced, without costs and with prejudice.

THIS COURT ORDERS AND DECLARES that, upon the Effective Date, each Other Action commenced in Ontario by any Ontario Settlement Class Member who has not validly opted out of the Ontario Proceeding shall be and is hereby dismissed against the Releasees, without costs and with prejudice.

THIS COURT ORDERS AND DECLARES that this Order, including the Settlement Agreement, is binding upon each Ontario Settlement Class Member who has not validly opted out of the Ontario Proceeding including those persons who are minors or mentally incapable and the requirements of Rules 7.04(1) and 7.08(4) of the Rules of Civil Procedure are dispensed with in respect of the Ontario Proceeding.

15 In the Elpida Settlement, this court and courts in British Columbia and Quebec jointly approved a single national notice program including a single opt-out period. The deadline for opting out was June 2, 2012. Class Counsel received two opt-out forms from class members at the conclusion of the opt-out period.

16 After further settlement negotiations, four more groups of Defendants have agreed to settle the claims being made against them; namely: (1) Micron Technology, Inc. and Micron Semiconductor Products, Inc. doing business as Crucial Technologies (collectively "Micron;" (2) NEC Corporation, NEC Corporation of America, NEC Canada, Renesas Electronic Corporation and Renesas Electronics America Inc. (collectively, "NEC"); (3) Nanya Technology Corporation and Nanya Technology Corporation USA (collectively, "Nanya"); and (4) Hitachi, Ltd., Hitachi America, Ltd., Hitachi Electronic Devices (USA), Inc., Hitachi Power Systems Canada Ltd. and Renesas Electronics Canada Ltd. (collectively "Hitachi/Renesas Canada").

17 More particularly, on July 24, 2012, the Plaintiffs entered into a formal settlement agreement with Nanya whereby Nanya agreed to pay $325,000 and to provide cooperation in the prosecution of the litigation against the remaining defendants.

18 On October 16, 2012, the Plaintiffs entered into a formal settlement agreement with Micron whereby Micron agreed to pay $17,500,000 and to provide cooperation in the prosecution of the litigation against the remaining Defendants.

19 On November 28, 2012, the Plaintiffs entered into a formal settlement agreement with NEC whereby NEC agreed to pay $2,750,000 and to provide cooperation in the prosecution of the litigation against the remaining defendants.

20 On December 18, 2012, the Plaintiffs entered into a formal settlement agreement with Hitachi/Renesas Canada whereby Hitachi/Renesas Canada agreed to pay $2,750,000 and to provide cooperation in the prosecution of the litigation against the remaining defendants.

21 The Settlement Agreements all provide that: (a) the Settlement Amounts will be held in an interest-bearing trust account for the benefit of Class Members; (b) the cost of disseminating the notice of certification and settlement approval are to be paid out of the Settlement Amounts; and, (c) that the Opt Out deadline expired on June 2, 2012.

22 The Settlement Agreements contemplate that no opt-out process will be required in respect of the First Ontario action and that no opt-out process will be required in the Second Ontario Action, unless required by the Ontario Court.

23 The Plaintiffs submit that no further opt-out process is necessary for the following reasons: (1) the Second Ontario Action is an extension of the first action and simply names a list of additional defendants not originally named; (2) the Notice in connection with the Elpida Settlement referenced the defendants in the Second Ontario Action and stated that the allegations in the two actions were the same and advised that a consolidation of the two Ontario actions was contemplated; (3) the settlement recoveries achieved in the First Ontario Action benefit the class in the Second Ontario Action and vice-a-versa; and (4) there is only a technical division as between the First and Second Ontario Action.

24 The Settling Defendants have consented to certification, solely for the purpose of giving effect to the Settlement Agreements. There was no opposition to the motion.

25 On December 3, 2012, the British Columbia Court made an order, amongst other things, certifying the action for settlement purposes as against Nanya, Micron, and NEC approving the notice of settlement approval hearing, and providing for multijurisdictional case management.

26 The proposed class definition for the Ontario Settlement Class is as follows:

> all Persons resident in Canada at the time of purchase and/or at the time of notice who purchased DRAM Products during the Settlement Class Period, except Excluded Persons and Persons who are included in the B.C. Settlement Class and the Quebec Settlement Class; and (ii) all Persons resident in the United States at the time of purchase and/or at the time of notice who purchased DRAM Products in Canada during the Settlement Class Period to the extent that such Persons have actual or potential claims as against the Defendants in respect of DRAM Products that have not been wholly or completely settled or extinguished in the U.S. Settlement or otherwise in respect of the U.S. Proceedings.

27 The plaintiffs proposes the class proceedings be certified on the following common issue to the Ontario Settlement:

Did the Settling Defendant(s), or any of them, conspire to harm the Settlement Class Members during the Settlement Class Period? If so, what damages, if any, are payable by the Settling Defendants, or any of them to the Settlement Class Members?

28 Having reviewed the motion record, pursuant to s. 5 (1) of the *Class Proceedings Act,* 1992, I am satisfied that all of the criteria for certification have been satisfied.

29 I am also satisfied that the class members have had their opportunity to opt-out of these proceedings, including both actions, and that no further opt out rights are necessary in the first or the second action.

30 The matter of whether more than one right to opt out should be provided when there are partial or progressive certifications of a class action has been addressed in several cases and has become a common practice. In *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065 (S.C.J.), Justice Leitch reviewed the practice and stated at paragraphs 17-21:

17. Plaintiff's counsel highlighted the fact that while certification is sought for settlement purposes as against the Lufthansa defendants, the proposal is for class members to be presented with an option to opt out from the proceeding as a whole.
18. Section 9 of the CPA allows class members to "opt out of the proceeding in the manner and within the time specified in the certification order". That provision does not provide for a right to opt out against a particular defendant or settlement. This issue was considered by Rady J. in *Guercio v. Stone Paradise Inc.*, (December 2006), London 46460CP/45604CP (Ont. S.C.J.). I agree with her reasoning in that case. Opting out affects a procedural right, not a substantive right - it requires class members to choose the venue in which to pursue their substantive claims.
19. In the context of a settlement approval, class members have more information than they would have following a contested certification motion. They have the prescribed information required under s. 17 of the CPA, but they also have information about the value of the settlement.
20. Allowing class members to pick and choose which defendants they will opt in or opt out against presents a number of difficulties, including the potential for delay, confusion and abuse. Opting out against some but not all defendants could result in class members benefiting from the cooperation that a settling defendant is required to provide to the class, while at the same time pursuing an individual action against that defendant.
21. In *Guercio v. Stone Paradise Inc*., *supra*, Rady J. agreed with following observations of the U.S. District Court:

> We believe that the balance struck by Rule 23 would be upset if individuals could choose to participate in a class for the purposes of settlement with some defendants, but to exclude themselves from the settlement with other defendants. Rule 23 requires potential class members to make a trade-off: an individual either decides to remain a class member, bound by any and all judgments rendered in the class action but spared the expense of litigating on her own behalf, or she elects exclusion. If she chooses exclusion, she is required to expend her own resources to bring her claims against the defendants, but she may potentially be rewarded by receiving a larger recovery. Permitting an individual eligible to be a class member to opt out as to some defendants but not as to others would allow her to have the best of both worlds. She could opt to remain in the class action as to defendants against whom her claims were relatively weak, hoping for some recovery at little or no expense to herself, while opting out as to other defendants to pursue relatively stronger claims in the hopes of securing a more lucrative recovery than she would receive as a class member (*Re Del-Val Financial Corp. Securities Litigation*, 162 F.R.D. 271 at 275-76 (S.D.N.Y. 1995)).

31 In *Guercio v. Stone Paradise Inc.*, *supra*, which is quoted in Justice Leitch's judgment, Justice Rady concluded that the right to opt out is not a substantive right but is a procedural right that is properly exercisable once. I would add that the practice of permitting only one opportunity to opt-out in a class proceeding is salutary because it solidifies class size and this facilitates further settlements (but would not establish class size for any defendants who did not participate in the settlement) and conversely permitting a renewed right to opt-out might compromise bar orders and thwart additional settlements.

32 In the case at bar, the certification notice of the Elpida Settlement was adequate to inform class members that they would not be able opt out of the class proceeding.

33 Accordingly, in the case at bar, the certification order should contain the following term:

> THIS COURT DECLARES that the opt-out period provided pursuant to the order of this Court made on March 27, 2012 in Court File No. CV-05-CV-4340 satisfies the requirement of section 9 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 for the purposes of this action, that no further opt-out period is necessary for the Ontario Actions and that the opt-out period expired on June 2, 2012.

34 For the motion at bar, the Notices and Plan of Dissemination are similar in form and structure as those that were approved by this Court in connection with the Elpida settlement but will not refer to an opt-out right.

35 The Plan of Dissemination provides that the Long-Form Notice would be posted online on Class Counsels' respective websites and the Short-Form Notice would be published in both English and French language newspapers and would be sent by direct mail to the following groups: (a) procurement officers of the federal, provincial and municipal governments; (b) computer dealers throughout Canada who handle commercial grade computer sales; and, (c) any Settlement Class Members who have contacted Class Counsel about the litigation.

36 I am satisfied that the notice and notice plan should be approved.

37 According, this motion should be granted. I have signed the Order.

P.M. PERELL J.

cp/e/qljel/qlrdp/qlpmg/qlcas

Case Name:

Eidoo v. Infineon Technologies AG

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Khalid Eidoo and Cygnus Electronics Corporation,
Plaintiffs, and
Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc., Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., Micron Semiconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc., Defendants

[2012] O.J. No. 2955

2012 ONSC 3801

Court File No. 05-CV-4340

Ontario Superior Court of Justice

P.M. Perell J.

Heard: June 20, 2012.
Judgment: June 27, 2012.

(17 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Motion by plaintiffs for approval of settlement of class proceeding allowed -- Action alleged price fixing and sought damages for breach of Competition Act, civil conspiracy and tortious interference with economic interests -- Settlement agreement provided for payment of $5.75 million to class members in three provinces, required cooperation in pursuing claims against non-settling defendants through provision of data, documents and oral evidentiary proffer and proposed bar against contribution and indemnity -- Settlement was fair reasonable and in best

interests of class as a whole.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. C.6, s. 29

Competition Act, R.S.C. 1985, c. C-34,

Counsel:

Jonathan Foreman and Robert Gain, for the Plaintiffs.

Alexandra Urbanski, for Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation.

Julie K. Parla, for Hynix Semiconductor Inc. Hynix Semiconductor America Inc. and Hynix Semiconductor Manufacturing America, Inc.

Cathy Beagan Flood, for Samsung Semiconductor, Inc. and Samsung Electronics America, Inc.

David W. Kent, for Micron Semiconductor Products, Inc. o/a Crucial Technologies.

Christopher P. Naudie, for Elpida Memory, Inc.

Susan E. Friedman, for Hitachi Ltd., Hitachi America Ltd., Hitachi Canada, Ltd. Hitachi Electronic Devices (USA) and Renesas Electronics Canada, Ltd.

Justin G. Necpal, for Mitsubishi Electronic Corporation, Mitsubishi Electric Sales Canada, Inc and Mitsubishi Electric & Electronics USA, Inc.

Zohaib Maladwala, for Toshiba Canada Limited.

REASONS FOR DECISION

1 P.M. PERELL J.:-- On March 28, 2012, I certified this proposed class action for the purposes of a settlement between the plaintiffs Khalid Eidoo and Cygnus Electronics Corporation and Elpida Memory, Inc. and Elpida Memory (USA) Inc., two of the many defendants to this action. I approved a notice plan to give the Class members notice that the plaintiffs seek to have the settlement approved pursuant to s. 29 of the *Class Proceedings Act, 1992,* S.O. 1992, c. C.6. See *Eidoo v. Infineon Technologies* AG 2012 ONSC 1987. The plaintiffs now seek approval of the settlement.

2 In this action, Khalid Eidoo and Cygnus Electronics Corporation sue Infineon Technologies AG, Infineon Technologies Corporation, Infineon Technologies North America Corporation, Hynix Semiconductor Inc., Hynix Semiconductor America Inc., Hynix Semiconductor Manufacturing America, Inc. Samsung Electronics Co., Ltd., Samsung Semiconductor, Inc., Samsung Electronics America, Inc., Micron Semiconductor Products, Inc. o/a Crucial Technologies, Mosel Vitelic Corp., Mosel Vitelic Inc. and Elpida Memory, Inc. for: (a) breach of Part IV of the *Competition Act*, R.S.C. 1985, c. C-34; (b) civil conspiracy; and (c) tortious interference with economic interests. The action concerns allegations that the Defendants conspired to fix prices in DRAM (dynamic random access memory) devices.

3 There are parallel proceedings in British Columbia and Québec. I am advised that the settlement has been approved in British Columbia and a settlement approval hearing is scheduled in Québec.

4 Mr. Eidoo purchased DRAM and DRAM products during the proposed class period. Cygnus Electronics is an Ontario corporation that was a direct purchaser of DRAM and DRAM products during the proposed class period.

5 Beginning in the fall of 2010, Mr. Eidoo and Cygnus Electronics began settlement negotiations with Elpida Memory, Inc. and Elpida Memory (USA) Inc. The negotiations were adversarial and at arms-length. The Elpida defendants never admitted liability and indicated that if there was no settlement, they would defend the action on its merits.

6 The parties reached an agreement in principle in November 2010, and they signed a settlement agreement dated November 15, 2011. Under the settlement agreement, Elpida agrees to pay $5.75 million plus interest for the benefit of the class members in Ontario, British Columbia, and Québec. The settlement funds are being held in an interest-bearing trust account for the benefit of Settlement Class Members.

7 Under the terms of the Settlement Agreement, the Elpida defendants are required to cooperate with the Plaintiffs in pursuing their claims against the Non-Settling Defendants. In a price fixing conspiracy action, a defendant's co-operation is obviously beneficial to the Plaintiffs. Under the Settlement Agreement, Elpida is required to:

* (a) provide an oral evidentiary proffer relating to the allegations in the Proceedings, including information with respect to dates, locations, subject matter, and participants in any meeting or discussions between competitors relating to the purchase, sale, pricing, discounting, marketing or distributing of DRAM Products in Canada;
* (b) provide electronic transactional data relating to sales of DRAM Products during the Settlement Class Period by Elpida to direct purchasers in Canada and respond to questions from Class Counsel regarding this data;

* (c) produce documents provided by Elpida to the Department of Justice, the Canadian Competition Bureau and to Class Counsel for the U.S. plaintiffs as part of the settlement of the US Direct Action;
* (d) to the extent permissible under the protective order issued in the U.S. Proceedings and subject to privilege and confidentiality, Elpida will provide access to all discovery evidence produced in the U.S. Actions, including transcripts or video depositions of Elpida employees; and,
* (e) make reasonable efforts to make available for testimony at trial, employees of Elpida who would be reasonably necessary to support the submission into evidence of any documents or information produced by Elpida pursuant to the Settlement Agreement.

8 As part of the Settlement Agreement, the Parties are seeking an order barring any claim for contribution or indemnity against Elpida. The terms of the bar order are set out in paragraphs 14 to 19 of the draft judgment, which state:

> 14. THIS COURT ORDERS that all claims for contribution, 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, which were or could have been brought in the Proceedings, the Ontario Additional Proceeding or otherwise, by any Non-Settling Defendant, any named or unnamed co-conspirators who are not Releasees, or any other Person or party, against a Releasee, or by a Releasee against a Non-Settling Defendant, are barred, prohibited and enjoined in accordance with the terms of this Order (unless such claim is made in respect of a claim by a Person who has validly opted-out of the Ontario Proceeding).
> 15. THIS COURT ORDERS that if, in the absence of paragraph 14 above, the Court determines that there is a right of contribution and indemnity or other claim over, whether in equity or in law, by statute or otherwise:
>
> (a) the Ontario Plaintiffs and the Ontario Settlement Class Members shall not be entitled to claim or recover from the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees that portion of any damages (including punitive damages, if any) restitutionary award, disgorgement of profits, interest and costs (including investigative costs claimed pursuant to s. 36 of the *Competition Act*) that corresponds to the Proportionate Liability of the Releasees proven at trial or otherwise;
> (b) the Ontario Plaintiffs and the Ontario Settlement Class Members shall limit their claims against the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees to, and shall be entitled to recover from the Non-Settling Defendants and/or named or unnamed

co-conspirators that are not Releasees, only those claims for damages, costs and interest attributable to the aggregate of the several liability of the Non-Settling Defendants and/or named or unnamed co-conspirators that are not Releasees to the Ontario Plaintiffs and the Ontario Settlement Class Members, if any, and, for greater certainty, the Ontario Settlement Class Members shall be entitled to claim and recover on a joint and several basis as between the Non-Settling Defendants and/or named or unnamed co-conspirators who are not Releasees, to the extent provided by law; and

(c) this Court shall have full authority to determine the Proportionate Liability of the Releasees at the trial or other disposition of the Ontario Proceeding or the Ontario Additional Proceeding, whether or not the Releasees remain in the Ontario Proceeding or appear at the trial or other disposition, and the Proportionate Liability of the Releasees shall be determined as if the Releasees are parties to the Ontario Proceeding and/or Ontario Additional Proceeding and any determination by this Court in respect of the Proportionate Liability of the Releasees shall only apply in the Ontario Proceeding and/or the Ontario Additional Proceeding and shall not be binding on the Releasees in any other proceedings.

16. THIS COURT ORDERS that if, in the absence of paragraph 14 hereof, the Non-Settling Defendants would not have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Releasees, then nothing in this Order is intended to or shall limit, restrict or affect any arguments which the Non-Settling Defendants may make regarding the reduction of any assessment of damages, restitutionary award, disgorgement of profits or judgment against them in the Ontario Proceeding or the Ontario Additional Proceeding.

17. THIS COURT ORDERS that a Non-Settling Defendant may, on motion to this Court determined as if the Settling Defendant remained a party to the Ontario Proceeding, and on at least ten (10) days notice to counsel for the Settling Defendant, and not to be brought unless and until the action against the Non-Settling Defendants has been certified and all appeals or times to appeal have been exhausted, seek orders for the following:

(a) documentary discovery and an affidavit of documents in accordance with the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 from the Settling Defendant;

(b) oral discovery of a representative of the Settling Defendant, the transcript of which may be read in at trial;

(c) leave to serve a request to admit on the Settling Defendant in respect of

factual matters; and/or

(d) the production of a representative of the Settling Defendant to testify at trial, with such witness to be subject to cross-examination by counsel for the Non-Settling Defendants.

18. THIS COURT ORDERS that the Settling Defendant retains all rights to oppose such motion(s) brought under paragraph 17. Notwithstanding any provision in this Order, on any motion brought pursuant to paragraph 17, the Court may make such orders as to costs and other terms as it considers appropriate.
19. THIS COURT ORDERS that a Non-Settling Defendant may effect service of the motion(s) referred to in paragraph 17 above on the Settling Defendant by service on counsel of record for the Settling Defendant in the Ontario Proceeding.

9 Under the proposed bar order, the non-settling defendants are barred from claiming contribution and indemnity with respect to the claims released against Elpida Memory, Inc. and Elpida Memory (USA). However, if the Court determines that the non-settling defendants have a right to contribution and indemnity: (a) the Class members may not recover from the Non-Settling Defendants any damages that correspond to the proportionate liability of Elpida Memory, Inc. and Elpida Memory (USA); (b) the Class members may only recover damages from the Non-Settling Defendants attributable to the aggregate of the several liability of the Non-Settling Defendants; (c) the Ontario Court shall have full authority to determine the Proportionate Liability of Elpida Memory, Inc. and Elpida Memory (USA) at the trial or other disposition of the Ontario Proceeding; and (d) the Non-Settling Defendants are at liberty to arguments that any assessment of damages, restitutionary award, or disgorgement of profits should be reduced. Under the proposed bar order, the non-settling defendants may move for orders for discovery from Elpida Memory, Inc. and Elpida Memory (USA), who are entitled to resist the discovery motions.

10 Notice of this approval hearing was published. No objections to settlement approval were received by Class Counsel in response to the notice. Many of the Non-Settling Defendants attended the hearing, but none made submissions.

11 Class Counsel from across the country, who are very experienced with class action litigation, recommend the settlement. The representative plaintiffs recommend the settlement and consent to the Court approving the settlement. Elpida Memory, Inc. and Elpida Memory (USA) Inc. consent to the approval of the settlement.

12 On February 27, 2012, Elpida Memory, Inc. commenced restructuring proceedings in Japan. Elpida Memory, Inc. is restrained from making certain payments and taking certain actions by Order of the Tokyo District Court. A recognition order has not been sought in Canada. Class Counsel submits that it is in the interest of all Class members that the settlement be approved without delay.

13 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 those affected by it: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.) at para. 9; *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 68-73.

14 In determining whether to approve a settlement, the court, without making findings of facts on the merits of the litigation, examines the fairness and reasonableness of the proposed settlement and whether it is in the best interests of the Class as a whole, having regard to the claims and defenses in the litigation and any objections raised to the settlement: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 10.

15 When considering the approval of negotiated settlements, the court may consider, among other things: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) settlement terms and conditions; (d) recommendation and experience of counsel; (e) future expenses and likely duration of litigation and risk; (f) recommendation of neutral parties; (g) if any, the number of objectors and nature of objections; (h) the presence of good faith, arms-length bargaining and the absence of collusion; (i) the degree and nature of communications by counsel and the representative parties with Class Members during the litigation; and (i) information conveying to the court the dynamics of and the positions taken by the parties during the negotiation: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 2811, (Gen. Div.), aff'd (1998), 41 O.R. (3d) 97 (C.A.), leave to appeal to S.C.C. refused October 22, 1998, [1998] S.C.C.A. No. 372; *Parsons v. The Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 71-72; *Frohlinger v. Nortel Networks Corp.*, [2007] O.J. No. 148 (S.C.J.) at para. 8; *Kelman v. Goodyear Tire and Rubber Co.*, [2005] O.J. No. 175 (S.C.J.) at paras. 12-13; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 117; *Sutherland v. Boots Pharmaceutical PLC*, [2002] O.J. No. 1361 (S.C.J.) at para. 10.

16 In my opinion, the settlement is fair, reasonable, and in the best interests of the class as a whole. It provides tangible benefits to class members and a settlement is preferable when compared against the prospect of litigation with an uncertain outcome and duration.

17 At the settlement approval hearing, I approved the settlement and signed the settlement approval order.

P.M. PERELL J.

cp/e/qlmdl/qlpmg

Case Name:

Fraser Papers Inc. (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 Proposed Plan of Compromise or Arrangement With Respect to Fraser Papers Inc./Papiers Fraser Inc. and FPS Canada Inc., Applicants

[2012] O.J. No. 4378

2012 ONSC 4882

100 C.C.P.B. 79

2012 CarswellOnt 11519

Court File No. CV-09-8241-00CL

Ontario Superior Court of Justice

G.B. Morawetz J.

Heard: June 29, 2012.
Judgment: September 18, 2012.

(69 paras.)

Civil litigation -- Civil procedure -- Settlements -- Releases -- Motion by the former directors of Fraser Papers for certain declarations, including a declaration that the claims against them in a Quebec class action had been released allowed -- Class member sued for deficit in a Quebec Pension plan sponsored by Fraser Papers -- Fraser Papers involved in CCAA proceedings -- In CCAA proceedings, Union executed a Global Agreement containing a release in favour of Fraser Papers' directors and officers -- Releases covered claims asserted against directors in class action.

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromise and arrangements -- Claims -- Claims against directors -- Motion by the former directors of Fraser Papers for certain declarations, including a declaration that the claims against them in a Quebec class action had been released allowed -- Class member sued for deficit in a

Quebec Pension plan sponsored by Fraser Papers -- Fraser Papers involved in CCAA proceedings -- In CCAA proceedings, Union executed a Global Agreement containing a release in favour of Fraser Papers' directors and officers -- Releases covered claims asserted against directors in class action.

Motion by the former directors of Fraser Papers for certain declarations, including a declaration that the claims against them in a Quebec class action had been released. Fraser Papers filed for protection under the Companies' Creditors Arrangement Act in 2009. Fraser Papers was the plan sponsor for four defined benefit pension plans registered in Canada. A class action was commenced as a result of a deficit in the Quebec Plan. The court issued an order confirming the Union's representation of all Current and Former Union Members and expressly authorized the Union to compromise any and all claims that existed or might arise in connection with any issue or matter relating to any recovery, compromise of rights or entitlements of the Current and Former Union Members. Pursuant to the order, the Union executed the Global Agreement containing a release in favour of Fraser Papers' directors and officers. A claim was filed against Fraser Papers and accepted in the CCAA Proceeding for the entire amount of the deficit under the Quebec Plan, and distributions had been made to the Quebec Plan based on the claim for the entire deficit. The Union chose not to file a proof of claim against the directors at any time during the CCAA Proceeding on behalf of the Current and Former Union Members.

HELD: Motion allowed. The Court had jurisdiction to determine the motion. The amended CCAA plan, which had been sanctioned by this court, stipulated that any issue relating to the effect of the amended CCAA plan was subject to the exclusive jurisdiction of this court. This motion directly involved issues relating to the effect of the amended CCAA plan. The Contractual Release extended to all claims relating to all facts and circumstances in respect of Fraser Papers existing at the date of the release, whether known or unknown, which included the claims under the Quebec Plan. A contractual settlement and a release that was binding on the signatories to the contract could be negotiated at any time in a CCAA proceeding. The CCAA court had the jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA proceeding and prior to any plan of arrangement being presented. A plain reading of the Contractual Release led to the inescapable conclusion that the Contractual Release covered all activities for which the Class Action Plaintiffs had asserted that the defendant directors were liable.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1, s. 11, s. 17

Counsel:

D.J. Miller and J.T. Porter, for the Applicants in the CCAA Proceedings and for the Former Directors in the Quebec Class Action.

D. Wray, J. Kugler and K. Duranleau, for the Quebec Class Action Plaintiffs.

A. Merskey and V. Sinha, for AON Conseil Inc. c.o.b. as AON Hewitt.

ENDORSEMENT

G.B. MORAWETZ J.:--

INTRODUCTION

1 This motion was brought by Mr. Paul E. Gagné and Mr. Samuel J. B. Pollock (the "Defendant Directors"), former directors of Fraser Papers Inc. ("Fraser Papers"), for certain relief relating to a class action commenced in the Superior Court of Quebec - Class Action Division, Court File No. 500-06-000598274 (the "Class Action Claim") by Rene Emond, Jean-Guy Provost and Geinette Bonneau-Parent (collectively, the "Class Action Plaintiffs") against, *inter alia*, the Defendant Directors.

2 The Defendant Directors seek declarations that:

(i) the Class Action Plaintiffs in the Class Action Claim constitute Current and Former CEP Members as such term is defined in the order issued in these proceedings dated September 17, 2009 (the "CEP Representation Order") and, as such, and in that capacity, are subject to the jurisdiction of this court;

(ii) the Class Action Plaintiffs and all other Current and Former CEP Members who are or were at any time beneficiaries, participants, surviving spouses or dependants under the Quebec Hourly Plan (defined below) were represented by the Communications, Energy and Paperworkers Union of Canada ("CEP") with respect to any claims in any way related to Fraser Papers, including but not limited to, in connection with the Quebec Hourly Plan;

(iii) pursuant to the CEP Representation Order and the order in these proceedings dated April 6, 2010 (the "April Sale Order"), CEP was authorized to and did:

(a) negotiate and compromise any claims that existed or that arose at law or equity in connection with any issue or matter relating to any recovery, compromise of rights or entitlements of the Current and

Former CEP Members, including but not limited to any claims in connection with the Quebec Hourly Plan;

(b) execute an agreement dated February 24, 2010 (the "Global Agreement") releasing the Defendant Directors from all claims relating to all facts and circumstances existing as at that date, whether known or unknown; and

(c) execute a further release in favour of the Defendant Directors dated April 7, 2010 (the "Contractual Release") releasing them from all claims relating to all facts and circumstances existing as at February 24, 2010, whether known or unknown;

(iv) section 5.1(2) of the *Companies' Creditors Arrangement Act* ("CCAA") does not affect the contractual releases of the Defendant Directors contained in the Global Agreement or the Contractual Release executed by the CEP on behalf of the Current and Former CEP Members;

(v) any claims that could have been asserted by the Current and Former CEP Members, whether in respect of the Quebec Hourly Plan or otherwise, have been fully and irrevocably released pursuant to the Global Agreement and the Contractual Release;

(vi) the contractual releases of the Defendant Directors contained in the Global Agreement and the Contractual Releases are unlimited, and do not exclude claims of any type, whether based on contract, allegations of misrepresentation, wrongful or oppressive conduct, or otherwise.

FACTS AND ISSUES

3 Fraser Papers and certain of its Canadian and U.S. affiliates filed for protection pursuant to the CCAA (the "CCAA Proceeding") on June 18, 2009.

4 Fraser Papers was the plan sponsor for four defined benefit pension plans registered in Canada; two of which were registered in Quebec and two of which were registered in New Brunswick.

5 One of the Quebec plans provides benefits to hourly (unionized) employees and former employees at the company's mill in Thurso, Quebec (the "Quebec Hourly Plan"), while the other Quebec plan was for salaried (non-unionized) employees and retirees.

6 On September 17, 2009, CEP brought a motion seeking to represent its current members and to represent former members of bargaining units represented by CEP including pensioners, retirees, deferred vested participants and surviving spouses and dependants employed or formerly employed by Fraser Papers (the "Current and Former CEP Members").

7 On September 17, 2009, the court issued an order confirming CEP's representation of all

Current and Former CEP Members (the "CEP Representation Order"). CEP was expressly authorized under the CEP Representation Order to compromise any and all claims that existed or might arise at law or equity in connection with any issue or matter relating to any recovery, compromise of rights or entitlements of the Current and Former CEP Members.

8 With the exception of 24 retirees of the International Brotherhood of Electrical Workers' Union, who were represented by Davies Ward Phillips & Vineberg pursuant to a separate representation order also dated September 17, 2009, all beneficiaries of the Quebec Hourly Plan were Current and Former CEP Members represented by CEP pursuant to the CEP Representation Order.

9 No party made an election to opt out of representation by CEP under the CEP Representation Order.

10 The three representative plaintiffs in the Quebec Class Action were Current and Former CEP Members as defined by the CEP Representation Order and were represented by CEP in that capacity.

11 Pursuant to the CEP Representation Order, CEP:

(i) executed the Global Agreement containing a release in favour of Fraser Papers' directors and officers;
(ii) consented to court orders approving the Global Agreement and the releases contained therein by orders dated February 24, 2010 and March 22, 2010;
(iii) executed a further contractual release in favour of Fraser Papers' directors and officers dated April 7, 2010 (the "Contractual Release"); and
(iv) consented to other releases in favour of Fraser Papers' directors and officers contained in the April Sale Order. Such releases are referred to collectively as the "CEP Releases".

12 The release contained in the Global Agreement, which was annexed to the court orders of Pepall J. (as she then was) dated February 24, 2010 and March 22, 2010, provides as follows:

> [20] Each of: (i) the applicant's directors and officers; and (ii) Brookfield Asset Management and its directors and officers shall be released from all claims relating to all facts and circumstances in respect of the applicant's existing as at this time (whether known or unknown) and the completion of the APA.

13 The language of the Contractual Release reads:

> 5. The union hereby irrevocably, fully and finally releases each of FP's directors and officers from all claims relating to all facts and circumstances in respect of FP existing as at February 24, 2010 (whether known or unknown) and the completion of the APA.

14 Mr. Glen McMillan, former Chief Financial Officer of Fraser Papers, deposed that, in reliance upon the releases granted by CEP, transactions were undertaken by the Applicants and other parties which provided significant value to all unsecured creditors, including all beneficiaries under the Quebec Hourly Plan, that would not have otherwise been possible. Further, Mr. McMillan states that the unqualified release in favour of Fraser Papers' directors was a fundamental term of an agreement that permitted the Applicants' largest business operations to be sold and value to be available for distribution to unsecured creditors including the Quebec Hourly Plan.

15 The Applicants take the position that the cause of action asserted in the Class Action Claim flows from the deficit under the Quebec Hourly Plan and the corresponding reduction of benefits to beneficiaries under the Quebec Hourly Plan.

16 The Applicants also take the position that the CCAA Proceeding included a claims process, pursuant to which all claims against the Applicants and their directors and officers were to be filed and that the process provided for the exclusive forum in which any and all claims that could be asserted by any person (defined in the Claims Order to include legal representatives) against the Applicants and their directors or officers must be filed. The Applicants further contend that this claims process allowed the Applicants, their directors and officers, the Monitor, the court and all other stakeholders to identify the universe of potential claims.

17 A claim was filed against Fraser Papers and accepted in the CCAA Proceeding for the entire amount of the deficit under the Quebec Hourly Plan, and distributions have been made to the Quebec Hourly Plan based on the claim for the entire deficit.

18 CEP did not file a proof of claim against the Defendant Directors at any time during the CCAA Proceeding.

19 The issue in the Class Action Claim with respect to the Defendant Directors is described as: Did the persons who are directly responsible for establishing, applying and monitoring the investment policy of the pension plan of the unionized workers of Fraser Papers Inc., Thurso Pulp Mill, commit an offence making them liable for the losses of benefits and reductions in the rights of the participants and beneficiaries.

20 From the standpoint of the Class Action Plaintiffs, this motion raises the following issues:

(i) whether this court has the jurisdiction to deal with an determine the present motion; and
(ii) if so, whether the claims pleaded in the Class Action have been released.

21 For the following reasons, I am of the opinion that this court has the jurisdiction to deal with and determine this motion. I am also of the opinion that the claims pleaded in the Class Action Claim have been released.

JURISDICTION

22 The Class Action Plaintiffs take the position that the Class Action Claim has been properly filed with the court in Quebec and that the position advanced by the Applicants on this motion ought to have been brought before the court in Quebec.

23 Counsel submits that, while the amended CCAA plan was sanctioned by this court, this does not grant "exclusive jurisdiction" upon this court to issue orders relating to litigation commenced in another jurisdiction. Further, even if the amended CCAA plan does grant "exclusive jurisdiction" to this court, the exclusivity of that jurisdiction is limited to the amended CCAA plan itself and does not extend to all of the issues raised by the Defendant Directors on this motion.

24 In my view, a complete answer to this argument is provided by the Applicants at paragraphs 24-26 of their factum.

25 Simply put, the amended CCAA plan, which has been sanctioned by this court, stipulates that any issue relating to the effect of the amended CCAA plan is subject to the exclusive jurisdiction of this court.

26 Further, sections 11 and 17 of the CCAA provide this court with the authorization to grant the relief requested by the Defendant Directors and to make any order that it considers appropriate in the circumstances.

27 Each of the orders made by this court, including the CEP Representation Order, the Claims Order, the orders approving the Global Agreement, the April Sales Order and the Sanction Order have legal force and effect in Quebec, by operation of law. It is the scope of these orders which has been called into question in the Class Action Claim. In my view, it is beyond question, that this motion directly involves issues relating to the effect of the amended CCAA plan.

28 The CCAA provides for and these orders requested the aid and assistance of the courts of other jurisdictions in recognizing and enforcing the terms of such orders. (See CCAA section 16.) I am satisfied that this court has the jurisdiction to deal with this motion.

RELEASES

29 With respect to the second issue, namely, whether the claims pleaded in the Class Action Claim have been released, the Class Action Plaintiffs take the position that section 2(f)(iii) of the Claims Procedure Orders called for claims to be filed against the Applicants and/or directors and, as such, the Claims Procedure did not call for creditors to file claims against directors acting in a capacity other than that of director or officer of the Applicants. Further, the Claims Procedure Order, they submit, cannot bar claims that cannot be compromised pursuant section 5.1(2) of the CCAA or claims that were unknown at the claims bar date.

30 The Class Action Plaintiffs point out that the Defendant Directors are former directors of the Applicants. They are, however, named as defendants in the Quebec Class Action both in their capacity as directors of the Applicants and in their capacity as members of the Applicants' management pension committee with delegated authority to oversee the funding, investment management and administration of the Quebec Hourly Plan pursuant to section 152 of the *Quebec Supplemental Pension Plan's Act* (the "SPPA") and the applicable instrument of delegation.

31 The Class Action Plaintiffs allege that, pursuant to their delegated authority, the Defendant Directors, as administrators of the Quebec Hourly Plan, were required to exercise the prudence, diligence and skill that a reasonable person would exercise in similar circumstances and, pursuant to their delegated authority, the Defendant Directors were required to report to the Quebec Hourly Plan Pension Committee in writing any situation in the normal course that might adversely affect the financial interests of the pension fund and that requires correction.

32 It is also contended that the claims in the Class Action Claim were not known or discovered until in or around the termination of the CCAA Proceeding.

33 The Class Action Claim seeks damages against the Defendant Directors personally in the amount of $11.7 million.

34 Counsel to the Class Action Plaintiffs submits that the Contractual Release contains a number of limitations. First, they contend that the Contractual Release does not extend to extinguish claims against the Defendant Directors acting in the capacity of delegates of the Quebec Hourly Plan Pension Committee. Counsel submits that directors may wear "two hats" - one in the role of employer and the other as administrator of a pension plan and there is a clear legal distinction between the conduct of the Defendant Directors' qua corporation, where they have an obligation to act in the best interests of the Applicants, and the Defendant Directors qua delegate of the Quebec Hourly Pension Plan Committee, where they have an obligation to act with prudence, care and in the best interests of the Quebec Hourly Plan.

35 Counsel submits that the releases, both contractual and statutory, should be interpreted in light of the dual roles carried out by the Defendant Directors and that releases in favour of directors qua corporation will not release the conduct of directors qua delegates of the Quebec Hourly Plan Pension Committee. The Class Action Claim consists of, *inter alia*, claims against the Defendant Directors qua delegates of the pension committee - claims, counsel submits, are not released pursuant to the Contractual Release. Counsel references *Morneau Sobecco Limited v. AON Consulting Inc.*, 2008 ONSC 196, paras. 31-37 and *Indalex Limited (Re)*, 2011 ONCA 265 at para. 129.

36 Counsel also submits that, with the exception of fraud or gross negligence, the Contractual Release expressly releases the releasees, which include, the Defendant Directors, from claims arising out of any decrease in the New Brunswick Hourly Plan ("NB Hourly Plan") but no similar release exists with respect to any decrease in the value of the Quebec Hourly Plan. Counsel submits

that the absence of a release in respect of any decrease in the value of the Quebec Hourly Plan reflects the parties' intention not to release such conduct.

37 Counsel to the Class Action Plaintiffs also submits that the context in which the Contractual Release was negotiated confirms the limitations to the release described above. The Contractual Release was negotiated in the context of satisfying the conditions precedent to the specialty papers transaction and was not negotiated in the context of the sale of the Thurso facility. As such, the releases granted should therefore be considered and interpreted in this context.

38 Counsel to the Class Action Plaintiffs also submits that the CCAA court orders do not release the claims against the Defendant Directors in the Class Action Claim.

39 Counsel submits that the release contained in the April Sale Order has a number of limitations and that claims against the Applicants' directors and officers for fraud and gross negligence are expressly carved out of the release. The claims against the Defendant Directors set out in the Quebec Class Action include claims of a fraudulent misrepresentation and gross negligence and, thus, counsel contends these claims are not extinguished by the release contained in the April Sale Order.

40 Further, counsel submits that the release in respect of claims against the Defendant Directors relating to their actions as or on behalf of the administrator or sponsors of the pension plans does not include a release of claims in respect of the Quebec Hourly Plan. Counsel submits that the definition of "pension plans" contained in the April Sale Order is limited to the Applicants' pension plans registered in New Brunswick and therefore does not include a release in respect of conduct as or on behalf of the administrator or sponsors of the Quebec Hourly Plan.

41 Counsel also raises the issue of the sanction order granted on February 11, 2011 which approves and sanctions the amended CCAA plan dated January 27, 2011. The sanction order includes a broad release in favour of the Defendant Directors which release was opposed by the CEP during the sanction hearing.

42 Counsel to the Class Action Plaintiffs contends that the broad release in favour of the Defendant Directors was expressly limited by application of s. 5.1 (2) of the CCAA.

43 Section 5.1 of the CCAA provides as follows:

> 5.1 (1) Claims against directors - compromise - a compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.

(2) Exception - a provision for the compromise of claims against directors may not include claims that

(a) relate to contractual rights of one or more creditors; or
(b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.

44 Counsel submits that the Class Action Claim includes claims that relate to contractual rights of creditors, including claims related to the Defendant Directors' breach of the delegation instrument that delegated to them authority and responsibility to administer and manage the Quebec Hourly Plan. The Class Action Claim also includes claims of misrepresentation and claims of wrongful conduct against the Defendant Directors in respect of their administration and management of the pension fund. It also alleges that the Defendant Directors acted with gross negligence, as well as made fraudulent and negligent misrepresentations to the pension committee. Oppressive conduct is also alleged and counsel submits that the claims fall within the statutory carve out in section 5.1(2) of the CCAA and therefore are not released by the sanction order.

45 In my view, the position put forth by the Class Action Plaintiffs has no merit.

46 The CCAA Proceeding included a comprehensive claims process, pursuant to which all claims against the Applicants and their directors and officers were to be filed.

47 The definition of "claim" is set out at paragraph 2(f)(iii) of the Claims Procedure Order. It reads as follows:

"Claim" means:

(i) a restructuring claim;
(ii) a secured claim; and/or
(iii) the rights of any person whatsoever, including any secured creditor, against one or more the applicants and/or directors, whether or not asserted and however acquired, in connection with any indebtedness, liability or obligation of any kind of one or more of the applicants and/or directors in existence on the claim date, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown, direct or indirect, by guarantee, surety, insurance deductible or otherwise, and whether or not such claim or right arises out of a contract that is executor or anticipatory in nature or any other claims that would have the claims provable in bankruptcy had the applicable applicant become bankrupt on a claim date; provided however, that in all cases "claim" shall not include an excluded claim.

48 It seems to me that the definition of claim was drafted in very broad terms. The claims process in place in this proceeding was such that it would allow the Applicants, their directors and officers, the Monitor, the court and all other stakeholders to identify the universe of potential claims.

49 As pointed out by Mr. McMillan in his affidavit at paragraphs 33, 52 and 58, a claim was filed against Fraser Papers and accepted in the CCAA Proceeding for the entire amount of the deficit under the Quebec Hourly Plan, and distributions have been made to the Quebec Hourly Plan based on the claim for the entire deficit.

50 Further, as noted by Mr. McMillan, CEP chose not to file a proof of claim against the Defendant Directors at any time during the CCAA Proceeding on behalf of the Current and Former CEP Members.

51 I am in agreement with the submission put forth by counsel to the Applicants to the effect that nothing in the CCAA:

(i) limits the ability of the party to grant contractual releases to another party;
(ii) limits the ability of the court to authorize the execution of releases by a representative party on behalf of others;
(iii) limits the ability of the court to grant releases to any party on a motion brought within the CCAA proceedings (other than an order sanctioning a plan in the case of directors), particularly where such order is made on consent of the releasors; or
(iv) limits the ability of the court to approve releases granted by one party to another.

52 Simply put, a contractual settlement and a release that is binding on the signatories to the contract can be negotiated at any time in a CCAA proceeding.

53 Further, I accept the submission of counsel to the Applicants that unlike releases in favour of directors contained in a plan of arrangement that are subject to section 5.1 of the CCAA, no such restrictions exist with respect to contractual releases granted by a party at any stage of the proceeding.

54 The CCAA court has the jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA proceeding and prior to any plan of arrangement being presented. See *Nortel Networks Corporation (Re)*, 2010 63 C.B.R. (5th) 44, *Nortel Networks Corporation (Re)*, 2010 66 C.B.R. (5th) 77 (leave to appeal denied at 2010 CarswellOnt 3752, leave to appeal to the Supreme Court of Canada dismissed (33491) and Grace Canada Inc. (Re) (2008), 50 C.B.R. (5th) 25.

55 I accept the submission of counsel to the Applicants that the Contractual Release extends to all claims relating to all facts and circumstances in respect of Fraser Papers existing at the date of the

release, whether known or unknown. The deficit under the Quebec Hourly Plan existed at the time the CCAA Proceeding was commenced which was clearly prior to the execution of the Contractual Release. Further, it was the subject of a proof of claim that had been filed against Fraser Paper. Even if all of the facts giving rise to the deficit under the Quebec Hourly Plan were not known at the time the Contractual Release was executed, it seems to me that the terms of the Release specifically and clearly provide it would be effective to release such claims.

56 In my view, a plain reading of the Contractual Release leads to the inescapable conclusion that the Contractual Release covers all activities for which the Class Action Plaintiffs have asserted that the Defendant Directors are liable. Even assuming that the allegations in the Class Action Claim amount to claims for gross negligence or breach of fiduciary duty, it seems to me that the language of the Contractual Release is sufficiently broad to include such claims. The Contractual Release is in favour of Fraser Papers' directors and officers. It is not restricted in the manner suggested by the Class Action Plaintiffs.

57 The purpose of a full and final release is to provide finality to a party, once and for all, from any liability or obligation to another party arising out of particular circumstances.

58 In my view, it is clear that the Defendant Directors have been fully and irrevocably released in respect of the claims asserted in the Class Action Claim pursuant to the Contractual Release.

59 Furthermore, I am also of the view that the Class Action Claim is barred on the grounds that the subject matter of the Class Action Claim has been released and extinguished in the Applicants' CCAA Proceeding.

60 As counsel to the Applicants points out, since claims in respect of pension, termination, severance, retirement payments and other benefit claims can be central issues in a CCAA Proceeding, where the interests of former employees are at stake, the court may make an order appointing representative counsel that is empowered to negotiate on behalf of its constituents. See *Nortel Networks Corporation (Re)*, 2009 CarswellOnt 3028 (S.C.J.). As noted in *Nortel, supra*, representation orders provide a social benefit by assisting former employees and providing them with a reliable resource for information about the process. The appointment of representative counsel also benefits the streamlining and introducing efficiency to the process for all parties involved in a CCAA proceeding.

61 The CEP Representation Order made in these proceedings is binding on the Class Action Plaintiffs. CEP was clearly authorized to negotiate a compromise of beneficiaries claims or rights on behalf of the Current and Former CEP members. At no time did any individual opt out of the CEP Representation Order.

62 The time to assert any claim against the Defendant Directors was during the Claims Process established by court order. As noted above, no claims were filed against the Defendant Directors at any time during the CCAA proceedings in respect of the Quebec Hourly Plan.

63 The amended CCAA Plan that received creditor approval was sanctioned by the court. The Class Action Plaintiffs are bound by the terms of the amended CCAA Plan in the sanction order, in addition to the CEP releases.

64 As noted by counsel to the Applicants, in the reasons supporting the granting of the sanction order over CEP's objections, Pepall J. (as she then was) referred to the prior releases that had been granted by or consented to by CEP, which were broader than the releases under the amended CCAA Plan. It seems to me, that the issues giving rise to the Class Action Claim were identified early in the proceedings and were the subject of considerable negotiation. These negotiations led to agreements pursuant to which consideration was paid to certain creditor groups. In exchange, comprehensive releases were executed. It culminated in a court-sanctioned plan, which again, contains release language which, in my view, was clearly intended to finalize the matters at issue on this motion.

65 The Quebec Hourly Plan and, therefore, its beneficiaries including all Current and Former CEP members, have received their *pro rata* share of the distributions under the amended CCAA Plan. In my view, any and all claims of any nature and kind that could be asserted against the Defendant Directors have been released pursuant to the CEP releases.

66 Clearly in the negotiation process that culminated in the execution of the Global Agreement and the Contractual Release, it was open to CEP to limit or restrict the scope of the release provisions, so as to preserve the claim that they now wish to prosecute. CEP did not do so. In fact, language that would limit or restrict the release in the manner suggested by the Class Action Plaintiffs at [35] above is conspicuously absent. Likewise, there is no court order that would lead to a conclusion that the court-approved releases were limited in the manner suggested by the Class Action Plaintiffs.

67 I am of the view that any claim that could be asserted be asserted by the Current and Former CEP Members, whether in respect of the Quebec Hourly Plan or otherwise, has been released.

DISPOSITION

68 The motion of the Defendant Directors is granted and an order shall issue to this effect. In addition, costs are awarded in favour of the Defendant Directors. If the parties are unable to agree on quantum, written submissions, to a maximum of four pages, may be submitted within 21 days.

69 It is noted that AON Conseil Inc. c.o.b. as AON Hewitt ("AON") filed a factum and was present at the hearing. Issues relating to AON have not been determined on this motion and the parties have reserved their rights as to whether AON is entitled to similar relief.

G.B. MORAWETZ J.

cp/e/qljel/qlpmg/qlcas

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.

Cases Cited

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

2 Misc.3d 1007(A), 784 N.Y.S.2d 919, 2004 WL 690380 (N.Y.Sup.), 2004 N.Y. Slip Op. 50171(U)
(Table, Text in WESTLAW), Unreported Disposition
(Cite as: 2 Misc.3d 1007(A), 2004 WL 690380 (N.Y.Sup.))

(The decision of the Court is referenced in a table in the New York Supplement.)

Supreme Court, Nassau County, New York.
In the Matter of COORDINATED TITLE INSURANCE CASES.
Joseph Piscioneri and Christina Piscioneri, on behalf of themselves and all others similarly situated, Plaintiffs,
v.
Commonwealth Land Title Insurance Co., Defendant.
Michael J. Scuorzo and Donna J. Scuorzo, on behalf of themselves and all others similarly situated, Plaintiffs,
v.
Lawyers Title Insurance Corporation, Defendant.
Rosa Smajlaj and Lazder Smajlaj, on behalf of themselves and all others similarly situated, Plaintiffs,
v.
First American Title Insurance Company of New York, Defendant.
Adam Good, on behalf of himself and all others similarly situated, Plaintiffs,
v.
American Pioneer Title Insurance Company, Defendant.
Scott Williams, Susan Williams, f/k/a Susan Dipaola, James Smith and Susan Smith, on behalf of themselves and all others similarly situated,
v.
Fidelity National Title Insurance Company of New York, Defendant.
John E. Lawlor, on behalf of himself and all others similarly situated, Plaintiffs,
v.
National Title Insurance Company of New York, Inc., Defendant.
Elizabeth Werter, on behalf of herself and all others similarly situated, Plaintiffs,
v.
Chicago Title Insurance Company, Defendant.
Jeffrey Schwartz and Leslie Schwartz, on behalf of themselves and all others similarly situated, Plaintiffs,
v.
Stewart Title Insurance Company, Defendant.

Index No. 010764/2002.
Jan. 8, 2004.

IRA B. WARSHAWSKY, J.

***1** Plaintiffs Rosa and Lazder Smajlaj, James and Susan Smith, Adam Good, John Lawlor, Joseph and Christina Piscioneri, Jeffrey and Leslie Schwartz, Michael and Donna Scuorzo, Elizabeth Werter, and Susan and Scott Williams (the "Proposed Class Representatives"), have brought independent actions against the defendant title insurance companies. Plaintiffs argue that defendants routinely collected premiums in excess of that to which they were legally entitled in connection with refinance transactions. Plaintiffs allege violations of the deceptive business conduct statute (General Business Law § 349), common law fraud, and unjust enrichment. Each plaintiff individually moved for class certification pursuant to CPLR article 9. Plaintiffs' motions for class certification are granted.

The initial eight independent actions were brought in various counties in and around the city of New York including Nassau and Westchester. Pursuant to the defendants' motion to consolidate the actions, on November 26, 2002, the State of New York Litigation Coordinating Panel issued an order consolidating and coordinating all of the above-mentioned cases for decision before the undersigned to determine if these matters should be certified as a class action.

Panel Case Number 0003/2002.

In the spring of last year this court rendered a decision in the case of *Good v. American Pioneer*

Title Insurance Company, (Sup Ct, Nassau County, April 25, 2003, Warshawsky, J., Index # 02–010335), directing that the matters proceed rather than being stayed and referred to the New York State Insurance Department ("NYSID"). That decision is currently pending a decision of the Appellate Division, but the parties have requested that said appeal be stayed pending a decision by this court on the issue of class certification.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Title insurance is sold in connection with mortgage loan and refinancing transactions. Typically, the homeowner or party refinancing will pay the cost of the premium. The beneficiary of the policy is the lender, who's collateral for the loan is thus insured in instances where a title challenge arise. Borrowers may purchase their own policy, a "fee" or "owner's" policy. However, these proposed class actions are related to the sale of so called "loan" policies.

News reports indicate that title insurers pay out 47 cents for every $10 collected. (Simon, *Refinancing Boom Put New Pressure on Title Industry*, Wall Street Journal [Dec. 18, 2002, Section A, at 9]. This compares with a payout rate of $8.70 for every $10 collected in the casualty insurance industry. (*Id.*) Americans paid approximately $11 billion for title insurance and related services in 2002. (*See id.*)

New York's legislature has enacted legislation to ensure that insurance rates are regulated to "promote the public welfare." (Insurance Law, art 23, § 1). The insurance laws are not simply a consumer protection statute, but are also meant to ensure the health and vitality of the insurance industry. (*See*, Insurance Law art 23, § 1; § 3). Each licensed insurer must file its schedule of rates with the state's insurance superintendent. (Insurance Law, art 23, § 5). Insurers may delegate their Insurance Law, article 23, § 5 obligations to a "designated rate service organization." (Insurance Law, art 23, § 6). Pertinent to the matter before us, all of the defendant title insurance underwriters have delegated their obligation to file their rate schedules with the superintendent to the Title Insurance Rate Service Association ("TIRSA"). TIRSA was licensed by the New York State Insurance Department on November 19, 1991. All eight of the defendants in these coordinated actions are members of TIRSA as of February 11, 2002.

***2** Individuals refinancing their home mortgages are to pay a reduced premium according to TIRSA's self-written regulations when four criteria are met. The discounted premium applies when (1) an application is made for a loan policy of title insurance; (2) within ten years from the date of closing of (a) a previously insured mortgage or (b) fee interest; (3) the premises to be insured are identical to the premises previously covered by eligible insurance, and (4) there has been no change in the fee ownership. The TIRSA regulations state that if the criteria are met, "the charge for insurance shall be" 50% or 70% of the of the "applicable loan rate." TIRSA Insurance Rate Manual § 14. A brief survey of the record indicates that overpayments generally amount to several hundred dollars.

Plaintiffs' counsel contends that each of these title insurance cases is a prototypical class action and each exemplifies the purpose of a class action, eloquently stated by Judge Lazer in the landmark case, *Friar v. Vanguard Holding*,

> The class action is seen as a means of inducing socially and ethically responsible behavior on the part of large and wealthy institutions which will be deterred from carrying out policies or engaging in activities harmful to large numbers of individuals. Absent the class action lawsuit these institutions will be permitted to operate virtually unchecked because the injured potential plaintiffs frequently are damaged in a small sum [and] our legal system inhibits the bringing of suits based upon small claims.

(78 A.D.2d 83, 94, 434 N.Y.S.2d 698 [2d Dep't 1980]).

Here, every plaintiff and Class member has allegedly been damaged by a few hundred dollars, while each title insurance defendant has allegedly collected millions of dollars from their failure to comply with their own filed and state-approved title insurance premium rates.

Defendants argue that class certification is inappropriate on the grounds that in each transaction where the full rate was charged, specific ingredients could mitigate if not eradicate any liability on the part of the defendants. Mortgage transactions often require the presence of numerous people, some representing the borrower, who, defendants argue, might have the duty to secure the reduced premium. More specifically they point out that in order to establish any underwriter's liability to any putative class member, the facts unique to the refinancing transaction of that individual will have to be examined at trial, thus destroying the economy of time that is a key benefit of the class action. (*See*, *Froehlich v.. Toia*, 71 A.D.2d 824, 419 N.Y.S.2d 386 [4th Dep't 1979]).

As is apparent, plaintiffs and defendants ask the court to analyze the motion for certification from vastly different perspectives. Plaintiffs see a routine on the part of the defendants of charging more than the legally mandated allowable rates. Plaintiffs would like to begin the inquiry by asking what happened at the top of the title insurance pyramid. Defendants see the occurrence of overcharging as an isolated event occurring for any of a variety of reasons but certainly not because of recklessness or nefarious intent on their part.

***3** These are essentially the positions of the parties. They are argued, answered and replied to by highly competent counsel in both broad strokes and in detail. The Court will address each of the arguments presented, along with the qualifications of each proposed class representative.

CPLR 901(a) provides: One or more members of a class may sue or be sued as representative parties on behalf of all if:

(1) the class is so numerous that joinder of all members, whether otherwise required or permitted, is impracticable;

(2) there are questions of law or fact common to the class which predominate over any questions affecting only individual members;

(3) the claims or defenses of the representative parties are typical of the claims or defenses of the class;

(4) the representative parties will fairly and adequately protect the interests of the class; and

(5) a class action is superior to other available methods for the fair and efficient adjudication of the controversy.

The consolidation panel's coordinating order caused the parties to submit joint memoranda of law arguing for and against certification of the eight separate classes. Both sides also submitted supplemental memoranda of law for and against each of the named plaintiffs. Each side's joint memorandum contains the bulk of the arguments related to CPLR 901(a)(2) and (5). The supplemental memoranda opposing or supporting certification relate to each individual prospective class representative and focus largely on those individuals' suitability to represent the proposed class vis a vis CPLR 901(a)(3) and (4).

General Background of the Law.

At the class certification stage, inquiry into the merits is limited "to whether on the surface there appears to be a cause of action which is not a sham." (*Brandon v. Chefetz*, 106 A.D.2d 162, 168, 485 N.Y.S.2d 55 [1st Dept 1985]). The complaint alleges common law fraud, violations of General Business Law § 349, and unjust enrichment. Plaintiffs allege that the failure of the defendants to charge the mandated, discounted premium for a refinance was the result of routine, material omissions. The allegations are supported by deposition testimony of, *inter alia*, representatives of the de-

fendant title insurance companies suggesting that they did not have a general practice, policy or procedure to send, nor required their title agents to send, the TIRSA mandated disclosure notice of the potential availability of the mandated discount to qualified re-financiers. (*Plaintiffs' Joint Memorandum of Law in Support of Class Certification* at 18 [“*Plaintiffs' Jt. Mem”*]). News reports discuss the apparent problem and contain a direct quote from a title insurance industry association executive suggesting the industry is aware of a “problem.” (*See* Harney, *Discounts on Title Coverage Hidden*, Newsday, April 11, 2003, Section C at 11). Defendant Fidelity National Title (“Fidelity National”) conducted an audit of twenty files from policies sold by its agent, Superior Abstract Corporation (“Superior”). Fidelity National was able to determine that Superior had “charged the full rate instead of the discounted rate” for seven of the twenty reviewed transactions” *Affidavit of Michele Fried Raphael in support of Plaintiffs' Motions for Class Certification* at Exhibit 2 (“Raphael Aff.”). Based on this preliminary evidence, plaintiffs meet the threshold inquiry of *Brandon v. Chefetz*, *supra.*

***4** New York's class action statute is to be “liberally construed” and read to “favor the maintenance of class actions.” (*Englade v. Harper Collins Publishers, Inc.*, 289 A.D.2d 159, 734 N.Y.S.2d 176 [1st Dep't 2001]). It is also clear that “[d]espite” the “recognition that CPLR article 9 should be broadly and liberally construed, we cannot grant class action certification where it is unwarranted on the law and facts of a case.” (*Evans v. City of Johnstown*, 97 A.D.2d 1, 2, 470 N.Y.S.2d 451 [3d Dept 1983]). This court is quite cognizant of the reality that class certification may place “hydraulic” pressure on defendants to settle, “even when the probability of an adverse judgment is low.” (*Newton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 259 F.3d 154, 168 [3d Cir2001]). Plaintiffs bear the burden of proof on these motions. It is against this backdrop that we proceed.

CPLR 901[a][1].

Numerosity.

Defendants collectively wrote over one million policies during the period for which class certification is sought. *Defendants' Jt. Mem.* at 13. Defendants stipulated to the numerosity prerequisite for class certification. *Minutes of Proceedings before Warshawsky, J.*, Jan. 29, 2003, at 14–16, Raphael Aff. Ex. F. Numerosity is thus not at issue and the requirement is met.

CPLR 901[a][2].

The predominance of common issues of law or fact.

This sub-section directs the court to determine whether common issues of fact or law predominate over any individual claims that may also affect possible class-action litigation. In *Friar v. Vanguard Holding Corp.*, *supra*, the court established a flexible test to determine commonality and effectuate the broad goals of CPLR article 9:

> [T]he decision as to whether there are common predominating questions of fact or law so as to support a class action should not be determined by any mechanical test but rather, whether the use of a class action would ‘achieve economies of time, effort and expense, and promote uniformity of decision as to persons similarly situated. 78 A.D.2d at 97, 434 N.Y.S.2d 698.

However, it has also been noted that the predominance requirement is the “most troublesome.” (*Ackerman v. Price Waterhouse*, 252 A.D.2d 179, 191, 683 N.Y.S.2d 179 [1st Dep't 1998]).

The Appellate Division has vacated class certifications previously where “the record was insufficient to make an informed determination as to all of the pre-requisites to certification of a class action.” (*Negrin v. Norwest Mortgage, Inc.*, 293 A.D.2d 726, 727, 741 N.Y.S.2d 287 [2d Dep't 2002]). However, the pleadings, affidavits, and affirmances provided by the parties in the case at bar contain more than sufficient information to rule competently on plaintiffs' motion for class certification.

Plaintiffs' brief in support of class certification lists fourteen common issues of fact or law that are likely to predominate in the disposition of their claims. They are:

> 1) whether the defendant title insurer routinely fails to provide the reissue rate in accordance with Section 14 of the TIRSA Rate Manual; 2) whether the defendant title insurer engages in deceptive and misleading conduct in violation of General Business Law § 349 by collecting premiums in excess of those permitted by the TIRSA Rate Manual; 3) whether the defendant title insurer engages in deceptive and misleading conduct in violation of General Business Law § 349 by routinely failing to notify the person who gets the loan and pays the premium that they may be entitled to a reduced premium rate, as required by Section 14(c) of the TIRSA Rate Manual; 4) whether the defendant title insurer commits common law fraud by routinely not informing homeowners of the availability of the discounted premiums and then charging and collecting premiums in excess of those permitted by Section 14 of TIRSA's Rate Manual; 5) whether title agents are agents of the defendant title insurer as a matter of law; 6) whether the defendant title insurer is liable for the actions of its agents who facilitate the aforesaid nondisclosures and overcharges and then split the premiums with the defendant; 7) whether each defendant title insurer adequately trains its agents with respect to disclosing and/or charging the reissue rate; 8) whether each defendant title insurer adequately monitors its agents with respect to disclosing and/or charging the reissue rate; 9) whether defendant title insurer's improper deceptive acts and practices should be enjoined; 10) whether each defendant title insurer was unjustly enriched by collecting premiums in excess of the rates permitted by the TIRSA Rate Manual; 11) whether the members of the Class have sustained damages and, if so, what is the proper measure of such damages; 12) what is meant by "a previously insured mortgage or fee interest" as set forth in Section 14 of the TIRSA Rate Manual for entitlement to the reduced premium rate; 13) what is meant by the "premises to be insured are identical" as set forth in Section 14 of the TIRSA Rate Manual for entitlement to the reduced premium rate; and 14) what is meant by "no change in fee ownership" as set forth in Section 14 of the TIRSA Rate Manual for entitlement to the reduced premium rate on a refinance? (*Plaintiffs' Jt. Br.* at 13–15). Defendants contend that there are individual questions of law or fact that predominate to defeat the economies that are the benefit of the class action format of litigation. "Class actions are not appropriate where questions involving individual members of the putative class predominate as a matter of law and fact." (*Jones v.. Christian,* 120 A.D.2d 367, 369, 501 N.Y.S.2d 854, [1st Dep't 1985]). "It is only where this predominance exists that economies can be achieved by means of the class action device." 39 F.R.D. 69, 103 (Advisory Comm. Notes, 1966 Amendments to Fed.R.Civ.P. 23).

***5** The initial contention by the defense is that merely labeling the alleged conduct of the defendants "routine" does not mean that the case is suitable for adjudication as a class action. "In deciding whether this [commonality and predominance] prerequisite is satisfied, the Court considers 'whether the proposed class members are more bound together by a mutual interest in the adjudication of common questions than they are divided by the individual members' interest in matters peculiar to them.' " (*Michels v. Phoenix Home Life Mutual Insurance Comp.*, 1997 N.Y. Misc. LEXIS 171, *28 [Sup Ct, Albany County, January 5, 1997, Teresi, J., Index No. 5318–95], *quoting* 2 J.B. Weinstein, et al., *New York Civil Practice* P 901.11). Defendants urge, as discussed elsewhere in this opinion, that the presence of intermediaries such as mortgage brokers, the possibility that consumers had knowledge or should have had knowledge of the discount rates, and the possibility that the TIRSA notice was sent to consumers, a change in the premises, or any combination of these or other factors need to be ex-

amined for every transaction because they might lead to a reasonable explanation as to why the full premium rate was charged.

It bears mention that defendants, in their own memorandum of law in support of their joint motion for coordination of these actions, argued that "each of the class actions presents the same basic factual allegations" involving the same legal theories. The "common issues presented in the class actions will, to a large extent, be determinative of the plaintiffs' claims." *Defendants' Mem. In Support of the Jt. Motion for an Order of Coordination*, 5–6.

The likelihood of whether the individual issues of fact and law set forth by the defense will predominate requires close examination of said issues against the plaintiffs' theories of liability.

A. Plaintiffs' Fraud Claim.

The plaintiffs' fraud claim is the only claim that is capable of sustaining punitive damages. In common law fraud claims, proof of plaintiff's reliance is crucial. Defendants central argument is that individual issues of reliance will necessarily predominate over any common issues at trial. However, while reliance is a key element of common law fraud, reliance has been presumed in certain cases involving material omissions. The Appellate Division has recognized the application of a presumption of reliance. (*See, Ackerman v. Price Waterhouse*, 252 A.D.2d 179, 197–98, 683 N.Y.S.2d 179 [1st Dept 1998]).

New York precedent is persuasive that issues of reliance are not an impediment to class action certification. While no case states a bright line rule that reliance is presumed in fraud cases involving omissions of material fact, the Appellate Division said that, "once it has been determined that the representations alleged are material and actionable, thus warranting certification, the issue of reliance may be presumed, subject to such proof as is required on the trial." (*Weinberg v. Hertz Corp.*, 116 A.D.2d 1, 7, 499 N.Y.S.2d 693 [1st Dep't 1986], *aff'd*, 69 N.Y.2d 979, 516 N.Y.S.2d 652, 509 N.E.2d 347). Other jurisdictions concur. (*See, Cope v. Metropolitan Life Ins. Co.*, 82 Ohio St.3d 426, 696 N.E.2d 1001, 1004–05 (Ohio 1998)(noting "Courts generally find that the existence of common misrepresentations obviates the need to elicit individual testimony as to each element of a fraud or misrepresentation claim, especially where written misrepresentations or omissions are involved.").

***6** Certainly failure to notify consumers of the availability of the reduced premium can be viewed as a material omission. If, in the review of files, defendants are able to show that actual notice was sent to a particular consumer, this evidence may be interposed at a later stage. (*Super Glue Corp. v. Avis Rent A Car System, Inc.*, 132 A.D.2d 604, 607, 517 N.Y.S.2d 764 [2d Dep't 1987])("there is no per se rule that actions sounding in fraud are unsuited for class certification under CPLR article 9, and the mere presence of a question of individual reliance does not preclude class action certification."); (*Weinberg v. Hertz Corp., supra*)("Whether reliance is to be presumed is a matter for trial and will not be disposed of in conjunction with this motion for class certification."); *Brandon v. Chefetz, supra*, at 168, 485 N.Y.S.2d 55)("The question of reliance is at best a matter of defense to be interposed with respect to individual claims after there has been a determination of liability.").

Further weighing against the defendants' argument that individual issues of reliance predominate is the difficulty of imagining a scenario where a consumer would agree to pay more for a product than the law allows. The basic notion that people generally don't agree to overpay was key to the court's reasoning in the *Friar* decision: "It is almost impossible to envisage circumstances in which a seller would willingly confer a financial gratuity upon the buyer's lender." 78 A.D.2d at 98, 434 N.Y.S.2d 698.

In conjunction with the common law fraud claim, the defendants argue that an attempt to prove punitive damages will involve scrutiny of each individual Agency Sellers' behavior because it is they

who were responsible for the vast majority of the title insurance policies sold. Imputing punitive damages for the acts of the Agency Sellers is legally unsupportable absent a showing of direct participation by defendants in the alleged conduct. (*See, Camillo v. Geer,* 185 A.D.2d 192, 587 N.Y.S.2d 306 [1st Dep't 1992]). However, the allegations in the complaint concern the defendants' duty and conduct, not that of the agents. Thus the plaintiffs will be seeking to prove that the defendants' actions caused the behavior of the agency sellers, not to prove that the agency sellers themselves were acting with the malicious, wanton, or recklessness that must be shown to recover punitive damages.

This court thus finds that individual issues of reliance do not preclude certification for the plaintiffs' fraud claim.

B. Plaintiffs' GBL § 349 Claim.

The liability inquiry under General Business Law § 349 is whether defendant "is engaging in an act or practice that is deceptive or misleading in a material way and [ ] plaintiff has been injured by reason thereof." (*Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, N.A.,* 85 N.Y.2d 20, 25, [1995]). A deceptive act or practice is objectively defined as a representation or omission "likely to mislead a reasonable consumer acting reasonably under the circumstances." (*Id.* at 26, 623 N.Y.S.2d 529, 647 N.E.2d 741). The Court of Appeals has held that reliance and scienter are not elements of a General Business Law § 349 claim. (*See, Id*). Thus, individual issues as to the putative-class members' reliance and the scienter of defendants do not preclude certification of the General Business Law § 349 claim.

***7** Common issues of fact and law predominate over any individual questions that may arise in the adjudication of the plaintiffs' General Business Law § 349 claim. Defendants' correctly note that "[w]hile justifiable reliance is not, *per se,* an element of a § 349 claims, courts have repeatedly held that the conduct of the defendant must be shown to have been the cause in fact of the injury to the plaintiff in any § 349 claim." *Defendants' Jt. Br.* at 31, *quoting Small v. Lorillard Tobacco Co.,* 94 N.Y.2d 43, 55 [1999]). The question raised in the complaint involves the conduct of the defendants in allegedly overcharging or failing to notify the members of the putative class of the availability of the mandated discounts. Because the allegations, as framed in the complaint, involve largely *omissions and not affirmative representations,* no individual issues of what the defendants' said will predominate. *Emphasis supplied.* In the cases cited by the defendants involving § 349 claims, class certification was denied in instances of affirmative misrepresentations. (*Goshen v. Mutual Life Ins. Co. of N. Y.,* 1997 WL 710669 [Sup Ct N.Y. County 1997]); (*Karlin v. IVF America, Inc.,* 239 A.D.2d 562, 657 N.Y.S.2d 460 [2d Dep't 1997])(denying class certification of General Business Law § 349 claim against a fertility clinic where issues existed as to what clinic personnel told each client about success rates at the clinic); (*Morgan v. A.O. Smith Corp.,* 233 A.D.2d 375, 650 N.Y.S.2d 748 [2d Dep't 1996]); (*Vermeer Owners, Inc. v. Guterman,* 169 A.D.2d 442, 564 N.Y.S.2d 335 (1st Dep't 1991), *aff'd,* 78 N.Y.2d 1114 [1991])(denying class certification in fraud case involving misrepresentations to co-op investors); *Russo v. Massachusetts Mut. Life Ins. Co.,* 192 Misc.2d 349, 746 N.Y.S.2d 380 [Sup Ct Tomkins County 2002])(involving "vanishing premiums" claims which turn largely on what insurance agents told consumers while selling certain life insurance policies). There is no question that the cases cited by defendants turned on actual representations. In the instant case, plaintiffs allege in large part that defendants *simply failed to represent the discounted premiums to their clients. Emphasis supplied.*

Small v. Lorillard Tobacco Co., 94 N.Y.2d 43 [1999] is also cited by the defendants. The class in *Small* was ultimately denied certification for claims against the manufacturers of various cigarette brands. The claims, including a General Business Law § 349 claim, were based on advertising by tobacco companies and their withholding of relevant

health information. The Appellate Division ruled that "individual proof of addiction" was vital to prove the claim, and proof of addiction was too subjective to be done on a class-wide basis. (*Id.* at 56, 698 N.Y.S.2d 615, 720 N.E.2d 892). The individual proofs of injury, therefore, *would* have been fatal to the plaintiffs' claims. (*Emphasis supplied*). The plaintiffs allowed addiction to be removed from the alleged harms suffered. In doing so, the plaintiffs' claims ceased to contain the actual harm required for a prima facie case under a General Business Law § 349 claim. (*Id.*). Nonetheless, the trial court in *Small* did note that a "claim which turns on proof of actual addiction would involve far too many subjective factors." *Id.* at 51–2, 698 N.Y.S.2d 615, 720 N.E.2d 892.

***8** The proof of the actual harm of addiction that was so nettlesome to the GBL claim in *Small* is no problem here because the harm asserted by the plaintiffs is measurable in dollars and cents. It is important not to confuse the issues of proving actual harm with issues of proving reliance and scienter, the latter specifically not being elements of the GBL claim. (*Stutman v. Chemical Bank* 95 N.Y.2d 24, 29 [2000]).

C. The unjust enrichment claim.

Claims for unjust enrichment must show that the defendant (1) was enriched; (2) at plaintiff's expense; and (3) that "it is against equity and good conscience to permit defendant to retain what is sought to be recovered." (*Albrechta v. Broome County Indus. Dev. Agency,* 274 A.D.2d 651, 652, 710 N.Y.S.2d 709 [3d Dep't 2003]). Defendants cite to *McGrath v. Hilding,* 41 N.Y.2d 625 [1977] in support of their argument that the parties to the transaction, and the circumstances of the transaction, be examined to determine whether any enrichment was unjust. Defendants also urge that perhaps putative class members acted inequitably and knew of the discounted rate, yet, for "whatever reasons," did not request the discounted rate. The court finds that this line of reasoning too speculative to bar class certification at this stage and, in fact, borders on the humorous. No evidence is in the record to indicate a situation where a consumer actually knew that they were entitled to the discount and knowingly waived the discount in favor of paying a higher premium.

The defendants raise an interesting point as to what portion of funds would be subject to disgorgement in light of the fact that they receive 15% of the premium cost versus the agencies which retain approximately 85%. The question of overpayment is common to the entire proposed class. Should liability be determined, disgorgement may be contemplated and percentages allocated at the appropriate time.

D. Additional contentions/issues of fact or law

The defense asserts that individual questions of law exist as to whether putative class-members had reason to know about the reduced rate, because knowledge is to be imputed either via their attorneys or mortgage brokers. Defendants frame a related question by asking whether notice to a fiduciary of the borrower constitutes notice to the borrower. Whether the TIRSA guidelines envisioned imputed knowledge or any other theory of knowledge on the behalf of a putative class-member is an issue for trial, and not to be decided at this point. Indeed, this seems to be a key point for trial. The TIRSA regulations state simply that, if the conditions are met, "the charge for insurance shall be" 50% or 70% of the of the "applicable loan rate." TIRSA Insurance Rate Manual § 14. In matters of statutory construction, the word shall is quite assertive. It appears that there is not much room to argue that the TIRSA guidelines and New York insurance law are not broken when rates that *shall* be charged are not. *Emphasis supplied.*

***9** The TIRSA manual also says its "provisions are binding upon all members and subscribers of TIRSA and their agents and must be used on and after the effective date hereof unless a specific deviation from this manual has been filed by an individual member company with and approved by the Superintendent of Insurance." *Id.* at inside cover.

All eight of the named defendants in these coordinated actions are members of TIRSA and therefore bound by the manual.

The defendants also assert that they have individual affirmative defenses to the claims of putative class members. These affirmative defenses include estoppel and waiver, which they claim hinge on the individual plaintiffs' states of mind. The defendants have also raised the specter of statute of limitations, accord and satisfaction, and ratification. "For these defenses," it is put forth, "defendants will need to know whether the title agency reached any subsequent agreement with individual borrowers." *Defendants' Jt. Br.* at 40. The affirmative defenses claimed do not prevent class certification. At issue, again, is whether the putative class was harmed by the actions of the defendants. "The statute clearly envisions authorization of class actions even where there are subsidiary questions of law or fact not common to the class. *Friar v Vanguard Holding Corp., supra.* If the defense does have legitimate affirmative defenses to the claims of various members, those defenses may be interposed subsequent to class certification. A noted authority on class action litigation, in discussing the federal class action commonality requirement, wrote:

> The rule 23(a)(2) prerequisite requires only a single issue common to the class. *Individual issues will often be present in a class action, especially in connection with individual defenses against class plaintiffs,* rights of individual class members to recover in the event a violation is established, and the type or amount of relief individual class members may be entitled to receive. Nevertheless, it is settled that the common issues need not be dispositive of the litigation. The fact that class members must individually demonstrate their right to recover will not bar a class action; *nor is a class action precluded by the presence of individual defenses against class plaintiffs.*

(Conte and Newberg, *1 Newberg on Class Actions, 4th Ed.*, § 3:12 [2002], *emphasis added.*)

Not only does the existence of pled affirmative defenses not bar class certification, but several of the proposed defenses fail a critical logic test and do not go to the heart of the allegations. In logical terms, it is not plausible to think that a consumer, made aware of the opportunity to save hundreds of dollars, would choose to pay the higher rate and forego a savings mandated by law. (*See, e.g., Friar v. Vanguard Holding Corp., supra*)("it is almost impossible to envisage circumstances in which a seller would willingly confer a financial gratuity upon the buyer's lender."). Plaintiffs allege that defendants' failure to provide the reduced premium rate at the closing and their failure to notify homeowners of the availability of the discounted rates misled them, and other reasonable homeowners acting reasonably under the circumstances, into paying the full rate. Whether defendants' failure to ensure they charged the correct rate or their simple acceptance of the full premium rate constituted any of the three alleged violations is the predominating question of law and fact.

***10** Defendants plead statute of limitations as an affirmative defense. The class is to include individuals who have refinanced in the six years prior to the commencement of this action. The statute of limitations for claims created by statute is three years. (CPLR 214[2]). But, "CPLR 214(2) does not automatically apply to all causes of action in which a statutory remedy is sought, but only where liability 'would not exist but for the statute." ' (*Gaidon v. Guardian Life Insurance Co. of America,* 96 N.Y.2d 201, 208 [2001]). "Thus, CPLR 214(2) 'does not apply to liabilities existing at common law which have been recognized or implemented by statute.' When this is the case," the statute of limitations for the common-law claim applies. (*Id., internal citations omitted*). The Court of Appeals in *Gaidon* reasoned that although General Business Law § 349 claims are quite similar to common law fraud causes, they are dissimilar enough that certain of them will be subjected to the three-year limitation of time from CPLR 214(2). "It is not merely the absence of scienter that distinguishes a violation

of section 349 from common-law fraud; section 349 encompasses a significantly wider range of deceptive business practices that were never previously condemned by decisional law." (*Id.* at 209–10, 727 N.Y.S.2d 30, 750 N.E.2d 1078). At this point in the litigation, with all claims intact, the court finds the General Business Law § 349 claim to have sufficient lineage with the common-law fraud claim to obtain coverage under CPLR 213(1). Even if this were not so, the statute of limitations would not bar class certification. Such concerns could be dealt with via the use of a subclass. (*Godwin Realty Associates v. CATV Enterprises, Inc.,* 275 A.D.2d 269, 712 N.Y.S.2d 39 [1st Dep't 2000]).

The statute of limitations for common-law fraud and unjust enrichment claims is six years. (CPLR 213[8]; CPLR 213[1]). Additionally, for actions sounding in fraud, the limitation of time is six years "from the time the plaintiff or the person under whom he claims discovered the fraud, or could with reasonable diligence have discovered it." (CPLR 213[8]). This provides additional protection to the preservation of these claims, since the consumers here may not have had reason to know of any injury until well after the transaction, if ever.

Therefore, statue of limitations defenses are inapplicable against each of the three theories of recovery and do not prevent certification.

CPLR 901[a][3]. The claims or defenses of the representative parties are typical of the claims or defenses of the class; and CPLR [a][4]. The plaintiff will fairly and adequately protect the interests of the class.

Defendants' joint memorandum of law in opposition to class certification contains arguments on predominance of issues of law and fact. Conversely, the typicality and adequacy requirements present the defendants with the opportunity to examine and undermine the individual proposed representatives of each putative class.

***11** It is essential that the plaintiff's claims be typical of the members of the putative class. The typicality requirement is satisfied where the "plaintiff's claim derives from the same practice or course of conduct that gave rise to the remaining claims of other class members and is based upon the same legal theory." (*Friar v. Vanguard Holding Corp.,* 78 A.D.2d at 99, 434 N.Y.S.2d 698).

The typicality requirement has been said to overlap to a certain degree with the requirement that the class representative fairly and adequately represent the interest of the class. However, each test must be independently satisfied in order to certify a class.

Adequacy of representation has three "primary components": Qualifications of counsel, ability of class representatives to assist their counsel, and the relationship between the interests of the class representatives and the interests of the other class members. *Michels v. Phoenix Home Life Mutual Insurance Comp., supra,* at *28).

Nowhere have the defendants challenged the qualifications of the plaintiffs' counsel. It is clear that the Proposed Class Representatives have retained counsel experienced in litigating class action cases and this element is deemed satisfied. The remaining two facets of the prospective class representatives' adequacy is at issue to a varying degree with the name class representatives.

The Schwartz plaintiffs.

Defendant Stewart Title Company would attack the typicality of Mr. & Mrs. Schwartz by claiming the Schwartz's refinance transaction was not eligible for the discounted rate. The reason the Schwartz' did not qualify for the discount was because they erected a fence on the property, and in so doing may have altered the premises within the meaning of the TIRSA guidelines. An altered premises potentially creates new risks of insuring title. The TIRSA guidelines clearly state that one of the several criteria for eligibility for the discounted refinance rate is that "the premises to be insured are identical to the premises previously covered by eli-

gible insurance." TIRSA Rate Manual § 14(B)(1). If the defense's assertion is correct, the Schwartz' claim would not satisfy the typicality requirement because they would not have a claim.

Defendant Stewart Title characterizes the fence as a possible "change in the risk continuum" for insuring title. The Schwartz plaintiffs contend they simply "replaced" a deteriorating wood fence for their "children's safety." (*Schwartz Transcript* at 58:22–59:7; 61:6–61:9.). Regardless, the TIRSA guidelines do not shed much light on the issue. Both sides note that the TIRSA manual does not contain a definition for "identical premises." The definition then becomes a question common to all members of the putative class.

The Schwartz' sworn testimony indicates two important points. First, the fence erected went up in the exact same area of the old one, even using the same postholes. Second, and perhaps more importantly, the description of the premises on Stewart Title's Schedule A form, viewable in the record, is identical to that of the Schedule A description from the first title insurance transaction. That testimony is not in controversy. It seems that because defendant's own forms said the Schwartz' premises were identical; it is inappropriate to disqualify them as class representatives.

***12** Stewart Title also contends that certain facts in the Schwartz' case show the extent that individual issues of law and fact will predominate. Stewart Title claims "individualized inquiry would be necessary to determine whether there have been changes to the premises." In addition to the fence on the Schwartz' property, Stewart Title specifically mentions the possibility that liens, easements, encumbrances, and other such restraints on alienation would need to be dealt with for many members of a putative class. This proposition is a key part of the defenses' strategy, discussed herein; but it is one that this court feels presents common questions of law or fact instead of a reason to bar class certification. Further, it seems that putative class members would be required to swear to the status of their premises upon submission of claims.

As for Stewart Title's contention that the Schwartz' lender was notified, and the Schwartz' themselves were likely notified of the discount, this goes to the issue of just what Stewart Title's obligations were in charging the reduced rate.

Further, the Schwartz' ability to assist counsel is not challenged and no issues arise in examining the relationship between the Schwartz' interests and the interest of the proposed class members.

The Werter Plaintiff.

Defendants vigorously challenge Ms. Werter's ability to adequately represent the class. The adequacy of representation is related to the need for all members of the class to receive due process in the handling of their claims. Defendants focus exclusively on Ms. Werter's ability to vigorously prosecute the litigation. On this point the defendants subject Ms. Werter to great scrutiny. The defense contends that Ms. Werter is an inadequate representative because she "does not even have a basic handle on her own every day affairs." (*Supplemental Mem. Of Law of Fidelity Nat'l.,* at 9). The assertion rests on Ms. Werter's inability to recall various names or other facts from her past. The plaintiffs contend that at deposition, Ms. Werter was able to give answers more satisfactory than "I don't recall" to 87% of questions posed. The defendants argue for rejection of Ms. Werter on grounds that her demonstrated lack of familiarity is too great to allow her to serve as an adequate class representative. Defendants cite *In re Lloyd's American Trust Fund Litigation,* 1998 WL 50211 (S.D.N.Y.). In *Lloyd's,* a proposed class representative was found inadequate because of her lack of familiarity with terms key to the litigation. Here, Ms. Werter indicated that she was unfamiliar with the concept of punitive damages, but she did show familiarity with the wrongs alleged and remedies sought by the lawsuit.

Lloyd's suggests that the nature and complexity of the litigation must be considered. Where *Lloyd's* involved insurance investments, trust agreements,

and fiduciary relationships, these title insurance claims appear more straightforward. "An adequate representative of a class of prisoners or school children, for example, establishes a different threshold than a class of sophisticated investors." (*Lloyd's* at *11). Of course, a class of mortgage refinancers is different than school children and prisoners, but their threshold for adequacy must fall short of that for sophisticated investors. Even the defendants' line of cases suggests that a party "will be deemed inadequate only if she is startlingly unfamiliar with the case." (*Id.* at *12, *citing Biancur v. Hickey*, No. C 95–2145, 1997 WL 9857 at *9 [ND Cal.1997]). That is not the case here and Ms. Werter may proceed as a class representative.

The Lawlor Plaintiff.

***13** Defendants argue Mr. Lawlor is inadequate to represent the class because he is the lessor of a leasehold interest in office space to Mr. Michael Gilmore's law firm, Sims Moss Kline & Davis LLP. Mr. Gilmore is an attorney assisting in representing the proposed class representatives in their quest for class certification. Additionally, Mr. Lawlor, an attorney, and Mr. Gilmore refer legal business to each other. It is argued that the financial relationship between Mr. Lawlor as lessor and Mr. Gilmore's law firm, and Mr. Gilmore himself as lessee, and referror and referral beneficiary creates a conflict of interest with regards to the litigation against National Title Insurance ("National"). Mr. Lawlor is seeking to represent the class of individuals that overpaid for insurance underwritten by National.

The potential for conflict of interest here is analogous to that of familial or direct employment relationships. In such situations it is important for the court to ensure that the "class representative have some measure of independence from the attorneys, or at least" ensure they are not "alter egos." (*Meachum v. Outdoor World Corp.*, 171 Misc.2d 354, 371, 654 N.Y.S.2d 240 [Sup Ct Queens County 1996]). The threshold of "some measure" mentioned in *Meachum* is met here. Mr. Lawlor, as an attorney, does not appear dependent entirely on and subservient to class-counsel. Further, defendants do not attack his claim otherwise, and he appears to meet the typicality requirement. The court concludes that Mr. Lawlor will be able to vigorously represent the interests of the putative class and is deemed an adequate representative.

The Williams Plaintiffs.

Susan and Scott Williams are proposed representatives for the class with claims against Fidelity National Title. Ms. Williams has been employed by the law firm Wolf Popper LLP, class counsel in this action, for approximately five years. The question that arises in this situation is where does Ms. Williams' loyalty lie, with the members of the putative class she seeks to represent, or with her employer, who stand to gain substantial fees from this litigation?

The court in *Meachum* noted that no rule exists to support a proposition that class representatives are not adequate when they are employed by class counsel. Both *Meachum* and *Tanzer v. Turbodyne Corp.*, 68 A.D.2d 614, 417 N.Y.S.2d 706 contain irregularities far beyond a simple employee-employer relationship. In *Meachum*, the court felt that the "totality of the circumstances, including the complicity of certain of the plaintiffs in the improper and unethical tape-recording of a conversation, has cast a cloud upon the proposed representation of the class-by-class counsel." (171 Misc. at 374, 12 N.Y.S.2d 678). In Ms. Williams' case, defendants do not contend there is impropriety on her part. It appears simply that subsequent to refinancing her home, she became aware of the allegations involved in the instant case.

The main danger posed is that Ms. Williams would sign off on a settlement that would be generous with attorney's fees yet miserly with payment to class members. However, it must be noted that in class actions, the court in New York maintains discretion to approve settlements and set attorney's fees. Without even a hint of impropriety on her part, it appears improper to disqualify Ms. Williams

as a proposed class representative.

The Smajlaj Plaintiffs.

***14** Defendants urge that the Smajlajs are inadequate class representatives because Rosa Smajlaj previously was employed by Wolf Popper LLP, class counsel in this action. Defendants properly note, as with the Williams, too, that "relationships arising out of employment can compromise the independence of the class representative from that of the class counsel." (*First American Title Co.'s Memorandum of Law in Opposition to Plaintiff's Motion for Class Certification* at 4). However, as with Ms. Williams, the defendants allege nothing beyond the previously existing employer-employee relationship to indicate an impropriety in Ms. Smajlaj serving as a class representative. Using reasoning similar to that used to determine Ms. Williams' ability to adequately represent the proposed class, the court concludes that Ms. Smajlaj is also an adequate representative. The defendants do mention in passing the need for judicial concern regarding solicitation, maintenance, and champerty in class actions. However, the argument is not pressed and it does not appear from the record that any exists. Ms. Smajlaj had lunch with a former colleague from Wolf Popper, and apparently, in casual conversation the title insurance case topic arose. From there, Ms. Smajlaj asked a Wolf Popper attorney to help her determine whether she was overcharged. That determination was made, and Ms. Smajlaj requested a refund. When the refund was refused, Ms. Smajlaj joined the suit. It appears from this sequence of events that she has a typical claim and there is no evidence that she will not adequately represent the putative class. Adam Good Plaintiff. Defendant American Pioneer Title Insurance Company ("American Pioneer") raises numerous issues regarding Mr. Good's ability to represent the putative class. Additionally, they echo the sentiments made in *Defendant's Joint Br.* on the predominance requirement.

The predominance requirement for certification is met for all of the consolidated class actions, as generally discussed above. American Pioneer's discussion raises no point that changes that conclusion. The theories of recovery are based on asking why consumers overpaid for title insurance during refinancing. Defendant American Pioneer asserts that Mr. Good was unable to immediately produce evidence of prior insurance, was unable to calculate his own damages, was represented by both an attorney and mortgage broker during his refinancing, and that his mortgage broker suggested to the title insurance agent that Mr. Good might be eligible for the reduced rate. None of these assertions, assuming their veracity, negate the fact that the suit inquires into the behavior of the defendants. This inquiry is precisely where the predominance of fact and law is.

American Pioneer argues that Mr. Good cannot adequately represent the class because he was "not concerned" with closing costs. (*American Pioneer's Suppl. Br.* at 6). This theory does not sustain a credible challenge to Mr. Good's ability to adequately represent a putative class. It is probable that virtually everyone who refinanced paid more than they desired in closing costs, yet found other benefits to balance the drawbacks of such costs. Regardless, Mr. Good has affirmatively demonstrated that he meets the threshold requirement for representing a class.

The Piscioneri Plaintiffs.

***15** In connection with a mortgage refinancing of their home, Christina and Joseph Piscionari purchased a lender's policy of title insurance from defendant Commonwealth Title Insurance Company. The Piscioneris now seek to represent a class of plaintiffs already described in this decision in a class action against Commonwealth.

Commonwealth asserts that resolving the Piscioneri's claim will not establish Commonwealth's liability as against the rest of the proposed class. Commonwealth uses substantially the same argument as was put forth in *Defendants' Jt. Br.* The Piscioneri's use of a mortgage broker means they relied on the mortgage broker to obtain the best

possible closing costs, title insurance included. Yet, as stated above, the complaint seeks to adjudicate alleged misconduct on the part of the defendants in connection with the rates they charged. The complaint seeks an analysis that focuses on the conduct of the defendants. The predominating issue of law and fact is did the defendants engage in the alleged misconduct.

Commonwealth challenges the typicality of the Piscioneri's claim. It is argued that because the Piscioneris engaged the services of a mortgage broker to handle closing arrangements, there is no "actual participation" in the transaction by the Piscioneris and therefore it cannot be "said that a plaintiff was deceived by an allegedly deceptive business practice." (*Commonwealth's Supp. Br.* at 18). This seems to be another way of arguing that common issues of fact and law will not predominate, an assertion already rejected. Further, the defendant cites no case law to support an "actual participation" theory. Such a theory is accepted to the degree that actual harm must be shown as an element of the GBL claim, and causation issues will be not be explored in great depth here.

Commonwealth also argues that the Piscioneris "reasonably could have, and should have," learned of the refinance rate from their mortgage broker. (*Commonwealth's Supp. Br.* at 18). However, it is likely that many members of the putative class followed the same road to refinance as the Piscioneris, and thus the claim is typical. "Relatively pronounced factual differences will generally not preclude a finding of typicality where there is a strong similarity of legal theories" (*In re Prudential Ins. Co. of America Sales Litig.*, 148 F.3d 283, 311 [3d Cir1998]). The Piscioneri's theories for recovery are exactly the same as the rest of the putative class and arise from the substantially similar transactions.

The Piscioneri's adequacy as class representatives is not challenged. As their claims are typical and they are adequate class representatives, they may proceed as such.

The Scuorzo Plaintiffs.

Donna and Michael Scuorzo refinanced their home in 1999 and in conjunction with that transaction purchased a lender's policy from defendant Lawyers Title Insurance Corporation ("Lawyers Title"). The Scuorzos seek to represent a class described herein in an action against Lawyers Title. Lawyers Title asserts that the Scuorzos meet neither the typicality nor adequacy or representation requirements. The Scuorzos plead a typical claim, that they were overcharged for a title insurance policy issued by Lawyers Title. Lawyers Title argues what appears to be a typical defense, that the responsibility for any overcharge and overpayment lies with intermediaries. It simply cannot be said that the Scuorzos claim is atypical of the claims of the other members of the putative class. All have the same common complaint described in detail above. Adequacy issues arise because Donna Scuorzo is a cousin of Mr. Kent Bronson, of Wolf Popper LLP. Mr. Bronson is involved with representing the proposed classes. Mr. Bronson's name appears on several documents filed with the court in relation to this consolidated litigation and represented Ms. Scuorzo at her deposition. The case law cited by defendant does not establish a rule that relatives of class counsel are *per se* inadequate. (*Meachum, supra; Tanzer supra*). In these cases relatives of class counsel were disqualified where there were other improprieties involved, as discussed in detail previously as to the Williams plaintiffs. Lawyers Title makes no allegation of any impropriety neither on the part of the Scuorzos nor class counsel. Indeed, evidence in the parties' submissions indicates that the process whereby the Scuorzos decided to litigate was not suspect, but arose as part of a casual conversation between Mr. Bronson and Mr. Scuorzo. Additionally, there is a body of precedent from the federal courts suggesting that class representatives are not inadequate simply because they are represented by a family member. (*See In re Cardizem CD Antitrust Litigation*, 200 F.R.D. 326 [ED Mich.2001]); (*In re Greenwich Pharmaceuticals Securities Litigation,*

1993 WL 436031 [ED Pa 1993]); (*Labaton v. Universal Leaf Tobacco Co., Inc.* 1978 U.S. Dist LEXIS 20163 [SDNY 1978]). It is thus concluded that the Scuorzos have typical claims and are adequate class representatives for purposes of the instant action.

***16** CPLR 901[a][5]. A class action is superior to other available methods for the fair and efficient adjudication of the controversy.

"A prime requisite of a class action is that it be superior to all other available methods for the fair and efficient adjudication of the controversy." (*Cannon v. Equitable Life Assurance Society of the US,* 87 A.D.2d 403, 411, 451 N.Y.S.2d 817 [2d Dep't 1982]). The class action device here seems appropriate. Nonetheless, because the class action device is "an exception to the principles that a person is entitled to determine whether, when and how to enforce his rights, it is essential" that available alternative methods of adjudication be considered. (Weinstein, et al., *New York Civil Practice* § 902.19). Alternative methods highlighted by the defense include adjudicating claims on an individual basis and administrative alternatives available from the NYSID.

As a preliminary matter, the NYSID has recently taken explicit cognizance of the allegations in the Coordinated Cases and initiated an investigation into title insurance rates charged in connection with mortgage refinancing transactions. That investigation appears to be directed to all of the underwriter members of TIRSA, not just the eight defendants in these cases. Defendants frame their argument for individual claim adjudication based on the possibility of an award of attorney's fees and treble damages in a General Business Law claim. Treble damages would be unavailable to members of a class, presumably. However, in weighing the benefit of the class mechanism against a plaintiff's ability to recover attorney's fees and treble damages, this court notes the value of each individual lawsuit, treble damages included, is probably too low to attract service of an attorney to prosecute the claim. Attorney's fees are awarded at the court's discretion and there would undoubtedly be a hesitation on the part of claimants to incur hourly counsel charges where a chance exists that attorney's fees would not be granted.

Administrative alternatives are also not superior to a class action in the instant matter. Plaintiffs point out that despite the heavy regulation of the insurance industry, including investigative and enforcement powers, there is a low likelihood that the full number of potential claimants will step forward to press an administrative proceeding. Although the likelihood of parties bringing claims to the NYSID is low, were the entire putative class to come forward with identical claims, that would be a waste of the NYSID's resources in the same way individually prosecuting the putative class members' claims in state court would be unduly burdensome on the judiciary.

Surely the CPLR 901(a)(5) requirement of efficiency steers us towards the class action. Whether considering the resources of an administrative agency or the judiciary, prosecuting a large amount of claims individually instead of deciding the matter of liability once is simply not efficient.

***17** The CPLR 901(a)(5) requirement for fairness is satisfied by a class action as well. The possibility of varying outcomes for those similarly situated is precisely what is considered here. Also noted by the court is the likelihood that numerous claimants would likely not be able to get a lawyer to take their claim.

As a practical matter, a class action is not only a superior method of

> adjudication, but the *only* method available for determining the issues raised, for 'the damages that may have been sustained by any single [customer] will almost certainly be insufficient to justify the expenses inherent in any individual action, and the number of individuals involved is too large, and the possibility of effective commu-

nication between them too remote, to make practicable the traditional joinder of action.

(*Weinberg v. Hertz Corp supra* at 5, 499 N.Y.S.2d 693).

Comparison with *Weinberg* is apt because there the alleged conduct violated state statutes and local regulations. The court concluded that the class action device was superior to joinder of individual claims and administrative options for relief.

CPLR 902 Considerations.

"Once the prerequisites are satisfied, the court must consider the factors set out in CPLR 902, to wit, the possible interest of class members in maintaining separate actions and the feasibility thereof, the existence of pending litigation regarding the same controversy, the desirability of the proposed class forum and the difficulties likely to be encountered in the management of a class action." (*Ackerman v. Price Waterhouse, supra* at 191, 683 N.Y.S.2d 179). This court has already taken the position that it is likely that putative class members have a comparatively small interest in bringing individual suits due to the moderate size of the alleged overpayments. It is also unlikely, even with the opportunity of attorney's fees awards and treble damages, that a claimant would find a lawyer to press the claim. Defendant's cite *Castano v. American Tobacco Co.*, 84 F.3d 734 (5th Cir.1996) for the proposition that where attorney's fees are available, individual suits are feasible because plaintiff no longer faces the prospect of a "negative value suit." But in *Castano*, the court reasoned that individual suits were feasible because the claims of each individual was so large. In the present case, as plaintiffs note, claims are relatively small. For this reason, the court finds the class action appropriate.

As noted in this decision, NYSID is investigating TIRSA members regarding the reduced rate premiums at issue in these consolidated actions. Members of the putative class are likely to be well-served by vigorous representation by named-plaintiffs and class counsel in these cases. The pendency of a state regulatory investigation is no impediment to the certification of this class.

The issue of desirability of the forum is not fully ready for decision. While the parties may consent to try the case before this court, Unif. Civ. R., Tr. Cts. § 202.69(c)(2), the consolidated cases may also be dispersed for trial. Defendants' only argument against concentration in one forum is that the New York real estate market is unique and regionalized, with local nuances pervading transactions. This argument is not persuasive, and further, it might be moot as these actions may be returned to the counties in which they were originally brought. There are several concerns raised by defendants in regards to the manageability of these cases as a class action which the court is required to analyze under section 902(5) of the CPLR. As a backdrop to the specific claims dispensed above, the defense argues that simply identifying members of the putative class is a gargantuan task arguing that the mere managerial tasks of the litigation weigh heavily against certification. The defendants contend that the structure of the mortgage policy premium sales business, and industry methods of record keeping, mean that it would take years to search the policyholder files to determine eligibility for the reduced rate. In order to even identify the members of the classes defined in plaintiffs' complaints, the files of hundreds of thousands of loan policy transactions will have to be analyzed, and the vast majority of these files are in the hands of title insurance sellers involved in agency relationships with the defendants. Further, defendants assert that even a thorough search of their records would not necessarily clarify which policy holders were entitled to, or did or did not receive the reduced rate.

***18** The record suggests this is not an insurmountable task. For example, Fidelity National Title conducted an audit of twenty files from policies sold by its agent, Superior Abstract Corporation. Fidelity National Title was able to determine that Superior had "charged the full rate instead of the discounted rate" for seven of the

twenty reviewed transactions." (*Raphael Affidavit* at Exhibit 2). "Most of the underwriters maintain databases from which they can identify completed loan policy transactions in which the Refinance Rate was applied. No underwriter, however, maintains a database from which it can identify policies which might have been eligible for the Refinance Rate but were issued for another rate." (*Defendants' Jt. Br.* at 12).

While the process of reviewing all files may indeed be immense, this court is not persuaded that the task cannot be managed. There is reluctance, here, as well, to halt the pursuit of alleged misconduct affecting a potentially very large number of consumers because of the state of the defendants' records. It should also be noted that Insurance Law § 2319(a) requires that "[e]very insurer and rate service organization shall within a reasonable time after receiving written request therefore, and upon payment of a reasonable charge, furnish to any insured affected by a rate made by it, or to the authorized representative of the insured, all pertinent information as to the rate."

In *Weinberg v. Hertz Corp., supra*, the court was not swayed by the defendants' assertion that a class action was inappropriate because the cost of ascertaining the class was "unduly burdensome." (*Weinberg* at 4, 499 N.Y.S.2d 693). *Weinberg* cited authority from California where the court ruled that the benefits of the class action for small consumer claims "outweighed any legal, administrative or economic burden on defendant in defining the class ." (*Id.* at 5, 499 N.Y.S.2d 693, *citing Lazar v. Hertz Corp.*, 143 Cal.App.3d 128, 191 Cal.Rptr. 849 [1983]).

In deciding that manageability concerns do not preclude certification, this court is sensitive to the guiding principles, noted earlier, of the class action, namely that the mechanism be used when it will save valuable judicial resources. (*See, Tegnazian v. Consolidated Edison, Inc.*, 189 Misc.2d 152, 155, 730 N.Y.S.2d 183, [Sup Ct N.Y. County 2000]). The allegations made in the pleadings bring a set of questions of law and fact that are common to all putative class members that predominate over individual issues cited by the defendants. Bringing the claims of individual class members one at a time would place an undue strain on scarce judicial resources and raise the possibility of differing judgments for claimants substantially similarly situated. Thus this court finds that any manageability concerns fail to outweigh the need to try these cases as class actions.

Conclusion.

Based on the reasons set forth in this decision, the court finds that plaintiffs have carried their burden on this motion for class certification. The requirements set out in CPLR 901 are satisfied and the factors considered by the court from CPLR 902 weigh in favor of certification. The classes are certified and this action will proceed accordingly. Defining the class. Pursuant to CPLR 903, the class is to be described with this order permitting the class action. As proposed by plaintiffs, the class will consist of:

> ***19** "all persons or entities in New York State who have refinanced their mortgages or fee interests on the identical premises within ten (10) years from the date of closing of their previously insured mortgage or fee interest, where there was no change in the fee ownership, and were charged a premium by defendant in an amount in excess of the reduced premium to the applicable loan rate filed on behalf of the Company with the NYSID (New York State Insurance Department) that they should have paid during the period from six (6) years prior to the date of the complaint through, and including, the date of resolution of this action (the "Class Period").

Pursuant to the authority vested in this court as the Coordinating Justice by Unif. Civ. R., Tr. Cts. § 202.69, the parties are hereby ordered to appear in court on February 10, 2004, at 9:30 A.M., for a Pretrial Conference to determine the manner of class notification. The court expects proposed forms of notification to be produced on the aforesaid date

and exchanged with adverse parties five days prior to said date. The parties shall be prepared to discuss as well the appropriateness of an opt-in versus an opt-out policy. On the above date a Preliminary Conference shall be held to set a schedule for all pre-trial discovery that might be needed in each case.

N.Y.Sup.,2004.
In re Coordinated Title Ins. Cases
2 Misc.3d 1007(A), 784 N.Y.S.2d 919, 2004 WL 690380 (N.Y.Sup.), 2004 N.Y. Slip Op. 50171(U)

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IN RE LONGTOP FINANCIAL TECHNOLOGIES LIMITED SECURITIES LITIGATION

11 Civ. 3658

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2012 U.S. Dist. LEXIS 162878; Fed. Sec. L. Rep. (CCH) P97,086

November 14, 2012, Decided
November 14, 2012, Filed

PRIOR HISTORY: In re Longtop Fin. Techs. Ltd., 2012 U.S. Dist. LEXIS 91004 (S.D.N.Y., June 28, 2012)

CORE TERMS: longtop, audit, scienter, auditor, red flags, misstatement, recklessness, reckless, margins, accounting, financial statements, short sellers, resignation, omission, audit reports, confirmation, uncovered, auditing, motive, wrongdoing, secondary, audited, subpoena, material misrepresentation, leave to amend, circumstantial evidence, disclosure, misleading, accountant, subjective

COUNSEL: [*1] For Plaintiffs: Kimberly A. Justice, Esq., John A. Kehoe, Esq., John J. Gross, Esq., Kessler Topaz Meltzer & Check, LLP (PA), Radnor, Pennsylvania; Daniel L. Berger, Esq., Jeff A. Almeida, Esq., Deborah A. Elman, Esq., Reena S. Liebling, Esq., Grant & Eisenhofer, P.A. (NY), New York, New York.

For Defendants: Gary F. Bendinger, Esq., Gazeena K. Soni, Esq., Sidley Austin LLP, New York, New York.

JUDGES: Shira A. Scheindlin, United States District Judge.

OPINION BY: Shira A. Scheindlin

OPINION

OPINION AND ORDER

SHIRA A. SCHEINDLIN, U.S.D.J.:

I. INTRODUCTION

Lead plaintiffs Danske Invest Management A/S and Pension Funds of Local No. One (collectively, "Lead Plaintiffs") bring this action on behalf of themselves and others similarly situated against Longtop Financial Technologies, Ltd. ("Longtop"), several of its officers, its auditor Deloitte Touche Tohmatsu CPA Ltd. ("DTTC"), and its auditor's parent company Deloitte Touche Tohmatsu Limited. The Class consists of all persons and entities who purchased American Depositary Shares ("ADSs") of Longtop Financial Technologies, Ltd. on the New York Stock Exchange ("NYSE") during the period June 29, 2009 through and including May 17, 2011 (the "Class Period") and who were allegedly **[*2]** damaged thereby. Lead Plaintiffs assert four causes of action for: violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder against Longtop and the Individual Defendants (Count One); violation of Exchange Act Section 20(a) against the Individual Defendants (Count Two); violations of Rule 10b-5 against DTTC (Count Three); and violation of Section 20(a) against Deloitte Limited (Count Four). Pursuant to Federal Rule of Civil Procedure 12(b)(6), DTTC now moves to dismiss Count Three. For the following reasons, DTTC's motion is granted.

II. BACKGROUND[1]

1 The facts set forth below are drawn from the Consolidated Class Action Complaint ("Compl."), and are presumed to be correct for the purposes of this motion unless otherwise designated. This Court has previously described the allegations in this case. *See In re Longtop Fin. Tech. Ltd. Secs. Litig.*, No. 11 Civ. 3658, 2012 U.S. Dist. LEXIS 91004, 2012 WL 2512280, at *1 (S.D.N.Y. June 29, 2012). To avoid needless duplication, only the facts necessary to resolve DTTC's motion to dismiss are described below.

Longtop is a Cayman Islands corporation with principal offices in Hong Kong and Xiamen, China,[2] which has described itself as a "leading provider" **[*3]** of information technology services to China's financial sector.[3] Throughout the Class Period, Longtop reported strong financial growth: from fiscal year 2008 to fiscal year 2010,[4] Longtop's total revenues grew from $65.9 million to $161.9 million, and its net income grew from $2.9 million to $59 million.[5] Longtop attributed this success to its extremely high gross and operating margins.[6] For example, in fiscal year 2010, Longtop's reported gross and operating margins were 62.5% and 35.8%, respectively, while its peer companies' gross and operating margins were, respectively, between 15-50% and 10-25%.[7] On the strength of these figures, Longtop availed itself of the United States capital markets through an initial public offering ("IPO") on October 25, 2007 and a secondary offering on November 23, 2009.[8]

2 *See* Compl. ¶ 2.

3 *Id*. ¶ 3.

4 Longtop's fiscal year ends on March 31. *See id*. ¶ 4.

5 *See id*.

6 *See id*. ¶ 38.

7 *See id*.

8 *See id*. ¶ 6.

Longtop's access to the capital markets was aided by DTTC.[9] DTTC served as Longtop's outside auditor, in which capacity it issued unqualified audit opinions on Longtop's Class Period financial statements, and consented to the use of its audit reports in Longtop's registration **[*4]** statements filed with the United States Securities and Exchange Commission ("SEC") in connection with the IPO and the Secondary Offering.[10] Specifically, DTTC permitted Longtop to reproduce its audit report in the 2009 20-F it filed with the SEC.[11] DTTC also permitted Longtop, in connection with its Secondary Offering, to incorporate this audit report on a Form F-3 and in a prospectus filed with the SEC.[12] DTTC also allowed Longtop to attach its unqualified audit report to Longtop to its 2010 20-F.[13] The audit reports state that DTTC's audits were performed in "accordance with the standards of the Public Company Accounting Oversight Board [("PCAOB")]," that Longtop's internal controls were adequate, and that DTTC "expressed an unqualified opinion" that Longtop's audited financial statements "present[ed] fairly, in all material respects, the financial position of Longtop . . . ."[14]

9 *See id*. ¶ 8.

10 *See id*.

11 *See id*. ¶ 77.

12 *See id*. ¶¶ 77-78.

13 *See id*. ¶ 89.

14 *Id*. ¶ 181.

The Complaint alleges that Longtop's above-market operating and gross margins were the result of various fraudulent actions taken by Longtop, including disguising its true cost of revenue and employee-related expenses through **[*5]** a series of off-balance sheet transfers to a wholly owned

entity, Xiamen Longtop Human Resources ("XLHRS"); falsifying its cash position and bank loan balances by manipulating and lying about its bank records; and interfering with DTTC's audits.[15] Longtop's alleged fraud began to unravel on April 26, 2011, when Citron Research issued a report questioning Longtop's high margins and whether XHLRS was properly deemed an unrelated entity.[16] The next day, Bronte Capital issued a report questioning Longtop's need for the Secondary Offering, given that, relative to expenses, Longtop then had six times more cash than Microsoft.[17]

15 *See id*. ¶ 59.

16 *See id*. ¶¶ 44-45.

17 *See id*. ¶ 48.

In the wake of these reports, Longtop's share price declined by approximately 26.4%.[18] To staunch the bleeding, Longtop held a conference call with investors on April 28, 2011, during which Longtop's Chief Financial Officer Derek Palaschuk denied any wrongdoing, and emphasized his close working relationship with DTTC.[19] The price of Longtop's ADSs rose nearly 11% by market's close that day.[20]

18 *See id*. ¶¶ 47, 49.

19 *See id*. ¶¶ 50-52.

20 *See id*. ¶ 53.

This rally was short-lived, as market analysts continued to publish reports **[*6]** (collectively with the Citron and Bronte reports, the "Short Seller Reports") speculating that Longtop was using the purportedly unrelated XLHRS to hide its losses and inflate its gross margins.[21] On May 27, 2011, the NYSE halted trading in Longtop's ADSs, citing "undisclosed material corporate developments . . . ."[22] In the face of these developments, and a continued decline in Longtop's ADSs, Palaschuk resigned on May 19, 2011.[23] On May 23, 2011, Longtop announced that DTTC had resigned as its outside auditor.[24] That same day, DTTC released to the public a letter (the "Resignation Letter") detailing the circumstances leading to its resignation.[25]

21 *See id*. ¶ 54.

22 *Id*. ¶ 61.

23 *See id*. ¶¶ 55-56.

24 *See id*. ¶ 57.

25 *See id*. ¶ 58.

The Resignation Letter relates the following narrative. DTTC determined that follow-up visits to certain Longtop banks were warranted in order to complete Longtop's 2011 audit.[26] When DTTC followed up with the banks it identified serious defects with Longtop's financials, including falsified bank confirmation replies, statements by bank officials that they had no record of certain transactions, significant discrepancies between bank balances and bank confirmations **[*7]** previously received by DTTC (and memorialized in the books and records of Longtop), and significant bank borrowing not identified in previously received confirmations.[27] In light of these defects, DTTC initiated a "formal second round of bank confirmation[s]" on May 17, 2011.[28] This inquiry was soon halted by Longtop's obstructionist behavior, including calls to banks by Longtop asserting that DTTC was not their auditor, the seizure of documents on bank premises by Longtop agents, and refusals by Longtop to allow DTTC's staff to leave Longtop's premises unless they relinquished audit files.[29] On May 20, Longtop's Chairman, Ka Xiao Gong ("Ka"), called DTTC's Eastern Region Managing Partner, Paul Sin, and informed him that Longtop had recorded fake revenues in the past, which they had offset with false cash.[30] Ka also stated that "senior management" was involved.[31] The letter further states that DTTC resigned as Longtop's auditor due to the falsity of Longtop's financial records, the deliberate interference by Longtop with the audit process, and the unlawful detention of DTTC's audit files.[32] The letter concludes by urging Longtop to make its required 8-K filing informing the public **[*8]** not to place reliance on DTTC's earlier audit reports, and by reminding Longtop of its obligations under the Securities Exchange Act of 1934.[33]

26 *See id*.

27 *See id*.

28 *Id*.

29 *See id*.

30 *See id*.

31 *Id*.

32 *See id*.

33 *See id*.

The NYSE began delisting proceedings against Longtop on July 22, 2011, and delisted Longtop on August 29, 2011.[34] On November 10, 2011, the SEC charged Longtop with failing to comply with SEC reporting requirements, based on Longtop's failure to file an annual report in fiscal year 2011, and based on DTTC's statement that the financial statements contained in Longtop's annual reports in 2008, 2009 and 2010 were no longer reliable.[35] The complaint in that action alleges that DTTC has thus far failed to comply with the SEC's investigation, "including producing documents in response to a subpoena. . . ."[36] However, it appears that DTTC's failure to produce documents is the result of inconsistencies between the regulatory regimes of the United States and China, pending the resolution of which the SEC has moved for, and been granted, a stay of its enforcement action against Longtop.[37]

34 *See id*. ¶¶ 61-62.

35 *See id*. ¶ 63.

36 *Id*. ¶ 64.

37 *See* Civil Docket for Case #: 1:11-mc-00512-GK-DAR ("SEC **[*9]** Docket"), Ex. F to Declaration of Gary Bendinger in Support of Defendant Deloitte Touche Tohmatsu CPA Ltd.'s Motion to Dismiss ("Bendinger Decl."), at 6 (revealing that the SEC made an unopposed motion for a stay, which was granted); Respondent DTTC's Statement of Points and Authorities Opposing the SEC's Application for Order to Show Cause and Order Requiring Compliance with a Subpoena ("DTTC Subpoena Mem."), Ex. G to Bendinger Decl., at 21-22 (describing DTTC's efforts to comply with the SEC's subpoena and alleging that DTTC needed Chinese regulatory permission to produce documents to the SEC); Unopposed Motion for Stay of this Action ("SEC Stay Mot."), Ex. H to Bendinger Decl., at 3 (describing the SEC's efforts to negotiate with Chinese regulators and seeking a six month stay of the enforcement action).

A. Alleged Violations of Generally Accepted Auditing Standards ("GAAS")

The Complaint alleges that DTTC violated a variety of accounting rules and principles found in the interpretive Statements on Auditing Standards ("AU") that are alleged to form a part of the GAAS.[38] The Complaint further alleges that Longtop's Class Period financial statements violated provisions

of the Generally **[*10]** Accepted Accounting Principles ("GAAP") mandating the disclosure of certain material related-party transactions and requiring that financial statements fairly and completely represent an enterprise's economic resources and financial performance in a way that is useful to the investing public.[39] Consequently, DTTC statements that its audits were conducted in accordance with PCAOB standards and that Longtop's financial statements were GAAP compliant are alleged to be materially false.[40]

38 *See* Compl. ¶¶ 123-126; 130-136.

39 *See id*. ¶¶ 107-110 (citing Federal Accounting Standards Board ("FASB") Statement of Concepts No. 1 ¶¶ 34, 40, 42; FASB No. 2 ¶¶ 58-59, 79; Statement of Financial Concepts No. 57).

40 *See id*. ¶ 107.

The Complaint alleges that DTTC failed to exercise the "[d]ue professional care" and "professional skepticism" required by the GAAS.[41] Specifically, the Complaint alleges that DTTC was reckless and fell short of GAAS standards because it failed to undertake any meaningful investigation of Longtop's bank and loan balances over the Class Period.[42] Similarly, the Complaint alleges that DTTC was reckless and violated GAAS standards because it failed to detect that Longtop was covertly **[*11]** transferring costs to XLHRS, despite the warning provided by Longtop's above market margins.[43]

41 *See id*. ¶ 123 (citing AU §§ 230, 230.02, 230.07, 230.09).

42 *See id*. ¶¶ 124-129 (citing AU §§ 230.10, 311.03, 311.06, 312.16, 312.17, 329.01, 329.02, 329.03).

43 *See id*. ¶¶ 130-135 (citations omitted)

B. Red Flags

The Complaint additionally alleges that even a "perfunctory" review by DTTC of the relationship between Longtop and XLHRS would have revealed the following six "red flags": (1) that XLHRS was formed shortly before Longtop's IPO;[44] (2) that although XLHRS was Longtop's largest line-item expenditure, it was not mentioned in Longtop filings until its 2009 Form 20-F;[45] (3) that XLHRS shared the same building with Longtop;[46] (4) that "Longtop" appears in XLHRS's name;[47]

(5) that XLHRS lacked a website and had no customers other than Longtop;[48] and (6) that XLHRS had placed job postings with a reply-to email address at longtop.com, raising questions about whether it shared an email server with Longtop.[49]

44 *See id*. ¶ 135

45 *See id*.

46 *See id*.

47 *See id*.

48 *See id*.

49 *See id*.

III. STANDARD OF REVIEW AND PLEADING STANDARD

A. Rule 12(b)(6) Motion to Dismiss

A pleading must contain "a short and plain statement **[*12]** of the claim showing that the pleader is entitled to relief."[50] "Such a statement must [] 'give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests.'"[51] In deciding a motion to dismiss pursuant to Rule 12(b)(6), the court "must accept all non-conclusory factual allegations as true and draw all reasonable inferences in the plaintiff's favor."[52] For the purposes of such motion, ". . . a district court may consider the facts alleged in the complaint, documents attached to the complaint as exhibits, and documents incorporated by reference in the complaint."[53] However, the court may also consider a document that is not incorporated by reference, "where the complaint 'relies heavily upon its terms and effect,' thereby rendering the document 'integral' to the complaint."[54]

50 Fed. R. Civ. P. 8(a)(2).

51 *See Swierkiewicz v. Sorema N. A.*, 534 U.S. 506, 512, 122 S. Ct. 992, 152 L. Ed. 2d 1 (2002) (quoting *Conley v. Gibson*, 355 U.S. 41, 47, 78 S. Ct. 99, 2 L. Ed. 2d 80 (1957), overruled in part on other grounds by *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 561-563, 127 S. Ct. 1955, 167 L. Ed. 2d 929 (2007)).

52 *Simms v. City of New York*, No. 11 Civ. 4568, 2012 U.S. App. LEXIS 9819, 2012 WL 1701356, at *1 (2d Cir. May 16, 2012) (citing *Goldstein v. Pataki*, 516 F.3d 50, 56 (2d Cir.

2008)).

53 *DiFolco v. MSNBC Cable L.L.C.*, 622 F.3d 104, 111 (2d Cir. 2010) **[*13]** (citing *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002)).

54 *Id*. (quoting *Mangiafico v. Blumenthal*, 471 F.3d 391, 398 (2d Cir. 2006)). *Accord Global Network Commc'ns, Inc. v. City of N.Y.*, 458 F.3d 150, 156 (2d Cir. 2006).

The court evaluates the sufficiency of the complaint under the "two-pronged approach" suggested by the Supreme Court in *Ashcroft v. Iqbal*.[55] Under the first prong, a court "'can . . . identify[] pleadings that, because they are no more than conclusions, are not entitled to the assumption of truth.'"[56] Thus, "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice" to withstand a motion to dismiss.[57] Under the second prong of *Iqbal*, "[w]hen there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement for relief."[58] A claim is plausible "when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[59] Plausibility "is not akin to a probability requirement;" rather, plausibility requires "more than a sheer possibility **[*14]** that a defendant has acted unlawfully."[60]

55 556 U.S. 662, 678-679, 129 S. Ct. 1937, 173 L. Ed. 2d 868 (2009).

56 *Hayden v. Paterson*, 594 F.3d 150, 161 (2d Cir. 2010) (quoting *Iqbal*, 556 U.S. at 679). *Accord Ruston v. Town Bd. for Town of Skaneateles*, 610 F.3d 55, 59 (2d Cir. 2010).

57 *Iqbal*, 556 U.S. at 663 (citing *Twombly*, 550 U.S. at 555).

58 *Id*. at 679. *Accord Kiobel v. Royal Dutch Petroleum Co.*, 621 F.3d 111, 124 (2d Cir. 2010).

59 *Iqbal*, 556 U.S. at 678 (quotation marks omitted).

60 *Id*. (quotation marks omitted).

B. Heightened Pleading Standard under Rule 9(b) and the PSLRA

Private securities fraud claims are subject to a heightened pleading standard.[61] First, Rule 9(b) requires that the circumstances constituting fraud be alleged with particularity, although "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

61 *See Meridian Horizon Fund, LP v. KPMG (Cayman)*, Nos. 11-3311-cv, 11-3725-cv, 2012 U.S. App. LEXIS 14013, 2012 WL 2754933, at *2 (2d Cir. July 10, 2012).

Second, the Private Securities Litigation Reform Act of 1995 ("PSLRA") further heightens the pleading standard for the plaintiff in a private securities fraud case. The PSLRA provides that:

> [i]n any private action arising under this chapter in which the **[*15]** plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.[62]

A plaintiff has alleged facts giving rise to a "strong inference" of scienter "only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[63] In deciding whether the plaintiff has alleged facts showing a strong inference of scienter, "a court must consider plausible, nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff."[64] The inquiry is holistic, *i.e*. the allegations going to scienter are to be evaluated collectively.[65] The PSLRA further provides that the complaint in a private securities fraud case must:

> specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, . . . state **[*16]** with particularity all facts on which that belief is formed.[66]

62 15 U.S.C. § 78u-4(b)(2).

63 *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007).

64 *Meridian Horizon Fund, LP*, 2012 U.S. App. LEXIS 14013, 2012 WL 2754933, at *2 (quoting *Tellabs*, 551 U.S. at 323-24).

65 *See Tellabs*, 551 U.S. at 326.

66 15 U.S.C. § 78u-4(b)(1)(B).

C. Leave to Amend

Whether to permit a plaintiff to amend its complaint is a matter committed to a court's "sound

discretion."[67] Rule 15(a) provides that leave to amend a complaint "shall be freely given when justice so requires." "When a motion to dismiss is granted, the usual practice is to grant leave to amend the complaint."[68] In particular, it is the usual practice to grant at least one chance to plead fraud with greater specificity when a complaint is dismissed under Rule 9(b).[69] Leave to amend should be denied, however, where the proposed amendment would be futile.[70]

67 *McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 200 (2d Cir. 2007).

68 *Hayden v. County of Nassau*, 180 F.3d 42, 53 (2d Cir. 1999).

69 *See ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 108 (2d Cir. 2007).

70 *See Dougherty v. Town of N. Hempstead Bd. of Zoning Appeals*, 282 F.3d 83, 87 (2d Cir. 2002).

IV. [*17] APPLICABLE LAW

A. Section 10(b) and Rule 10b-5 of the Securities Exchange Act

Section 10(b) of the Securities Exchange Act of 1934 makes it illegal to "use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . ."[71] Under Rule 10b-5 one may not "make any untrue statement of a material fact or [] omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security."[72] "To sustain a private claim for securities fraud under Section 10(b), 'a plaintiff must prove (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.'"[73] There is no secondary liability under Section 10(b),[74] but "secondary actors like accountants may be held liable as primary violators if all the requirements for **[*18]** primary liability are met . . . ."[75]

71 15 U.S.C. § 78j(b).

72 17 C.F.R. § 240.10b-5.

73 *Ashland Inc. v. Morgan Stanley & Co., Inc.*, 652 F.3d 333, 337 (2d Cir. 2011) (quoting *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, Inc., 552 U.S. 148, 157, 128 S. Ct. 761,

169 L. Ed. 2d 627 (2008)). *Accord Erica P. John Fund, Inc. v. Halliburton Co.*, -- U.S. -- , 131 S.Ct. 2179, 2184, 180 L. Ed. 2d 24 (2011).

74 *See Central Bank of Denver N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191, 114 S. Ct. 1439, 128 L. Ed. 2d 119 (1994).

75 *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998) (quoting *Central Bank*, 511 U.S. at 191).

1. Misstatements or Omissions of Material Fact

In order to satisfactorily allege misstatements or omissions of material fact, a complaint must "state with particularity the specific facts in support of [plaintiffs'] belief that [defendants'] statements were false when made."[76] "For the purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it."[77]

76 *Rombach v. Chang*, 355 F.3d 164, 172 (2d Cir. 2004) (quotation marks omitted).

77 *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S.Ct. 2296, 2302, 180 L. Ed. 2d 166 (2011).

"'[A] fact is to be **[*19]** considered material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell shares [of stock].'"[78] In situations "'[w]here plaintiffs contend defendants had access to contrary facts, they must specifically identify the reports or statements containing this information.'"[79] Mere "allegations that defendants should have anticipated future events and made certain disclosures earlier than they actually did[,] do not suffice to make out a claim of securities fraud."[80] "[A]n omission is actionable when the failure to disclose renders a statement misleading."[81]

78 *Operating Local 649 Annuity Trust Fund v. Smith Barney Fund Mgmt. LLC*, 595 F.3d 86, 92-93 (2d Cir. 2010) (quoting *Azrielli v. Cohen Law Offices*, 21 F.3d 512, 518 (2d Cir. 1994)).

79 *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital Inc.*, 531 F.3d 190, 197 (2d Cir. 2008) (quoting *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000)).

80 *Id. Accord Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000).

81 *In re Alstom SA*, 406 F. Supp. 2d 433, 453 (S.D.N.Y. 2005) (citing *In re Time Warner Inc. Secs. Litig.*, 9 F.3d 259, 268 (2d Cir. 1993)).

2. Scienter

A plaintiff may **[*20]** plead scienter by "alleging facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness."[82] "'Sufficient motive allegations entail concrete benefits that could be realized by one or more of the false statements and wrongful nondisclosures alleged.'"[83] "Motives that are generally possessed by most corporate directors and officers do not suffice; instead, plaintiffs must assert a concrete and personal benefit to the individual defendants resulting from the fraud."[84]

82 *ATSI*, 493 F.3d at 99 (citing *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 168-69 (2d Cir. 2000)). *Accord Dandong v. Pinnacle Performance Ltd.*, No. 10 Civ. 8086, 2011 U.S. Dist. LEXIS 126552, 2011 WL 5170293, at *11 (S.D.N.Y. Oct. 31, 2011) (quoting *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290-91 (2d Cir. 2006)).

83 *Campo v. Sears Holdings Corp.*, 371 Fed. App'x 212, 215 (2d Cir. 2010) (quoting *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001)).

84 *Kalnit*, 264 F.3d at 139. *Accord ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 198 (2d Cir. 2009).

However, "'[w]here motive is not apparent, it is **[*21]** still possible to plead scienter by identifying circumstances indicating conscious behavior by the defendant, though the strength of the circumstantial allegations must be correspondingly greater.'"[85] Under this theory of scienter, a plaintiff must show that the defendant's conduct is "at the least . . . highly unreasonable and [] represents an extreme departure from the standards of ordinary care to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[86] "To state a claim based on recklessness, plaintiffs may either specifically allege defendants' knowledge of facts or access to information contradicting defendants' public statements, or allege that defendants failed to check information they had a duty to monitor."[87]

85 *Kalnit*, 264 F.3d at 142 (quoting *Beck v. Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987)). *Accord South Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009); *In re NovaGold Res. Inc. Sec. Litig..*, 629 F. Supp. 2d 272, 297 (S.D.N.Y. 2009) (quoting *ECA*, 553 F.3d at 198-99).

86 *South Cherry St.*, 573 F.3d at 109 (quotation marks and emphasis omitted). *Accord ECA*, 553 F.3d at 203.

87 *In re Gildan Activewear, Inc. Secs. Litig.*, 636 F. Supp. 2d 261, 272 (S.D.N.Y. 2009) **[*22]** (quotation marks and citation omitted).

An outside auditor will typically not have an apparent motive to commit fraud. Consequently, "'[f]or recklessness on the part of a non-fiduciary accountant to satisfy securities fraud scienter, such recklessness must be conduct that is highly unreasonable, representing an extreme departure from the standards of ordinary care.'"[88] In a common formulation, such recklessness must "'approximate an actual intent to aid in the fraud being perpetrated by the audited company.'"[89] Recklessness has been adequately alleged if it appears from the complaint that "[t]he accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts."[90] "A complaint might reach [the] 'no audit at all' threshold by alleging that the auditor disregarded specific 'red flags' that 'would place a reasonable auditor on notice that the audited company was engaged in wrongdoing to the detriment of its investors.'"[91] "However, . . . merely **[*23]** alleging that the auditor had access to the information by which it could have discovered the fraud is not sufficient."[92]

88 *Meridian Horizon Fund, LP*, 2012 U.S. App. LEXIS 14013, 2012 WL 2754933, at *3 (quoting *Rothman*, 220 F.3d at 98).

89 *Id*.

90 *In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370, 385 (S.D.N.Y. 2007) (quoting *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 657 (S.D.N.Y. 2007)).

91 *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 483 (S.D.N.Y. 2008) (quoting *In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d at 385).

92 *Id*.

3. Causation

Causation (i.e. reliance and loss causation) is not at issue in this motion. Therefore, I will not address it here.

V. DISCUSSION

The gravamen of the claim against DTTC is that DTTC's audit opinions were material misstatements that, in light of Longtop's high gross margins and the alleged red flags, DTTC issued recklessly. The instant motion contends that the Complaint fails to adequately allege scienter, and that DTTC did not make a material misrepresentation because DTTC's auditor statements were opinions, which DTTC reasonably believed at the time they were made.

A. Scienter

For the purposes of this motion, the appropriate standard for evaluating the allegations of **[*24]** scienter is whether, viewed holistically, the facts alleged give rise to a strong inference that DTTC was reckless to a point approximating an actual intent to aid Longtop's deception. Such inference must be at least as compelling as any competing inference.[93] The Complaint does not meet this standard. The Complaint's deficiency is that it insufficiently alleges facts that would have put DTTC on notice that Longtop was engaged in fraud during the Class Period. At its core the Complaint alleges that, had DTTC performed a better audit, it would have uncovered Longtop's fraud.[94] At most this describes negligence by DTTC, not the recklessness approaching actual intent required by the PSLRA.

93 *Tellabs*, 551 U.S. at 324.

94 *See Compl*. ¶¶ 129, 134-137, 183.

1. The Alleged Accounting Standards Violations

The alleged GAAS violations are mostly pitched at such a high level of generality that, even if credited, they could not support a compelling inference of scienter.[95] The strongest inference from even the most specifically alleged "violations" is that DTTC was duped by Longtop, not that DTTC conducted no audit.[96] The GAAS cautions that even a well-planned audit may be ineffective in the face of **[*25]** fraud.[97] And the Complaint amply alleges that Longtop went to great lengths to conceal its fraud from DTTC, e.g. by falsifying bank confirmations.[98] In the end, the Complaint's laundry list of auditing standards boils down to the assertion that "[h]ad DTT[C] exercised even the most cursory of audit procedures" during its audits, "it would have discovered [the] serious defects in Longtop's financial records" detailed in the Resignation Letter.[99] Without supporting allegations suggesting that DTTC failed to perform even a "cursory" audit, this generalized assertion fails to

adequately allege scienter under the PSLRA.

95 *See, e.g., id*. ¶¶ 124 ("In conducting the audit, the auditor must obtain 'reasonable assurance that the financial statements are free from material misstatements, whether caused by error or fraud.") (citing AU § 230.10); 125 ("In considering audit risk, "the auditor should specifically assess the risk of material misstatement of the financial statements due to fraud.") (citing AU § 312.16); 126-127 (stating that DTTC "failed to adequately plan its audit of Longtop and use appropriate analytical procedures[,]" because it did not discover Longtop's fraud prior to the Short **[*26]** Seller Reports) (citing AU §§ 329.01-329.03).

96 *Compare id*. ¶¶ 133-134 (citing AU §§ 334.07-334.09) (describing an auditor's obligation under PCAOB standards to "apply the procedures he considers necessary to obtain satisfaction concerning the purpose" of large or unusual transactions in order to ascertain the relationship between the parties, and charging DTTC with failing to implement these procedures, as evidenced by their failure to ascertain that DTTC had "transferred the majority of its cost structure off-balance sheet to XLHRS"); *with id*. ¶ 58 (describing, *inter alia*, the lengths to which Longtop went to conceal its fraud as it began to unravel).

97 *See* AU § 230 ("[b]ecause of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement"); *id*. § 316.12 ("absolute assurance [that financial statements are free of material misstatement due to fraud or error] is not attainable and thus even a properly planned and performed audit may not detect a material misstatement resulting from fraud . . .").

98 *See* Compl. ¶ 58.

99 *Id*. ¶ 128.

2. Red Flags

Bare allegations of disregarded auditing standards are insufficient to plead scienter against an outside **[*27]** auditor for the purposes of Section 10(b).[100] "Only where such allegations are coupled with evidence of 'corresponding fraudulent intent,' might they be sufficient."[101] A complaint may show this "corresponding fraudulent intent" through allegations that the auditor disregarded red flags.[102] The Complaint alleges that DTTC was reckless in failing to pay heed to the six red flags enumerated above.[103] However, the Complaint does not allege that DTTC was actually aware of the putative red flags.[104] Instead, the argument is that had DTTC conducted a better audit, it would have become aware of the red flags, and the red flags would have pointed the way to Longtop's wrongdoing. The problem with this argument is that it does not appear that the alleged

circumstances would have put a reasonable auditor on inquiry notice of fraud.[105]

100 *See In re Merkin*, 817 F. Supp. 2d 346, 358 (S.D.N.Y. 2011) (stating that "allegations of GAAP or GAAS violations, standing alone, are insufficient to state a claim for relief against an accountant under the federal securities laws.").

101 *Novak*, 216 F.3d at 309.

102 *See In re AOL Time Warner*, 381 F. Supp. 2d 192, 240 (S.D.N.Y. 2004) ("Allegations of 'red flags,' when **[*28]** coupled with allegations of GAAP and GAAS violations, are sufficient to support a strong inference of scienter.") (holding, *inter alia*, allegation that auditor ignored the fact that large amounts of advertising revenue regularly came in at the end of quarter, fortuitously allowing the audited company to hit their earnings targets, was a red flag supporting a pleading of scienter for the purposes of a motion to dismiss).

103 *See* Compl. ¶ 183 ("Had DTT[C] conducted its audit in accordance with the PCAOB, it would have reacted to the numerous, obvious 'red flags' set forth above and, in so doing, would have discovered the truth about Longtop's operations.")

104 *See, e.g. id*. ¶ 135 ("Indeed, a perfunctory review of the relationship [between XLHRS and Longtop] would have exposed the following [red flags]") (emphasis added). *Cf. Stephenson v. PricewaterhouseCoopers, LLP*, Civ No. 11-1204-cv, 2012 U.S. App. LEXIS 10017, 2012 WL 1764191, at *3 (2d Cir. May 18, 2012) ("[P]leading the existence of red flags does not establish that a defendant was aware of those warning signals.") (affirming dismissal of 10(b) claim when the complaint did not sufficiently allege that the auditor defendant was aware of the red flags alleged).

105 *See* **[*29]** *South Cherry St.*, 573 F.3d at 112-15 (affirming dismissal of section 10(b) claim grounded on allegations that investment advisor would have uncovered fraud if it had conducted due diligence).

In order for a complaint founded on the theory that an auditor should have uncovered red flags to survive a motion to dismiss, the red flags must be "so obvious that knowledge of them by the auditor can be presumed."[106] Of the six alleged red flags, only three are obvious enough to warrant the presumption that DTTC was aware of them: (1) the allegation that XLHRS was formed shortly before Longtop's IPO; (2) the allegation that XLHRS was not mentioned in Longtop's audited financials until its 2009 Form 20-F;[107] and (3) the allegation that XLHRS has "Longtop" in its name.

106 *Stephenson v. Citco Group Ltd.*, 700 F. Supp. 2d 599, 623 (S.D.N.Y. 2010).

107 The Complaint states that "[a]lthough XLHRS is Longtop's largest line item expenditure by far, it is never mentioned in Longtop filings until the 2009 20-F. . . ." Compl. ¶ 135. This assertion is mistaken. Longtop's 2008 20-F discloses that Longtop entered into a staffing arrangement with XLHRS on May 18, 2007. *See* 2008 20-F, Ex. E to Bendinger Decl., **[*30]** at 93, Ex. 4.29.

DTTC's failure to uncover Longtop's fraud on the basis of these facts does not suggest that its performance amounted to "no audit" of Longtop.[108] In fact, the three facts listed above are not "red flags" at all. "A 'red flag' is a sign consciously disregarded by the auditor that 'would place a reasonable auditor on notice that the audited company was engaged in wrongdoing to the detriment of its investors.'"[109] The fact that XLHRS was formed shortly before Longtop's IPO, and that it had "Longtop" in its name, would not lead a reasonable auditor to suspect wrongdoing, given that this sort of staffing arrangement is common. Moreover, Longtop disclosed in its 2008 Form 20-F that it entered into a staffing contract with XLHRS in May 2007.[110] This disclosure included, *inter alia*, an account of the relationship that Longtop had with XLHRS, the number of employees provided by XLHRS, and a copy of XLHR's contract with Longtop.[111] Despite this disclosure, which included XLHRS's full name, neither the SEC nor the investing public recognized Longtop's alleged fraud. This raises the inference that these purported red flags are in fact red herrings.[112] Like the SEC and the investing **[*31]** public, DTTC could have reasonably concluded that XLHRS was precisely what Longtop presented it as: a fully-disclosed independent staffing agency.

108 *In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d at 657.

109 *Advanced Battery Tech.*, No. 11 Civ. 2279, 2012 U.S. Dist. LEXIS 123757, 2012 WL 3758085, at *16 (S.D.N.Y. Aug. 29, 2012) (quoting *In re IMAX Sec. Litig.*, 587 F. Supp. 2d at 483-84).

110 *See* 2008 20-F, Ex. E to Bendinger Decl., at 93, Ex. 4.29.

111 *See* Compl. ¶ 67.

112 *See Meridian Horizon Fund, LP*, 2012 U.S. App. LEXIS 14013, 2012 WL 2754933, at *3 (affirming dismissal of 10(b) claim against independent auditor, and holding that alleged red flags that were disclosed to the investing public could not support an inference of scienter).

3. The Short Seller Reports

The allegations relating to the Short Seller Reports do not provide the basis for an adequate pleading of scienter. As an initial observation, short sellers operate by speculating that the price of a security will decrease. They can perform a useful function by bringing information that securities are overvalued to the market. However, they have an obvious motive to exaggerate the infirmities of the securities in which they speculate.

The Complaint argues that the Short Seller reports provide **[*32]** proof of scienter because "[i]t was not until after [the Short Seller Reports] questioned the legitimacy of Longtop's financial results that DTT[C] began to specifically assess the risk of material misstatement of Longtop's financial statements due to fraud."[113] The narrative told by the Resignation Letter, though, shows that DTTC had performed its prior audits with diligence, and further was diligent enough to go back and check its work in the face of the Short Seller Reports, despite the obvious temptation to discount them.[114] And when, less than a month after the first shortseller's report, DTTC had verified that there were problems at Longtop, it noisily resigned.[115]

113 Compl. ¶ 127.

114 *See id*. ¶ 58 (describing the "second round of bank confirmations" performed by DTTC).

115 *See id*.

To the extent that the argument is that DTTC must have acted recklessly because Longtop's fraud was uncovered by short-sellers, not DTTC, such argument also fails. If an auditor were liable every time a short seller issued a report prior to a fraud being uncovered, then the scope of auditor liability would extend well beyond that contemplated by the PSLRA. Once more, the most compelling inference is that **[*33]** DTTC performed its duties with reasonable diligence, not that it conducted "no audit."

4. Additional Scienter Theories

In their opposition brief, Lead Plaintiffs put forward two additional theories of scienter.[116] The first is that the size of Longtop's fraud indicates that DTTC was reckless.[117] The second is that the rapidity with which DTTC uncovered the fraud once it began to unravel indicates that DTTC was reckless.[118] These theories, too, fail the *Tellabs* pleading standard.

116 *See* Lead Plaintiffs' Amended Memorandum of Law in Opposition to Deloitte Touche Tohmatsu CPA Limited's Motion to Dismiss Plaintiffs' Consolidated Class Action Complaint

("Opp. Mem.") at 17-18.

117 *Id*. at 17.

118 *Id*. at 17-18.

Naturally, failing to detect a fraud of large magnitude provides some circumstantial evidence of scienter, just as failing to detect a large boulder in front of your face qualifies as circumstantial evidence of blindness.[119] As DTTC rightly points out, though, the size of Longtop's fraud was never quantified, due to Longtop's interference with DTTC's audit.[120] And there are no allegations that the scale of the fraud was sufficiently great, as a percentage of Longtop's business, that DTTC was **[*34]** reckless in not catching it earlier.[121] Moreover, a fraud's large size, standing alone, is insufficient to show recklessness.[122]

119 *See Katz v. Image Innovations Holdings, Inc*., 542 F. Supp. 2d 269, 273 (S.D.N.Y. 2008) (citing *In re Scottish Re Group Sec. Litig*., 524 F. Supp. 2d at 394 & n. 174) ("[t]he magnitude of the alleged fraud provides some additional circumstantial evidence of scienter").

120 *See* Defendant Deloitte Touche Tohmatsu CPA Ltd.'s Reply Memorandum in Further Support of Its Motion to Dismiss the Consolidated Class Action Complaint at 5-6.

121 *See, e.g. In re Bear Stearns Cos., Inc. Secs, Derivative, and ERISA Litig*., 763 F. Supp. 2d 423, 497, 517 (S.D.N.Y. 2011) (finding that an auditor's failure to catch a $1.3 billion write-down provided evidence of recklessness); *Katz*, 542 F. Supp. 2d at 273 (finding evidence of scienter when accountant booked six million dollars worth of largely non-existent sales).

122 See *Pennsylvania Public School Employees' Retirement System v. Bank of America Corp*., No. 11 Civ. 733, 2012 U.S. Dist. LEXIS 96317, 2012 WL 2847732, at *18 (S.D.N.Y. July 11, 2012) (dismissing 10(b) claim on the basis that magnitude of fraud is insufficient to state a claim unless coupled with other **[*35]** "convincing allegations").

Nor does the rapidity with which Longtop's fraud unraveled give rise to a strong inference of scienter. The nub of this theory, which is factually grounded in the Resignation Letter, is that because DTTC was driven to disavow its previous opinions after performing follow-up confirmations with Longtop's banks, it was reckless in not doing so earlier.[123] The most compelling inference to be drawn from the Resignation Letter, though, is that Longtop had been hiding its fraud from DTTC, but was forced to reveal it under enhanced scrutiny.[124]

123 *See* Opp. Mem. at 17-18 ("the speed and ease with which the fraud was 'identified' [after the follow up visits to Longtop's banks] further supports a finding of scienter").

124 *See* Compl. ¶ 58.

Finally, to the extent that the Complaint alleges that Longtop's above-market gross margins functioned as a red flag,[125] this allegation also fails to satisfy the pleading standard. If superior performance were a self-sufficient cause to suspect fraud, then the entire Fortune 500 is in dire need of a thorough forensic accounting. DTTC's failure -- along with the SEC and the market -- to suspect Longtop on the basis of its high gross margins **[*36]** is too thin a reed on which to hang a finding of recklessness.[126]

125 *See id*. ¶¶ 4-5, 45-46.

126 *See Chill v. General Elec. Co.*, 101 F.3d 263, 270 (2d Cir. 1996) ("The fact that GE did not automatically equate record profits with misconduct cannot be said to be reckless."). *See also Novak*, 216 F.3d at 309 ("the failure . . . to interpret extraordinarily positive performance . . . as a sign of problems and thus to investigate further does not amount to recklessness").

At bottom, the Complaint alleges fraud by hindsight, a claim that is accorded the same respect in this Circuit today as it was when Judge Friendly gave it a name.[127] Fraud is always obvious in retrospect, but it is not reckless to lack clairvoyance. Apart from its exhaustive recitation of auditing standards and purported red flags, the Complaint does little more than allege that, had DTTC performed a better audit, Longtop's fraud would have been uncovered sooner. Considering the allegations in the Complaint as a whole, the strongest inference is that DTTC was duped by Longtop, not that it recklessly enabled them. Accordingly, the Complaint fails to adequately plead scienter.[128]

127 *See Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) **[*37]** (giving the name "fraud by hindsight" to complaint where "plaintiff [] simply seized upon disclosures made in later annual reports and alleged that they should have been made in earlier ones").

128 Lead Plaintiffs' argument that DTTC's failure to comply with the SEC's subpoena provides proof of scienter is also baseless. *See* Compl. ¶¶ 12, 64. It appears that DTTC's delay was caused by conflicting demands from Chinese regulators, and that the SEC has moved for

(and received) a stay pending the resolution of these issues. *See* "SEC Docket", Ex. F to Bendinger Decl., at 6; DTTC Subpoena Mem., Ex. G to Bendinger Decl., at 21-22; SEC Stay Mot., Ex. H to Bendinger Decl., at 3.

B. Material Misrepresentations

DTTC contends that an auditor's statement of GAAS compliance is a statement of opinion and therefore not a material misstatement unless subjectively false at the time it was made.[129] Lead Plaintiffs counter that if the Complaint adequately alleged a violation of GAAP by Longtop, it must follow that DTTC made a material misrepresentation.[130]

129 *See* Defendant Deloitte Touche Tohmatsu CPA Ltd.'s Memorandum in Support of Its Motion to Dismiss the Consolidated Class Action Complaint at 22.

130 *See* **[*38]** Opp. Mem. at 12 (citing *In Re Longtop*, 2012 U.S. Dist. LEXIS 91004, 2012 WL 2512280, at *10).

These contentions raise the issue of the boundary between fact and opinion. In broad outline, this issue is not unfamiliar to the law.[131] In the last case in this Circuit to examine this precise issue in detail, the court in *In re Lehman Bros. Securities and Erisa Litigation* held that auditor reports of GAAS compliance are "inherently . . . one[s] of opinion."[132] Consequently, the *Lehman* court held, "[plaintiff must] allege facts that, if true, would permit a conclusion that [the auditor] either did not in fact hold that opinion or knew that it had no reasonable basis for it."[133] I also adopt this sensible approach. Under this standard, to allege that an auditor opinion is a misrepresentation, a complaint must show that the statement in question is grounded on a specific factual premise that is false, and that the speaker did not "genuinely or reasonably believe" it.[134]

131 *See, e.g. Gertz v. Robert Welch, Inc*., 418 U.S. 323, 339-40, 94 S. Ct. 2997, 41 L. Ed. 2d 789 (1974) (discussing the fact-opinion distinction in the libel context); *Vulcan Metals Co. v. Simmons Mfg. Co*., 248 F. 853, 856 (2d Cir. 1918) (stating in the context of a dispute over allegedly **[*39]** fraudulent sales representations that "[a]n opinion is a fact, and it may be a very relevant fact; the expression of an opinion is the assertion of a belief, and any rule which condones the expression of a consciously false opinion condones a consciously false statement of fact.").

132 799 F. Supp. 2d 258, 302 (S.D.N.Y. 2011).

133 *Id*. The Lehman court's approach is supported by *Virginia Bankshares, Inc. v. Sandberg*, in which the Supreme Court held that a director's fairness opinion in connection with a freeze out merger must be both objectively and subjectively false in order to qualify as a material misstatement under section 14(a) of the Exchange Act. *See* 501 U.S. 1083, 1093-98, 111 S. Ct. 2749, 115 L. Ed. 2d 929 (1991). *See also Bond Opportunity v. Unilab*, No. 99 Civ. 11074, 2003 U.S. Dist. LEXIS 7838, 2003 WL 21058251, at *5 (S.D.N.Y. May 9, 2003) (applying *Virginia Bankshares). Cf. Abu Dhabi Commercial Bank v. Morgan Stanley & Co. Inc*., No. 08 Civ. 7508, 2012 U.S. Dist. LEXIS 119671, 2012 WL 3584278, at *11 (S.D.N.Y. 2012) (holding that a jury could find that Triple-A rating of securities constituted a material misstatement, despite the fact that such ratings are opinions, because there was ample evidence of subjective falsehood.)

134 *In re International Business Machines Corporate Secs. Litig*., 163 F.3d 102, 107 (2d Cir. 1998). **[*40]** Analogously, a statement that is explicitly labeled an opinion may be actionable in defamation if it implies a false or unreasonable statement of fact. *See Milkovich v. Lorain Journal Co*., 497 U.S. 1, 18-19, 110 S. Ct. 2695, 111 L. Ed. 2d 1 (1990) ("If a speaker says, 'In my opinion John Jones is a liar,' he implies a knowledge of facts which lead to the conclusion that Jones told an untruth. Even if the speaker states the facts upon which he bases his opinion, if those facts are either incorrect or incomplete, or if his assessment of them is erroneous, the statement may still imply a false assertion of fact.").

Naturally, the weight of the showing needed to plausibly allege a material misstatement varies with the underlying auditing defect. In some cases, the problems with the audit will be so egregious that issuing an unqualified opinion will qualify as a false statement without additional allegations of subjective falsehood. In other cases, the underlying alleged auditing standard violations will be inherently subjective, requiring strong circumstantial evidence of subjective falsehood in order to survive a motion to dismiss.[135]

135 *See Fait v. Regions Fin. Corp*., 655 F.3d 105, 110 (2d Cir. 2011) (stating that a statement **[*41]** concerning the impairment of goodwill is inherently subjective, because it depends on a series of assumptions about the "fair value" of an asset). *See also City of Omaha, Neb. Civilian Employees' Retirement Sys. v. CBS Corp*., 679 F.3d 64, 68-69 (2d Cir. 2012) (affirming dismissal under *Fait* when securities fraud complaint lacked allegations that company did not believe its goodwill estimate at the time it was made). Presently there is no need to decide whether, in the 10(b) context, a statement of opinion could be "materially false" because it does not express the speaker's true opinion. *Cf. Virginia Bankshares, Inc*., 501 U.S. at 1096 (quoting *Stedman v. Storer*, 308 F. Supp. 881, 887 (S.D.N.Y. 1969)) ("to recognize liability on mere disbelief or undisclosed motive without any demonstration that the proxy statement was false or misleading about its subject would authorize § 14(a)

litigation confined solely to what one skeptical court spoke of as the "impurities" of a director's "unclean heart.").

Here, the alleged material misstatements are that DTTC stated that its audits had been performed in accordance with PCAOB standards and that Longtop's financials were fairly presented.[136] The **[*42]** allegation that these opinions were misstatements fails for the same reason as the allegation that DTTC acted with scienter. At base, Lead Plaintiffs' argument is that DTTC's audit reports contained material misstatements because they erroneously certified that Longtop's financials were prepared in accordance with GAAP.[137] No facts alleged show that DTTC was aware, or should have been aware, of wrongdoing on Longtop's part at the time DTTC issued the audit reports. Instead, the allegations in the Complaint lead to the compelling and stronger inference that DTTC performed a diligent audit, only to be duped by Longtop's fraud.[138] Accordingly, Lead Plaintiffs have failed to plead a material misstatement.

136 *See* Compl. ¶¶ 181-182.

137 *See* Opp. Mem. at 9-13.

138 *See* Compl. ¶ 58. In their opposition brief, Lead Plaintiffs argue that the Resignation Letter indicates that DTTC did not "independently verify Longtop's bank balances and borrowing until May 2011 . . . ." Opp. Mem. at 16. This contention is contradicted by the text of the Resignation Letter, which refers to "confirmations" of replies "previously received," "follow up visits," etc. Compl. ¶ 58.

C. Leave to Amend

Lead Plaintiffs seek leave **[*43]** to amend the Complaint. Although a court "should freely give leave" to amend "when justice so requires,"[139] there is cause for suspicion that amendment here would be futile. Namely, Lead Plaintiffs have fallen far short of showing that DTTC made a material misrepresentation with scienter, instead relying on general recitations of accounting standards, post-hoc reasoning, and conclusory allegations. Nonetheless, I grant Lead Plaintiffs leave to amend, but only if they can correct the deficiencies noted in this Opinion in compliance with their obligations under Rule 11. Any repleading must be made within thirty days of the date of this Order.

139 Fed. R. Civ. P. 15(a)(2).

V. CONCLUSION

For the foregoing reasons, defendant Deloitte Touche Tohmatsu CPA Ltd.'s motion to dismiss is granted. It is hereby Ordered that defendant Deloitte Touche Tohmatsu CPA Ltd. is to be dismissed from this action. It is further Ordered that Lead Plaintiffs are granted leave to replead within thirty days of the date of this Order. The Clerk of Court is directed to close this motion (Docket No. 101).

SO ORDERED:

/s/ Shira A. Scheindlin

Shira A. Scheindlin

U.S.D.J.

Dated: New York, New York

November 14, 2012

H

United States District Court,
S.D. New York.
In re PFIZER INC. SECURITIES LITIGATION.

No. 04 Civ. 9866(LTS)(DCF).
July 1, 2008.

Background: Investors filed securities fraud class actions against pharmaceutical manufacturer and corporate officers, claiming violation of §§ 10(b), 18, 20(a), and 20A of Exchange Act, Rule 10b–5, and state laws by misrepresenting and concealing adverse results of three medical studies concerning cardiovascular risks of drugs, Celebrex and Bextra, and by misstatements and omissions in public filings and statements. Following consolidation of class actions, defendants moved to dismiss.

Holdings: The District Court, Laura Taylor Swain, J., held that
(1) investors sufficiently alleged that studies revealed drugs were linked to cardiovascular risks to statistically significant degree;
(2) manufacturer's disclosure of studies to Food and Drug Administration (FDA) did not provide safe harbor under § 10(b) and Rule 10b–5;
(3) investors' § 10(b) and Rule 10b–5 claims were sufficiently alleged under group pleading doctrine;
(4) investors sufficiently alleged scienter of corporate officers regarding cardiovascular risks;
(5) market manipulation claims were not sufficiently alleged;
(6) control person liability claims were sufficiently alleged;
(7) Securities Exchange Act claims for submittal of misleading statements in filed reports were time barred; and
(8) insider trading claims were sufficiently alleged.

Motion granted in part and denied in part.

West Headnotes

[1] Federal Civil Procedure 170A 1829

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1827 Determination
170Ak1829 k. Construction of Pleadings. Most Cited Cases

Federal Civil Procedure 170A 1835

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1827 Determination
170Ak1835 k. Matters Deemed Admitted; Acceptance as True of Allegations in Complaint. Most Cited Cases

In deciding a motion to dismiss a complaint for failure to state a claim, the district court must accept as true all factual statements alleged in the complaint and draw all reasonable inferences in favor of the non-moving party. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[2] Federal Civil Procedure 170A 1771

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)3 Pleading, Defects In, in General
170Ak1771 k. In General. Most Cited Cases

On motion to dismiss for failure to state a claim, the issue is whether the plaintiff is entitled to offer evidence to support the claims. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[3] Federal Civil Procedure 170A 1772

170A Federal Civil Procedure
170AXI Dismissal

170AXI(B) Involuntary Dismissal
170AXI(B)3 Pleading, Defects In, in General
170Ak1772 k. Insufficiency in General. Most Cited Cases

To survive a motion to dismiss for failure to state a claim, factual allegations must be enough to raise a right of relief above the speculative level. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[4] Federal Civil Procedure 170A 1832

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1827 Determination
170Ak1832 k. Matters Considered in General. Most Cited Cases

In deciding a motion to dismiss for failure to state a claim, a district court may consider documents which are integral to the complaint or are incorporated by reference in the pleadings. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[5] Securities Regulation 349B 60.53

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.53 k. Misrepresentation. Most Cited Cases

"Particularity," as required to plead securities fraud claim, requires the plaintiff to (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[6] Securities Regulation 349B 60.51(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(1) k. In General. Most Cited Cases

Where plaintiffs' securities claims sound in fraud, plaintiff must satisfy the PSLRA pleading requirements in addition to the requirements of federal civil procedure rule. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[7] Securities Regulation 349B 60.18

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.18 k. In General. Most Cited Cases

To state a claim under § 10(b) and Rule 10b–5 promulgated thereunder, a plaintiff must allege that the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff' reliance on defendant's action caused injury to the plaintiff. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[8] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets

349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

To survive a motion to dismiss for failure to state a securities fraud claim, a plaintiff's scienter allegations must give rise to a strong inference of fraudulent intent. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[9] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

A plaintiff can establish fraudulent intent regarding securities either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[10] Federal Civil Procedure 170A 1831

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1827 Determination
170Ak1831 k. Fact Issues. Most Cited Cases

A motion to dismiss a complaint for failure to state a claim is not an appropriate vehicle for determination as to the weight of the evidence, expert or otherwise. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[11] Evidence 157 14

157 Evidence
157I Judicial Notice
157k14 k. Facts Relating to Human Life, Health, Habits, and Acts. Most Cited Cases

On motion to dismiss for failure to state claim, district court would decline to judicially notice that three medical studies showed lack of any statistically significant link between pharmaceutical manufacturer's drugs and adverse cardiovascular events, since that supposed fact was neither generally known nor capable of accurate and ready determination by reference to unquestionably accurate sources, and court could not determine as matter of law whether such links were statistically insignificant because statistical significance was question of fact. Fed.Rules Evid.Rule 201, 28 U.S.C.A.; Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[12] Securities Regulation 349B 60.54

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.54 k. Nondisclosure. Most Cited Cases

Investors' complaint in securities fraud class action sufficiently alleged that three medical studies revealed that manufacturer's drugs, Celebrex and Bextra, were linked to cardiovascular risks to statistically significant degree but that manufacturer and officials concealed adverse data, resulting in dramatic stock price drop after information became known to market, as required for § 10(b) and Rule 10b–5 claims, under PSLRA requirements, including allegations that authors of one study themselves concluded that statistically significant difference favoring placebo in adverse events was observed, that

results of another study showed certain increases in cardiovascular events in population taking Celebrex as opposed to placebo, and that in another study Food and Drug Administration (FDA) medical officer noted excess of serious cardiovascular blood clots, that both drugs accounted for almost 9% of manufacturer's revenue, and that share value fell precipitously after safety risks began to emerge. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[13] Securities Regulation 349B ⚿60.28(11)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.28 Nondisclosure; Insider Trading
349Bk60.28(10) Matters to Be Disclosed
349Bk60.28(11) k. Materiality. Most Cited Cases

For securities fraud claims, an alleged omission is “material” if there is a substantial likelihood that the disclosure of the omitted fact would be viewed by the reasonable investor as having significantly altered the total mix of information made available, including information already in the public domain and facts known or reasonably available to the shareholders. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5 .

[14] Securities Regulation 349B ⚿60.28(13)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.28 Nondisclosure; Insider Trading
349Bk60.28(10) Matters to Be Disclosed
349Bk60.28(13) k. Particular Matters. Most Cited Cases

Drug manufacturer's disclosure of three medical studies to Food and Drug Administration (FDA) was not sufficient, by itself, to provide manufacturer safe harbor from investors' class action claims, under § 10(b) and Rule 10b–5, that manufacturer and officials misrepresented and concealed studies' results linking drugs Celebrex and Bextra to adverse cardiovascular events to statistically significant degree, resulting in dramatic stock price drop after information became known to market. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[15] Securities Regulation 349B ⚿60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

Securities Regulation 349B ⚿60.41

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.41 k. Aiders and Abettors. Most Cited Cases

Generally, a defendant must actually make a false or misleading statement in order to be held liable under § 10(b); anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b). Securities Ex-

change Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[16] Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

Under the group pleading doctrine, permitting § 10(b) securities fraud plaintiffs to rely on a presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company, a plaintiff may circumvent the general pleading rule that fraudulent statements must be linked directly to the party accused of the fraudulent intent. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[17] Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

The group-pleading doctrine is extremely limited in scope, under § 10(b) actions, and one such limitation is that it applies only to group-published documents, such as SEC filings and press releases. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[18] Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

The group-pleading doctrine does not permit § 10(b) securities fraud plaintiffs to presume the state of mind of the defendants at the time the alleged misstatements were made. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

[19] Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

PSLRA does not abrogate group pleading doctrine, permitting § 10(b) securities fraud plaintiffs to rely on a presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[20] Securities Regulation 349B 60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

Investors' complaint in securities fraud class action sufficiently alleged, under group pleading doctrine, that pharmaceutical manufacturer's corporate officials misrepresented and concealed that medical studies revealed drugs, Celebrex and Bextra, were linked to cardiovascular risks to statistically significant degree, resulting in dramatic stock

price drop after information became known to market, as required for § 10(b) and Rule 10b–5 claims, under PSLRA requirements, including allegations that corporate officials made strategic decisions for manufacturer, were directly involved with day-to-day operations, and participated in drafting, reviewing, approving, ratifying, and/or disseminating financial statements and press releases containing misrepresentations or omissions of cardiovascular risks. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[21] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

Plaintiffs have adequately pled scienter, as required for securities fraud claim, if their allegations give rise to a strong inference of fraudulent intent. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

[22] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

"Scienter" requirement, under PSLRA, for securities fraud claim can be established either (1) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (2) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[23] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

In determining whether the pleaded facts give rise to a strong inference of scienter, as required under PSLRA for securities fraud claim, the district court must take into account plausible opposing inferences, because for an inference of scienter to be strong, a reasonable person must deem it cogent and at least as compelling as any opposing inference one could draw. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[24] Securities Regulation 349B 60.51(2)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(2) k. Scienter. Most Cited Cases

Investors' class action complaint sufficiently alleged facts giving rise to strong inference of fraudulent intent, as required for pleading scienter under PSLRA, for securities fraud claims against pharma-

ceutical manufacturer and corporate officers, in violation of § 10(b) and Rule 10b–5, by misrepresenting and concealing adverse results of medical studies for Celebrex and Bextra, resulting in stock price drop when information became known, including allegations that corporate officers were acutely aware of studies containing statistically significant links between drugs and cardiovascular illness, that officers knew facts or had access to information suggesting that their public statements were not accurate, that top management was "right on top of" clinical studies, that decisions about what drugs to bring to market and when to launch drugs ultimately came "from the top," that negative information from clinical trial findings were reported to top managers with specificity, that cardiovascular safety profile of Celebrex was big issue with top management, that medical information group knew science of drug "inside and out" and had to approve everything, and that head of drug brand teams was responsible for disseminating critical information about drugs throughout company. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[25] Securities Regulation 349B 60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

A plaintiff alleging market manipulation, in violation of Rule 10b–5, must specify what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed, and what effect the scheme had on the securities at issue. 17 C.F.R. § 240.10b–5(a, c).

[26] Securities Regulation 349B 60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

"Manipulation" is virtually a term of art when used in connection with securities markets, and refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity in violation of Rule 10b–5. 17 C.F.R. § 240.10b–5(a, c).

[27] Securities Regulation 349B 60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

Drug manufacturer's alleged misrepresentations and omissions regarding adverse cardiovascular risks of drugs Celebrex and Bextra, resulting in dramatic stock price drop after information became known to market, were not sufficient for investors' market manipulation claims, under Rule 10b–5, since investors alleged no deceptive course of conduct going beyond misrepresentations or omissions. 17 C.F.R. § 240.10b–5(a, c).

[28] Securities Regulation 349B 35.15

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.15 k. Controlling Persons. Most Cited Cases

In order to establish a prima facie case of control person liability, under Securities Exchange Act,

a plaintiff must show: (1) a primary violation by a controlled person, (2) control of the primary violator by the defendant, and (3) that the controlling person was in some meaningful sense a culpable participant in the primary violation. Securities Exchange Act of 1934, § 20(a), 15 U.S.C.A. § 78t(a).

[29] Securities Regulation 349B ⚿35.15

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.15 k. Controlling Persons. Most Cited Cases

Determination of control person liability, under Securities Exchange Act, requires an individualized determination of a defendant's control of the primary violator as well as a defendant's particular culpability. Securities Exchange Act of 1934, § 20(a), 15 U.S.C.A. § 78t(a).

[30] Securities Regulation 349B ⚿60.40

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.39 Persons Liable
349Bk60.40 k. In General; Control Persons. Most Cited Cases

Investors' allegations in class action securities fraud complaint that corporate officers of drug manufacturer misrepresented and concealed adverse cardiovascular risks of drugs Celebrex and Bextra, resulting in dramatic stock price drop after information became known to market, were sufficient to assert control person liability claims, in violation of Rule 10b–5, including allegations that officers participated directly in day-to-day management of company and made strategic decisions. Securities Exchange Act of 1934, § 20(a), 15 U.S.C.A. § 78t(a).

[31] Securities Regulation 349B ⚿134

349B Securities Regulation
349BI Federal Regulation
349BI(E) Remedies
349BI(E)1 In General
349Bk134 k. Time to Sue and Limitations. Most Cited Cases

One-year limitations period, under Securities Exchange Act, applied to investors' claims that drug manufacturer's officials made materially misleading statements in reports filed pursuant to Act, regarding cardiovascular risks of drugs Celebrex and Bextra, rather than two-year limitations period contained in Sarbanes-Oxley Act. Securities Exchange Act of 1934, § 18(a, c), 15 U.S.C.A. § 78r(a, c).; 28 U.S.C.A. § 1658(b).

[32] Securities Regulation 349B ⚿60.51(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 In General
349Bk60.51(1) k. In General. Most Cited Cases

Investors' allegations in class action securities fraud complaint that corporate officers of drug manufacturer traded manufacturer's stocks within five and six days of trading by investors were sufficient, under PSLRA requirements, for claim of insider trading in violation of Securities Exchange Act, requiring contemporaneous trading of corporation's stock by investors and corporation's officers. Securities Exchange Act of 1934, § 20A, 15 U.S.C.A. § 78t–1; Private Securities Litigation Reform Act of 1995, § 101(b), 15 U.S.C.A. § 78u–4(b)(2).

[33] Fraud 184 ⚿3

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k2 Elements of Actual Fraud
184k3 k. In General. Most Cited Cases

The elements of common law fraud under New York law are essentially the same as those required to state a claim under Section 10(b) and Rule 10b–5. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

[34] Fraud 184 ⚿20

184 Fraud
184I Deception Constituting Fraud, and Liability Therefor
184k19 Reliance on Representations and Inducement to Act
184k20 k. In General. Most Cited Cases

Investors' general allegations of direct reliance on alleged misrepresentations and concealment by drug manufacturer and corporate officers regarding cardiovascular risks of drugs Celebrex and Bextra, resulting in dramatic stock price drop after information became known to market, were not sufficient for investors' class action common law fraud claims, under New York law, since fraud-on-the-market theory was not available.

[35] Federal Civil Procedure 170A ⚿636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Investors' allegations in class action complaint that drug manufacturer and corporate officers misrepresented and concealed cardiovascular risks of drugs Celebrex and Bextra in violation of "those state securities laws that have a private right of action of each of the states in which the members of the subclass are located," were not pled with sufficient particularity, as required by civil procedure rule, since complaint failed to identify specific state securities laws allegedly violated. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

***627** Grant & Eisenhofer P.A. by Jay W. Eisenhofer, Esq., Geoffrey C. Jarvis, Esq., James R. Banko, Esq., New York, NY, by Stephen G. Grygiel, Esq., Brian M. Rostocki, Esq., Wilmington, DE, for Lead Plaintiff.

Cadwalader, Wickersham & Taft LLP by Gregory A. Markel, Esq., Ronit Setton, Esq., New York, NY, for Defendants.

OPINION AND ORDER[FN1]

FN1. ***The ECF system provides notice of the entry of this Order to each party that has both entered an appearance in this case and registered with ECF. The ECF-registered attorneys are responsible for providing notice to any co-counsel whose e-mail addresses are not reflected on the ECF docket for this case, and Lead Plaintiffs counsel, upon receiving notice of this Order, is hereby ordered to fax or otherwise deliver promptly a copy to all parties who are not represented by ECF-registered counsel. A certificate of such further service shall be filed within 5 days from the date hereof Counsel who have not registered for ECF are ordered to register immediately as filing users in accordance with the Procedures for Electronic Case Filing.***

LAURA TAYLOR SWAIN, District Judge.

Lead Plaintiff Teachers' Retirement System of Louisiana ("TRSL") brings this action on behalf of a putative class of investors ("Plaintiffs") who purchased or acquired Pfizer Inc. ("Pfizer") stock between October 31, 2000 and October 19, 2005 (the "Class Period") against Pfizer and corporate officers Henry McKinnell, John LaMattina, Karen Katen, Joseph Feczko, and Gail Cawkwell (together, the "Individual Defendants") (together with Pfizer, "Defendants"). Plaintiffs allege that Defendants violated federal and state laws by concealing the results of three medical studies concerning two Pfizer drugs, Celebrex and Bextra, and by

making misstatements and omissions in their public filings and statements.

Defendants have moved to dismiss the complaint. Plaintiffs have moved to strike certain exhibits attached to and portions of Defendants' memorandum of law in support of their motion to dismiss. The Court has reviewed thoroughly all of the parties' submissions and arguments in connection with these motions. For the reasons that follow, Defendants' motion to dismiss is granted in part and denied in part. In light of the resolution of the motion to dismiss, Plaintiffs' motion to strike is moot.

BACKGROUND

For the purposes of this motion, the Court takes the following facts drawn from the Consolidated Class Action Complaint ("CCAC") as true.

I. Defendants

Pfizer is a research-based, global pharmaceutical company that develops, manufactures, and markets prescription medicines***628** for humans and animals, as well as consumer healthcare products. (CCAC ¶ 17.) As of November 4, 2005, Pfizer had approximately 7.37 billion shares outstanding trading on the New York Stock Exchange. (*Id.*) Pfizer is the successor-in-interest of Pharmacia, having acquired Pharmacia—and Pharmacia's interest in Celebrex and Bextra—on or about April 16, 2003, in a transaction valued at $60 billion. (*Id.*)

The Individual Defendants were executive officers of Pfizer during the relevant period. Since 2001, Henry McKinnell has been Pfizer's Chief Executive Officer and Chairman of the Board of Directors. (*Id.* ¶ 18.) John LaMattina has been Senior Vice President and President of Pfizer Global Research and Development since 2003. (*Id.* ¶ 23.) Karen Katen was Executive Vice President and President of Pfizer Pharmaceuticals from April 2001 to March 2005. Thereafter, she became Vice Chairman and President of Pfizer Human Health. (*Id.* ¶ 27.) During the Class Period, Joseph M. Feczko was the President of Worldwide Development, and Gail Cawkwell was Pfizer's medical team leader for Celebrex. (*Id.* ¶¶ 31, 33.)

During the Class Period, McKinnell, LaMattina, and Katen all made strategic decisions for the company. (*Id.* ¶¶ 19, 24, 28.) Furthermore, all of the Individual Defendants made numerous public statements concerning Celebrex and Bextra during the Class Period. (*Id.* ¶¶ 21, 25, 29, 32, 34.) By virtue of their high-level positions and direct involvement in the day-to-day activities of the company, the Individual Defendants were privy to confidential non-public information concerning the operations of Pfizer. (*Id.* ¶ 36.) In addition, the Individual Defendants were involved in drafting, reviewing, approving, ratifying, and/or disseminating the financial statements disclosed by Pfizer. (*Id.*)

II. Development of Celebrex and Bextra

Celebrex and Bextra, like the well-known drug Vioxx, are non-steroidal anti-inflammatory drugs ("NSAIDs") belonging to a class of drugs known as Cyclooxygenase 2 ("COX–2") inhibitors. (*Id.* ¶ 48.) Celebrex (celecoxib) and Bextra (valdecoxib) were developed to treat chronic pain. (*Id.* ¶¶ 1, 43.) Traditional NSAIDs, such as aspirin, ibuprofen, and naproxen, inhibit both the COX–1 and COX–2 enzymes, and tend to cause harmful gastrointestinal side effects. (*Id.* ¶¶ 42–43.) The COX–1 enzyme promotes the production of the stomach's natural protective mucus lining. (*Id.* ¶ 43.) The COX–2 enzyme is responsible for promoting inflammation. (*Id.*) The possibility of suppressing only the COX–2 enzyme—responsible for inflammation and pain—without inhibiting the COX–1 enzyme meant that COX–2 inhibitors had the potential to harness the beneficial attributes of NSAIDs without the harmful gastrointestinal side effects. (*Id.* ¶ 44.)

Celebrex was the first COX–2 inhibitor to obtain FDA approval, which it received in December 1998. (*Id.* ¶ 48.) The FDA first approved Celebrex for use by prescription for treating pain and inflammation caused by osteoarthritis and adult rheumatoid arthritis. (*Id.* ¶ 50.) Later, Celebrex was approved for the treatment of acute adult pain or pain after surgery, as well as for the treatment of

primary dysmenorrhea—painful menstrual cramps. (*Id.*) The FDA approved Bextra in November 2001 for use by prescription for treating osteoarthritis, rheumatoid arthritis, and primary dysmenorrhea, but not for acute pain. (*Id.* ¶ 61.)

Plaintiffs allege that Pfizer's financial success and future prospects depended on Celebrex and Bextra becoming "blockbuster" drugs because of looming patent expiration dates for several of its best-selling drugs. (*Id.* ¶¶ 66.) Pfizer's patents on ***629** Ambien (2006), Zithromax (2005), and Zoloft (2006) were set to expire within five years after Celebrex and Bextra's expected market arrival. (*Id.*) Indeed, initially Celebrex and Bextra were extremely successful. (*Id.* ¶ 69.) By 2004, for example, Celebrex and Bextra accounted for almost nine percent of Pfizer's revenue, totaling over $4.5 billion. (*Id.* ¶ 71.)

Defendants made numerous representations about the safety of Celebrex and Bextra, including that they were safer than Merck & Co. Inc.'s ("Merck") competing drug, Vioxx. (*Id.* ¶ 72.) For example, in an October 18, 2002 press release, Pfizer touted Bextra as an effective and safe form of pain reliever: "Analyses of pooled study results for the COX–2 specific inhibitor BEXTRA ... underscored its improved upper gastrointestinal (GI) safety as well as its cardiovascular safety profile." (*Id.* ¶¶ 88, 187.) On November 13, 2002, Pfizer stated in its 10–Q that "the FDA approved revised labeling for Celebrex. The new prescribing information includes additional gastrointestinal safety data and data indicating that there was no increased risk for serious cardiovascular adverse events observed, including heart attack, stroke and unstable angina." (*Id.* ¶ 188.) On July 25, 2003, on a quarterly conference call, Katten stated that "[a]n independent analysis that included our entire Celebrex arthritis clinical trial database, found no evidence in increased cardiovascular risk for Celebrex, relative to both conventional, non-steroidal anti-inflammatory drugs and placebo." (*Id.* ¶ 194.) The CCAC alleges that Pfizer and its representatives made numerous similar statements throughout the class period. (*Id.* ¶¶ 170–231.)

III. The Studies

Plaintiffs allege that senior officials at Pfizer, including the Individual Defendants, knew from a very early date that Celebrex and Bextra had adverse cardiovascular effects. (*Id.* ¶¶ 74–82, 248–67.) Specifically, Plaintiffs contend that Defendants were aware of three studies which revealed these adverse effects.

The first, the Alzheimer's Study, completed in 1999, revealed that patients taking Celebrex were more likely to experience negative cardiovascular effects such as stroke or cardiac failure than patients taking a placebo. (*Id.* ¶ 93.) The Alzheimer's Study included 425 patients and, as the name suggests, focused on the effect of Celebrex on patients with Alzheimer's Disease. (*Id.* ¶ 94.) In the study, 285 patients were given Celebrex and 140 were given a placebo. Twenty-two of the patients taking Celebrex and three of the patients taking the placebo suffered adverse cardiovascular effects. (*Id.*) Adverse cardiovascular events were observed in patients taking Celebrex at a rate 3.6 times greater than observed in patients taking the placebo. (*Id.* ¶ 93.) The study's authors concluded that "[a] statistically significant difference favoring placebo in adverse events was observed." (*Id.* ¶ 94.) The study was never published (*id.* ¶ 95), and the results only became public in early January 2005, when Pfizer surreptitiously posted the results on the pharmaceutical industry's main trade group's website. (*Id.* ¶ 97.)

In the second study, the Celecoxib Long–Term Arthritis Safety Study (the "CLASS Study"), Pfizer sought to demonstrate Celebrex's superior gastrointestinal safety profile. (*Id.* ¶ 98.) When the study was completed in March 2000, Pfizer sent the Food and Drug Administration ("FDA") the portion of the study showing the gastrointestinal results. (*Id.* ¶ 99.) Pfizer did not send the FDA another portion of the study, which showed increased risk of cardiovascular problems. (*Id.*) The results of the

CLASS Study were published on September 13, 2000, in ***630** an article in the Journal of the American Medical Association ("JAMA"). (*Id.* ¶ 101.) However, the published study and the accompanying JAMA article omitted key information about the study, namely that it covered a twelve-month period, not a six-month period, and revealed that Celebrex posed serious cardiovascular risks. (*Id.* ¶ 102.) Indeed, the full twelve-month data set revealed that the rate of adverse cardiovascular events in the population taking Celebrex was 1.4%, as opposed to rate of 1.0% for the other NSAID groups. (*Id.* ¶ 93.) Furthermore, the results showed an elevated rate of heart attacks. In the Celebrex sample pool, the heart attack rate was 1.6% whereas in the pool taking low-dose aspirin, the rate was 1.2%. (*Id.* ¶ 105.)

In the third study, the Coronary Artery Bypass Graft Trial of Bextra ("CABG Trial"), Pfizer studied 311 patients on Bextra and 151 on a placebo. (*Id.* ¶ 108.) In the course of Bextra's FDA approval, an FDA medical officer commented that "[t]he excess of serious cardiovascular thromboembolic [blood clots] in the valdecoxib arm of the CABG trial ... is of note as the entire study population received prophylactic low dose aspirin as part of the standard of care in this setting to minimize just such events." (*Id.* ¶ 111.) Pfizer redacted this statement from the publicly-available Bextra Approval package. (*Id.* ¶ 112.) In December 2004, Pfizer quietly released all of the results of the CABG Trial. (*Id.* ¶ 118.) These previously concealed results warned of negative cardiovascular side effects associated with Bextra. (*Id.*)

Plaintiffs allege that Defendants deliberately concealed or misrepresented the results of these studies. According to one member of a safety monitoring board for Celebrex, the Alzheimer's Study "should have been fully published in 2000, and perhaps if it had been some attention might have been drawn to potential safety issues." (*Id.* ¶ 87.) On November 13, 2001, Defendants issued a press release stating that the CLASS Study revealed that "Celebrex (celecoxib capsules) is not associated with an increased risk of cardiovascular (CV) adverse events compared to the NSAIDs studied." (*Id.* ¶ 177.) On September 30, 2004, Pfizer asserted in a press release that " Bextra's cardiovascular safety profile is ... well established in long-term studies." (*Id.* ¶ 206.) In addition, Plaintiffs allege that Defendants made numerous misstatements and omissions in Pfizer's public filings and statements, thereby misleading investors about the commercial potential of Celebrex and Bextra. *See, e.g., id.* ¶ 181 (stating in a press release announcing Pfizer's fourth quarter and full-year financial results for 2001 that "Celebrex provides strong efficacy, outstanding tolerability, and a superior safety profile to Vioxx. These advantages have translated into a higher refill rate, higher patient satisfaction level, and higher persistence of use for Celebrex"); *id.* ¶ 207 ("Data demonstrate[s] that Celebrex does not increase the risk of heart attack or stroke in patients with arthritis and pain, even at higher-than-recommended doses."); *see also id.* ¶¶ 170–231.

IV. Revelations About Celebrex and Bextra

On September 30, 2004, Merck withdrew Vioxx from the market. (*Id.* ¶ 120.) That day, Pfizer issued a statement that "[t]he evidence distinguishing the cardiovascular safety of Celebrex has accumulated over the years in multiple completed studies, none of which has shown any increased cardiovascular risk for Celebrex." (*Id.* ¶ 121.) Defendant Cawkwell further stated that "[t]he cardiovascular data for Celebrex and Bextra in the long-term arthritis studies has been good." (*Id.*)

***631** Nevertheless, in late 2004 and early 2005, information about Celebrex and Bextra's negative cardiovascular effects began to emerge. (*Id.* ¶¶ 127–136.) On April 7, 2005, the FDA insisted Pfizer insert a "black box" warning in Celebrex's label. (*Id.* ¶ 141.) A black box warning is the most negative warning the FDA uses, and is the last step before a drug is pulled from the market. (*Id.* ¶ 140.) On the same day, April 7, 2005, Pfizer announced

that the FDA had directed it to remove Bextra from the market. (*Id.* ¶ 146.) Currently, Celebrex is sold with a black box warning label. (*Id.* ¶ 7.) Bextra remains off the market. (*Id.*) During the Class Period, Pfizer stock rose to a high of $47.44 per share before falling to $21.09. (*Id.* ¶ 150.)

V. Claims Asserted

Plaintiffs assert the following causes of action: Defendants violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b–5 promulgated thereunder by making materially false statements or omissions about the commercial viability of Celebrex and Bextra (Count I); Defendants violated Section 10(b) and Rule 10b–5(a) and (c) specifically by creating a scheme to defraud Plaintiffs (Count II); and Individual Defendants McKinnell, LaMattina, and Katen violated Sections 20(a), 18, and 20A of the Exchange Act (Counts III, VI, and VII, respectively). Finally, Lead Plaintiff TRSL and a subclass assert claims of common law fraud and violations of state securities law against all Defendants (Counts IV and V, respectively).

DISCUSSION

I. Rule 12(b)(6) and 9(b) Standards

[1][2][3] In deciding a motion to dismiss a complaint for failure to state a claim pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, the Court must "accept as true all factual statements alleged in the complaint and draw all reasonable inferences in favor of the non-moving party." *McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 191 (2d Cir.2007) (citation omitted). The issue is whether the plaintiff is entitled to offer evidence to support the claims. *Hudson Valley Black Press v. Internal Revenue Service*, 307 F.Supp.2d 543, 545 (S.D.N.Y.2004). Nonetheless, "factual allegations must be enough to raise a right of relief above the speculative level." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S.Ct. 1955, 1965, 167 L.Ed.2d 929 (2007) (requiring plaintiff to plead "enough fact [s] to raise a reasonable expectation that discovery will reveal evidence of [his claim]"); *see also ATSI Communs., Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 98 (2d Cir.2007) ("We have declined to read *Twombly* 's flexible 'plausibility standard' as relating only to antitrust cases.").

[4] In deciding a motion to dismiss, a court may consider documents which are integral to the complaint or are incorporated by reference in the pleadings. *Rizzo v. The MacManus Group, Inc.*, 158 F.Supp.2d 297, 301 (S.D.N.Y.2001) (a court may consider "documents that are incorporated by reference in the pleadings" when deciding a motion to dismiss under Rule 12(b)(6)); *Sable v. Southmark/Envicon Capital Corp.*, 819 F.Supp. 324, 328 (S.D.N.Y.1993) (quoting *I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co.*, 936 F.2d 759, 762 (2d Cir.1991) (in deciding a motion to dismiss, a court "may consider documents which form the basis of allegations of fraud if the documents are 'integral to the complaint' ")). A court may also take judicial notice of facts "not subject to reasonable dispute" either because they are "(1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." ***632**Fed.R.Evid. 201(b) ; *Kramer v. Time Warner, Inc.*, 937 F.2d 767, 773 (2d Cir.1991).

[5][6] Rule 9(b) of the Federal Rules of Civil Procedure governs pleading in fraud actions generally, providing that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake." Fed.R.Civ.P. 9(b). Particularity requires the plaintiff to "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Stevelman v. Alias Research, Inc.*, 174 F.3d 79, 84 (2d Cir.1999) (internal quotation marks and citation omitted); *Anatian v. Coutts Bank (Switzerland) Ltd.*, 193 F.3d 85, 88 (2d Cir.1999). Plaintiffs' Exchange Act claims sound in fraud, and must therefore satisfy the pleading requirements of the Private

Securities Litigation Reform Act of 1995 ("PSLRA") in addition to the requirements of Rule 9(b). *See In re Scholastic Corp.*, 252 F.3d 63, 69–70 (2d Cir.2001).

For the reasons that follow, Defendants' motion is granted with respect to Counts II, IV, V, and VI, and is denied in all other respects. In summary, viewing the pleadings in the light most favorable to the Plaintiffs, the CCAC alleges sufficiently that the three studies revealed that Celebrex and Bextra were linked to adverse cardiovascular events to a statistically significant degree, and that these results were known to Defendants. The CCAC also alleges sufficiently that Defendants knew or had access to information showing that their public statements were inaccurate. Given the alleged importance of Celebrex and Bextra to Pfizer's overall economic health, as well as the fall in Pfizer's stock performance, the CCAC's allegations are sufficient to plausibly state a claim under Section 10(b) and Rule 10b–5. The Court also finds that Plaintiffs' 10b–5 allegations are not preempted by the FDCA and do not rely improperly on group pleading. As for the remaining causes of action, Plaintiffs' claims regarding market manipulation are dismissed because Plaintiffs allege nothing more than misrepresentations or omissions. Plaintiffs' control person claims against McKinnell, LaMattina, and Katen are sufficient to state a cause of action because the CCAC alleges adequately a securities violation by Pfizer, control of Pfizer by these defendants, and culpable participation in the fraud. Plaintiffs' claims for insider trading are also stated sufficiently as to these three defendants because the CCAC alleges contemporaneous trades. Plaintiffs' claims for violation of Section 18 are dismissed on statute of limitations grounds. Finally, Plaintiffs' claims for common law fraud and violations of unspecified state securities laws are dismissed for lack of particularity.

II. Section 10(b) and Rule 10b–5 Claims

[7][8][9] To state a claim under Section 10(b) of the Exchange Act and Rule 10b–5 promulgated thereunder, a plaintiff must allege that "the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that plaintiff's reliance on defendant's action caused injury to the plaintiff." *Lawrence v. Cohn*, 325 F.3d 141, 147 (2d Cir.2003) (citation omitted). To survive a motion to dismiss, a plaintiff's scienter allegations must "give rise to a strong inference of fraudulent intent." *Novak v. Kasaks*, 216 F.3d 300, 307 (2d Cir.2000). "A plaintiff can establish this intent either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir.2001) ***633** (citation and internal quotation marks omitted).

A. Material Misrepresentations or Omissions

Defendants, citing *In re Carter–Wallace, Inc. Sec. Litig.*, 150 F.3d 153, 157 (2d Cir.1998) ("*Carter–Wallace I*") and *In re Carter–Wallace, Inc., Sec. Litig.*, 220 F.3d 36 (2d Cir.2000) ("*Carter–Wallace II*") (collectively, the "*Carter–Wallace* cases"), contend that they had no duty to disclose the results of the three studies at the core of Plaintiffs' complaint because the results were not statistically significant and thus were immaterial. In the *Carter–Wallace* cases, plaintiffs alleged that Carter–Wallace, the manufacturer of an anti-epileptic medication named Felbatol, was liable for securities fraud because it failed to disclose adverse event reports (e.g., reports by doctors of deaths or other adverse health events) concerning users of the medication. In *Carter–Wallace I*, the Second Circuit found that Carter–Wallace had no duty to disclose reports of scattered adverse events: "Drug companies need not disclose isolated reports of illness suffered by users of their drugs until those reports provide statistically significant evidence that the ill effects may be caused by—rather than randomly associated with—use of the drugs and are sufficiently serious and frequent to affect future earnings." *Carter–Wallace I*, 150 F.3d at 157. In

Carter–Wallace II, the Second Circuit held that the lack of statistically significant evidence of Felbatol's adverse effects prior to the company's decision to make disclosure precluded plaintiffs' allegations that the failure to disclose was reckless. *See Carter–Wallace II,* 220 F.3d at 42.

Defendants also rely on *Oran v. Stafford,* 226 F.3d 275 (3d Cir.2000), in which plaintiffs brought a securities class action against American Home Products Corporation ("AHP") and certain of its directors and officers after AHP withdrew its prescription weight-loss drugs Pondimin and Redux from the market in response to reports of serious medical side effects. In affirming the district court's dismissal of the complaint, the Third Circuit held that the undisclosed adverse event reports had not provided sufficiently significant information: "Because the link between the two drugs and heart-valve disorders was never definitively established ..., [the defendant's] failure to disclose this data cannot render its statements about the inconclusiveness of the relationship materially misleading." *Oran,* 226 F.3d at 284; *see also Masters v. Glaxosmithkline,* No. 06–5140–CV, 2008 WL 833085, at *3 (2d Cir. Mar. 26, 2008) (summary order) ("We have held that reports of harmful drug effects are immaterial—and thus need not be disclosed—unless those reports (1) show statistically significant evidence of an adverse effect[;] (2) establish that the adverse effect threatens the 'commercial viability' of the drug; and (3) show that the effect poses a significant risk to the company's future earnings." (citing *Carter–Wallace I* and *Oran*)).

Central to the holdings of the *Carter–Wallace* cases and *Oran* were the lack of statistically significant evidence linking the drugs to adverse health consequences. In the *Carter–Wallace* cases, the evidence at issue regarding the negative effects of Felbatol was limited to six deaths, reported to Carter–Wallace between January and May 1994. On August 1, 1994, after four more deaths had been reported in July, Carter–Wallace disclosed the dangers of the drug. *See Carter–Wallace I,* 150 F.3d at 157 ("In the present case, four of the ten reported deaths occurred in July—the disclosure was on August 1—and the earlier reports are not by themselves sufficient to support inferences of either actual knowledge or recklessness."). Following the same pattern, in *Oran* the evidence of negative effects initially was limited to 24 reports of ***634** heart-valve anomalies, reported to the company by July 1997. However, on September 12, 1997, the FDA informed AHP of a survey showing that 92 of 291 users had developed heart-valve abnormalities. The next day, AHP withdrew the drugs from the market. *Oran,* 226 F.3d at 280. Based on these facts, the Third Circuit concluded that "[t]he withheld reports did not provide such statistically significant evidence. Therefore, we agree with the District Court that the disclosure of the European data and the adverse reaction reports would not have 'significantly altered the "total mix" of information' available to AHP's investors." *Id.* at 284 (citation omitted).

1. The Studies' Statistical Significance

Relying on the *Carter–Wallace* cases and *Oran,* Defendants argue that the three studies do not demonstrate statistically significant evidence of adverse cardiovascular events. In support of this argument, Defendants invite the Court to take judicial notice of the meaning of statistical significance, as well as of certain descriptions and discussions of the studies annexed to Defendants' declarations.

The Court declines to take judicial notice of the meaning of statistical significance or of the data interpretations proffered by Defendants in the context of this motion practice. Rule 201 of the Federal Rules of Evidence provides that courts may only take notice of facts "either (1) generally known ... or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." Fed.R.Evid. 201(b). While statistical significance may have certain characteristics capable of general abstraction, it is far beyond the scope of Rule 201 to accept as fact the particu-

lar definitions of statistical significance proffered by Defendants as either facts generally known or as drawn from sources whose accuracy cannot reasonably be questioned. It is one thing to take notice of the fact that an author has written that 5% is the threshold for statistical significance. It is quite another thing entirely to use that 5% figure as a basis for rejecting the significance of complicated medical studies.

In addition, although Defendants have submitted exhibits that state or suggest that the studies are not statistically significant, those conclusions are not only disputed by Plaintiffs but also appear to be contradicted by other conclusions drawn in the exhibits submitted by the Defendants. In the Clinical Study Synopsis of the Alzheimer's Study, for example, the authors state that "[i]ndividual cardiovascular adverse events did not differ significantly between the celecoxib [Celebrex] and placebo treatment groups." (Markel Dec, Ex. 10 at 6.) However, the report continues: "A statistically significant difference favoring placebo in adverse events was observed for certain CV-related body system terms." (*Id.*) Nevertheless, the proportions of patients experiencing serious adverse events were similar: 22.9% for the placebo group and 25.6% for the group taking Celebrex. (*Id.* at 7.) Other interpretations of the study are equally unhelpful. The FDA wrote that the study "did not demonstrate a significantly increased risk of serious adverse CV events, but did show a trend toward more CV events in the celecoxib treatment arm." (Markel Dec, Ex. 13, at 5.) Dr. Sidney Wolfe wrote that the study reveals a "statistically significant increase in the composite of all serious cardiovascular events in patients getting Celebrex compared to patients getting a placebo." (Markel Dec, Ex. 44 at 1.) Dr. Wolfe stated that the risk of serious cardiovascular adverse events in the Celebrex population was 3.6 times greater than in the placebo population. (*Id.*)

Describing the results of the CLASS Study, the FDA's Medical Officer Review ***635** of Celebrex stated that "[t]here does not appear to be any clinically or statistically significant trend with celecoxib to suggest additional cardiovascular risks over the comparator drugs." (Markel Dec, Ex. 8, at 68.) Nevertheless, the FDA's cardiorenal reviewer, Dr. Doug Throckmorton, concluded that there "seems to be a trend toward more [anginal disorder] events in those patients receiving celecoxib, regardless of aspirin use." (*Id.*) The FDA Medical Officer Review of Celebrex also states that "[i]n the non-aspirin users, there appears to be a slight trend toward more events in those patients receiving celecoxib for combined atrial and anginal disorders; this does not appear to be the case for aspirin users." (*Id.* at 69.) In a subsequent report, the FDA wrote that the results of the CLASS Study revealed "[n]o differences ... for serious adverse CV events between celecoxib and the two non-selective NSAID comparators in this trial." (Markel Dec, Ex. 13 at 5.)

Discussing the first half of the same study, the authors of the JAMA article wrote: "The overall incidence of cardiovascular events, and the incidences of cerebrovascular events and myocardial infarction in particular, were similar in the 2 treatment groups. No treatment-related differences in such events were apparent in the cohort of patients not taking aspirin for cardiovascular prophylaxis." (Markel Dec, Ex. 33, at 1253.) On the other hand, Dr. Wolfe wrote that the data from the CLASS Study "revealed that the rate of combined anginal adverse events was 1.4% in the celecoxib group versus 1.0% in either NSAID group," but conceded this is "a non-statistically significant difference." (Markel Dec, Ex. 32, at 2.) Dr. Wolfe noted that the trend was magnified in those patients not taking low-dose aspirin, where "the celecoxib group had 0.6% vs. 0.2% and 0% in the diclofenac and ibuprofen groups, respectively." (*Id.*) Dr. Wolfe also noted that the CLASS Study data reveals that the "annualized myocardial infarction rate was statistically significantly higher in the CLASS trial compared to the placebo group from a meta-analysis of other studies evaluating the primary prevention of myocardial infarction with low-dose aspirin.

(Placebo 0.52%; CLASS 0.80%, P=0.02).” (*Id.*)

The exhibits discussing the results of the CABG Trial of Bextra are similarly unhelpful. For example, the Final Report of the CABG Trial states that 25.7% (80 out of 311) patients administered Bextra suffered clinically relevant adverse events versus 15.2% (23 out of 151) patients administered a placebo. (Markel Dec, Ex. 1, at 6.) The report concludes that the difference between 25.7% and 15.2% is a “statistically significant difference between treatment groups at p. <0.05.” (*Id.* at 5–6.) On the other hand, Defendants assert that the study concludes that the difference between the number of *individual* cardiovascular events in the placebo and Bextra groups was not statistically significant. (*Id.* at 130–31.) In other words, the significance the parties perceive in the report turns on whether the relevant data set of clinically relevant adverse events is to be broken down by sub-group or assessed in the aggregate.

[10][11][12] A motion to dismiss a complaint is not an appropriate vehicle for determination as to the weight of the evidence, expert or otherwise. Clearly, the Court cannot take judicial notice that the three studies show a lack of any statistically significant link between Celebrex/ Bextra and adverse cardiovascular events because that supposed fact is neither generally known nor capable of accurate and ready determination by reference to unquestionably accurate sources. Moreover, the Court cannot determine as a matter of law whether such links were statistically insignificant because statistical ***636** significance is a question of fact. *Cf. Union Carbide Chems. & Plastics Tech. Corp. v. Shell Oil Co.*, Nos. Civ. 99–274, Civ. 99–846, 2004 WL 1305849, at *6 (D.Del. June 9, 2004) (“Statistical significance ... is a question of fact for the jury as it is an issue of evidentiary weight.”), *vacated in part on other grounds*, 425 F.3d 1366 (Fed.Cir.2005); *Johnston v. Philadelphia*, 863 F.Supp. 231, 236 (E.D.Pa.1994) (holding that significance of statistical trend in hiring practices raised fact question for a jury). Plaintiffs allege that the authors of the Alzheimer's Study themselves concluded that “[a] *statistically significant* difference favoring placebo in adverse events was observed.” (CCAC ¶ 94 (emphasis added).) Plaintiffs also allege that the results of the CLASS Study showed certain increases in cardiovascular events in the population taking Celebrex as opposed to the placebo. (*Id.* ¶¶ 93, 105.) Finally, with respect to the CAGB Trial, Plaintiffs allege that an FDA medical officer commented that “[t]he excess of serious cardiovascular thromboembolic [blood clots] in the valdecoxib arm of the CABG trial ... is of note as the entire study population received prophylactic low dose aspirin as part of the standard of care in this setting to minimize just such events.” (*Id.* ¶ 111.) Although there are aspects of the studies that could lead a fact finder to discount the significance of their results, such as the relatively small sample sizes and the small percentage increases in cardiovascular events, the Court cannot say at this point that, when the facts are viewed in the light most favorable to Plaintiffs, the studies are statistically insignificant as a matter of law.

The Court's conclusion with respect to statistical significance is further supported by the Second Circuit's explanation that materiality is a flexible, fact-based determination, generally a matter for the finder of fact, and should be decided on a motion to dismiss only when “reasonable minds could not differ” on the importance of the misrepresentation “to a reasonable investor.” *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 162 (2d Cir.2000) (quoting *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir.1985)); *Ganino*, 228 F.3d at 164 (rejecting “a bright-line test for materiality”); *Glazer v. Formica Corp.*, 964 F.2d 149, 156 (2d Cir.1992). Although the *Carter–Wallace* and *Oran* decisions stand for the proposition that isolated adverse event reports, lacking statistical significance, do not prove that a drug is unsafe, *Carter–Wallace I*, 150 F.3d at 157; *Oran*, 226 F.3d at 284, the decisions “do not hold that adverse event reports are always immaterial.” *In re Bayer AG Sec. Litig.*, 2004 WL 2190357, at *8 (S.D.N.Y. Sept. 30, 2004); *see also In re Elan*

Corp. Sec. Litig., 543 F.Supp.2d 187, 210 (S.D.N.Y.2008) ("[T]his Court agrees with the *Bayer* court that *Carter–Wallace I* does not establish a bright-line rule for the materiality of information regarding drug safety risks."). The Court notes in this connection that Plaintiffs also allege that, by 2004, Celebrex and Bextra accounted for almost 9% of Pfizer's revenue (CCAC ¶ 71), and that after Bextra had been taken off the market and a black box warning label placed on Celebrex Pfizer's share value fell from a high of $47.44 per share during the Class Period to $21.09 on October 20, 2005, the day after the end of the Class Period. (*Id.* ¶ 150.)

2. Disclosure to the FDA

[13][14] Defendants also contend that, because they disclosed the studies to the FDA, they did not conceal them in violation of any obligations imposed by the securities laws. This argument is also inappropriately fact-based and incorrectly presumes that disclosure to the FDA is equivalent to disclosure to the market. Although it is likely the FDA would highlight or require disclosure of material negative ***637** safety information about a drug, the FDA is not the arbiter of materiality for purposes of the securities laws. Rather, an alleged omission is material if there is a substantial likelihood that the disclosure of the omitted fact would be viewed by the reasonable investor as having significantly altered the "total mix" of information made available. *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir.2002). "The 'total mix' of information includes 'information already in the public domain and facts known or reasonably available to the shareholders.' " *In re Regeneron Pharmaceuticals, Inc. Sec. Litig.*, No. 03 Civ. 3111, 2005 WL 225288, at *14 (S.D.N.Y. Feb. 1, 2005) (quoting *Rodman v. Grant Found.*, 608 F.2d 64, 70 (2d Cir.1979)). Disclosure to the FDA does not by itself provide a safe harbor under the securities laws.

The Court also rejects Defendants' related argument that the Food, Drug, and Cosmetic Act ("FDCA") preempts Plaintiffs' claims. Although the degree to which the FDCA preempts products liability claims is an important and still-developing question following the Supreme Court's decision in *Buckman Co. v. Plaintiffs' Legal Committee*, 531 U.S. 341, 121 S.Ct. 1012, 148 L.Ed.2d 854 (2001), the present case does not require the Court to venture into this territory because Plaintiffs are not asserting state product liability claims. Rather, Plaintiffs are asserting misrepresentation and fraud claims arising primarily under federal securities laws—claims that are not preempted by the FDA's approval of Celebrex and Bextra. *Cf. Green v. Fund Asset Management, L.P.*, 245 F.3d 214, 223 n. 7 (3d Cir.2001) ("Unlike the plaintiffs in *Buckman*, the plaintiffs in the case at bar allege not fraud against a federal agency, but rather violations of state and federal securities laws." (citing *Buckman*, at 1016)); *In re Amgen Inc. Sec. Litig.*, 544 F.Supp.2d 1009, 1033 (C.D.Cal.2008) ("The issue before the Court is not whether the FDA improperly approved [Defendants'] products as safe and effective, but rather whether Defendants violated securities laws by improperly marketing [its drugs] for off-label uses. The FDA has no jurisdiction, primary or otherwise, to decide whether disclosures in the market violate the securities laws.... Consequently, the FDA does not preempt Plaintiffs' claims." (internal quotation marks and citations omitted)).

3. Group Pleading

[15][16][17][18] Defendants challenge Plaintiffs' use of group pleading as well. Normally, "a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)." *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir.1998) (internal quotation marks and alterations omitted). However, under the group pleading doctrine, a plaintiff may "circumvent the general pleading rule that fraudulent statements must be linked directly to the party accused of the fraudulent intent." *In re BISYS Sec. Litig.*, 397 F.Supp.2d 430, 438 (S.D.N.Y.2005) (citation omitted). The group

pleading doctrine permits plaintiffs to "rely on a presumption that statements in prospectuses, registration statements, annual reports, press releases, or other group-published information, are the collective work of those individuals with direct involvement in the everyday business of the company." *In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 142 (S.D.N.Y.1999) (internal quotation marks omitted). However, the doctrine is "extremely limited in scope," and "[o]ne such limitation is that it applies only to group-published documents, such as SEC filings and press releases." ***638** *Goldin Associates, L.L.C, v. Donaldson, Lufkin & Jenrette Sec. Corp.*, No. 00 Civ. 8688, 2003 WL 22218643, at *5 (S.D.N.Y. Sept. 25, 2003) (citations omitted). Furthermore, the doctrine does not permit plaintiffs to presume the state of mind of the defendants at the time the alleged misstatements were made. *See In re Citigroup, Inc. Sec. Litig.*, 330 F.Supp.2d 367, 381 (S.D.N.Y.2004) ("Although the group pleading doctrine may be sufficient to link the individual defendants to the allegedly false statements, Plaintiff must also allege facts sufficient to show that the Defendants had knowledge that the statements were false at the time they were made." (citation omitted)).

[19] Defendants urge this Court to reject the group pleading doctrine as inapplicable following the passage of the PSLRA. *See Winer Family Trust v. Queen*, 503 F.3d 319, 334–37 (3d Cir.2007); *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602–03 (7th Cir.2006), *rev'd on other grounds*, 551 U.S. 308, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007); *Southland Sec. Corp. v. INSpire Ins. Solutions Inc.*, 365 F.3d 353, 364 (5th Cir.2004). However, the PSLRA does not explicitly abolish the doctrine, and, as Judge Lynch has observed, there is no "apparent contradiction between the idea that each defendant's role must be pled with particularity and the fact that corporate officers may work as a group to produce particular document [s]." *In re Refco, Inc. Sec. Litig.*, 503 F.Supp.2d 611, 641–42 (S.D.N.Y.2007). Indeed, consistent with the limits of particularized pleading, it is reasonable to assume that the kinds of documents Plaintiffs seek to impute to the Individual Defendants would, in a large company such as Pfizer, not only be the product of a group effort but also be the responsibility of top management such as the Individual Defendants. Moreover, though "[t]he Second Circuit has not addressed this issue, ... the majority of courts in this district have found that the PSLRA does not abrogate group pleading." *S.E.C. v. Collins & Aikman Corp.*, 524 F.Supp.2d 477, 489 n. 101 (S.D.N.Y.2007) (collecting cases); *In re BISYS Sec. Litig.*, 397 F.Supp.2d 430, 439 n. 42 (S.D.N.Y.2005) (collecting cases). Therefore, this Court joins the others in this district that have held the group pleading doctrine is "alive and well" following the passage of the PSLRA. *In re BISYS Sec. Litig.*, 397 F.Supp.2d at 439.

[20] Defendants do not dispute that, if group pleading is allowed, then Plaintiffs' group pleading allegations are properly stated against McKinnell, LaMattina, and Katen. Instead, Defendants contend that Plaintiffs' group pleading is insufficient to support Plaintiffs' claims against Feczko and Cawkwell because they were not involved in the daily management of Pfizer. However, Plaintiffs allege that all of the Individual Defendants—McKinnell, LaMattina, Katen, Feczko, and Cawkwell—made strategic decisions for Pfizer, were directly involved with the day-to-day operations of the company, and that all participated in drafting, reviewing, approving, ratifying, and/or disseminating the company's financial statements and press releases during the Class Period. (CCAC ¶¶ 19, 24, 28, 36, 38.) Given the number and nature of the statements alleged in the complaint (*see* CCAC ¶¶ 170–231), these allegations are sufficient to survive the motion to dismiss.

B. Scienter

[21][22][23] Plaintiffs have adequately pled scienter if their allegations "give rise to a strong inference of fraudulent intent." *Novak v. Kasaks*, 216 F.3d 300, 307 (2d Cir.2000). Scienter can be established either "(a) by alleging facts to show that de-

fendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence***639** of conscious misbehavior or recklessness." *Kalnit v. Eichler*, 264 F.3d 131, 138 (2d Cir.2001) (citation and internal quotation marks omitted). In *Novak*, the Second Circuit identified four types of allegations that may be sufficient to allege scienter: "[D]efendants (1) benefitted in a concrete and personal way from the purported fraud; (2) engaged in deliberately illegal behavior; (3) knew facts or had access to information suggesting that their public statements were not accurate; or (4) failed to check information they had a duty to monitor." *Novak*, 216 F.3d at 311 (citation omitted). In determining "whether the pleaded facts give rise to a strong inference of scienter, the court must take into account plausible opposing inferences. For an inference of scienter to be strong, a reasonable person [must] deem [it] cogent and at least as compelling as any opposing inference one could draw." *ATSI Commc'n, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir.2007) (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S.Ct. 2499, 2510, 168 L.Ed.2d 179 (2007)) (internal quotation marks omitted).

[24] Plaintiffs allege that Defendants, including the Individual Defendants, were acutely aware of the studies' negative results. (CCAC ¶¶ 75–82.) In particular, Plaintiffs allege that, according to Dr. John Talley, one of the developers of Celbrex and Bextra, senior managers such as the Individual Defendants were "right on top of the clinical studies related to the drugs." (*Id.* ¶ 76.) Paul Dodson, the former Senior Director of Strategic Planning and Regional operations of Pharmacia—which Pfizer acquired in 2003, along with Pharmacia's interest in Celebrex and Bextra—allegedly reported that decisions on what drugs to bring to market and when to launch them ultimately came "from the top." (*Id.*) According to Plaintiffs, Dodson further stated that information on clinical trial findings would be reported to top management and would be reported with some specificity where there was "some negative effect or a problem" with the drug. Dodson noted that the cardiovascular safety profile of Celebrex was a big issue with top management and that a Dr. Needleman was responsible for updating top management on significant developments relating to Celebrex and Bextra. (*Id.*) Similarly, Krista Fox, a former Global Marketing Communications Manager at Pharmacia, is alleged to have stated that Pharmacia had a medical information group within the company that "knows the science of a drug inside and out .... Anything that you are going to get out to the public as it relates to sales and marketing efforts has to go through a review committee which usually consists of legal, medical and regulatory and they are experts on the drug and they have to approve everything." (*Id.* ¶ 77.) Finally, Defendant Katen was involved with the two drugs in her capacity as head of the Celebrex and Bextra brand teams. In that position, she was responsible not only for anything promotional about the products, but also for disseminating critical information about the drugs throughout Pfizer. (*Id.* ¶¶ 80–82.) These passages of the CCAC provide the requisite allegations that all of the Defendants were aware of the studies.

Having established the sufficiency of Plaintiffs' allegations as to materiality as well as the Individual Defendants' knowledge, the question of scienter is implicitly resolved, insofar as the sufficiency of the pleading is concerned, in favor of Plaintiffs' "conscious misbehavior or recklessness" theory. Because Plaintiffs have sufficiently pled that Defendants were aware of multiple studies that linked Celebrex and Bextra to adverse cardiovascular events to a statistically significant degree, the CCAC asserts sufficiently that Defendants "knew facts or had access to information suggesting that their public statements ***640** were not accurate." *Novak*, 216 F.3d at 311; *see also In re Elan Corp. Sec. Litig.*, 2008 WL 839744, at *16 (S.D.N.Y. Mar. 27, 2008) ("Though *Carter–Wallace I* and *Bayer* combined materiality and scienter into a single inquiry, the *Carter–Wallace I* holding has implications for both elements."); *In re Alstom SA*, 406 F.Supp.2d 433, 456 (S.D.N.Y.2005) ("In cases

in which scienter is pled in part by alleging that the defendant 'knew facts or had access to information suggesting that their public statements were not accurate,' the scienter analysis is closely aligned with the analysis as to misleading statements." (citation omitted)). Because Plaintiffs have alleged adequately that Defendants were aware of studies containing statistically significant links between Celebrex/Bextra and illness, Plaintiffs have satisfied their burden of alleging facts giving rise to a strong inference of fraudulent intent. No opposing inference is more compelling. Accordingly, Plaintiffs' allegations are sufficient to satisfy their pleading obligation with regard to scienter.

Plaintiffs have thus stated a claim under Section 10(b) and Rule 10b–5. Defendants' motion to dismiss is denied with respect to Count I.

III. Market Manipulation Claims

[25][26] Plaintiffs also assert an alternate theory of liability based on Defendants' alleged use of a manipulative or deceptive device or participation in a scheme to defraud. Subsections (a) and (c) of Rule 10b–5 prohibit the use of "any device, scheme, or artifice to defraud" or participation "in any act, practice, or course of business" that would perpetrate fraud on investors. A plaintiff alleging market manipulation in violation of Rule 10b–5(a) and (c) must specify "what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed and what effect the scheme had on the securities at issue." *In re Global Crossing,* 322 F.Supp.2d 319, 329 (S.D.N.Y.2004) (quoting *In re Blech Sec. Litig.,* 961 F.Supp. 569, 580 (S.D.N.Y.1997)). " 'Manipulation' is 'virtually a term of art when used in connection with securities markets' " and "refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Indus., v. Green,* 430 U.S. 462, 476–77, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977) (quoting *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 199, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976)).

[27] The Second Circuit has held "that where the sole basis for such claims is alleged misrepresentations or omissions, plaintiffs have not made out a market manipulation claim under Rule 10b–5(a) and (c), and remain subject to the heightened pleading requirements of the PSLRA." *Lentell v. Merrill Lynch & Co., Inc.,* 396 F.3d 161, 177 (2d Cir.2005) (citing *Schnell v. Conseco, Inc.,* 43 F.Supp.2d 438, 447–48 (S.D.N.Y.1999)); *accord In re Alstom SA,* 406 F.Supp.2d 433, 475 (S.D.N.Y.2005) ("[I]t is possible for liability to arise under both subsection (b) and subsections (a) and (c) of Rule 10b–5 out of the same set of facts, where the plaintiffs allege both that the defendants made misrepresentations in violations of Rule 10b–5(b), as well as that the defendants undertook a deceptive scheme or course of conduct that went beyond the misrepresentations."). Here, because Plaintiffs allege no deceptive course of conduct going beyond misrepresentations or omissions, their market manipulation claims must be dismissed. *See Lentell,* 396 F.3d at l77.

Defendants' motion to dismiss is granted with respect to Count II.

IV. Control Person Liability

[28] Plaintiffs assert control person liability claims under Section 20(a) against ***641** McKinnell, LaMattina, and Katen. "In order to establish a prima facie case of liability under § 20(a), a plaintiff must show: (1) a primary violation by a controlled person; (2) control of the primary violator by the defendant; and (3) 'that the controlling person was in some meaningful sense a culpable participant' in the primary violation." *Boguslavsky v. Kaplan,* 159 F.3d 715, 720 (2d Cir.1998) (quoting *SEC v. First Jersey Sec. Inc.,* 101 F.3d 1450, 1472(2d Cir.1996)). The law in this Circuit is unsettled with respect to whether the PSLRA requires plaintiffs to plead culpable participation under Section 20(a) with heightened particularity. *See In re Global Crossing,* 322 F.Supp.2d 319, 349 n. 24 (S.D.N.Y.2004). This question need not be resolved in connection with the instant motion practice because, even assuming Section 20(a) requires

such heightened pleading, Plaintiffs have met the higher standard.

[29][30] "[D]etermination of § 20(a) liability requires an individualized determination of a defendant's control of the primary violator as well as a defendant's particular culpability." *Boguslavsky*, 159 F.3d at 720. As demonstrated by the facts discussed above, Plaintiffs state a claim under Section 10(b) and Rule 10b–5 for Pfizer's primary participation in making material misrepresentations and omissions. Plaintiffs have also alleged adequately—and Defendants do not dispute—that McKinnell, LaMattina, and Katen controlled Pfizer by virtue of their key positions with the company. (*See* CCAC ¶¶ 22, 26, 27 (describing defendants' high-level positions); *id.* ¶ 35 (alleging that all of the Individual Defendants controlled Pfizer); *id.* ¶ 38 ("By reason of their positions with the Company, the ... Defendants attended management and/or board of directors meetings, and had access to internal Company documents, reports and other information, including adverse non-public information regarding Pfizer's business, operations, products and future prospects, and including non-public information concerning Celebrex and Bextra .").); *see also In re Check Point Software Technologies Ltd. Sec. Litig.*, No. 03 Civ. 6594, 2006 WL 1116699, at *5 (S.D.N.Y. Apr. 26, 2006); *In re Parmalat Sec. Litig.*, 375 F.Supp.2d 278, 310 (S.D.N.Y.2005).

Finally, Plaintiffs' allegations that McKinnell, LaMattina, and Katen participated directly in the day-to-day management of Pfizer and made strategic decisions is sufficient to meet Plaintiffs' pleading obligation as to culpable participation. *Compare* (CCAC ¶¶ 19, 24, 28 (alleging responsibility for strategic decisions)), *with Suez Equity Investors, L.P. v. Toronto–Dominion Bank*, 250 F.3d 87, 101 (2d Cir.2001) ("The complaint alleges that [Defendant] was an officer of the Bank and that he had primary responsibility for the dealings of that Bank .... While somewhat broad, this allegation is sufficient to plead controlling-person liability."). Accordingly, Plaintiffs have pled Section 20(a) liability sufficiently as to McKinnell, LaMattina, and Katen.

Defendants' motion to dismiss is denied with respect to Count HI.

V. Section 18 Claims

[31] Plaintiffs also assert Section 18 claims against McKinnell, LaMattina, and Katen. Section 18 creates a private cause of action against any defendant who makes or causes to be made materially misleading statements in reports or other documents filed pursuant to the Exchange Act, unless that defendant can prove that he or she acted in good faith and without knowledge that the statement was false or misleading. *See* 15 U.S.C. § 78r(a); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 211 n. 31, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). Although Plaintiffs concede that they have ***642** failed to bring their claims within the one-year statute of limitations provided in 15 U.S.C. § 78r(c), they argue that the "discovery" two-year statute of limitations period contained in Section 1658(b) of the Sarbanes–Oxley Act governs. *See* 28 U.S.C. § 1658(b). In *In re Alstom SA*, the court held that Section 18 claims are governed by the one-year limitations period contained in 15 U.S.C. § 78r(c). 406 F.Supp.2d 402, 420–21 (S.D.N.Y.2005). *But see In re Adelphia Communications Corp. Sec. and Derivative Litig.*, No. 03 MD 1529, 2005 WL 1679540, at *4 (S.D.N.Y. July 18, 2005) ("Given that § 18 involves more than negligence, this Court finds that the extended two-year/five-year limitations period applies.").

Which limitations period applies turns on the nature of claims brought under Section 18. By its own terms, Section 1658(b) of the Sarbanes–Oxley Act applies only to actions "involv[ing] a claim of fraud, deceit, manipulation, or contrivance." 28 U.S.C. § 1658(b). Because fraudulent intent is not part of a plaintiff's prima facie case under Section 18—indeed, good faith is an affirmative defense—the limitations period prescribed by Section 1658(b) of the Sarbanes–Oxley Act does not trump

the provisions of 15 U.S.C. § 78r(c). *See Alstom*, 406 F.Supp.2d at 420–21. Accordingly, because the one-year limitations period of 15 U.S.C. § 78r(c) controls, Plaintiffs' Section 18 claims are time-barred on their face and thus must be dismissed.

Defendants' motion to dismiss is granted with respect to Count VI.

VI. Insider Trading

Plaintiffs also bring insider trading claims against McKinnell, LaMattina, and Katen under Section 20A. To state a Section 20A claim for insider trading, plaintiffs must allege an insider trading violation by an individual defendant and trading by the plaintiffs contemporaneously with that of the individual defendant. *See* 15 U.S.C. § 78t-1 ("Any person who violates any provision of this chapter ... by purchasing or selling a security while in possession of material, nonpublic information shall be liable ... to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased ... or sold ... securities of the same class."). Plaintiffs and Defendants agree that Section 20A claims require a predicate securities violation and are subject to the heightened pleading requirements of Rule 9(b) and the PSLRA. However, they disagree as to the impact of the contemporaneousness requirement on the viability of Plaintiffs' claim.

While courts have interpreted the contemporaneousness requirement of Section 20A differently, the Court cannot say as a matter of law that trades made within less than week are insufficiently contemporaneous. *See In re Oxford Health Plans, Inc.*, 187 F.R.D. 133, 144 (S.D.N.Y.1999) ("Five trading days is a reasonable period between the insider's sale and the plaintiff's purchase to be considered contemporaneous."); *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 258 F.Supp.2d 576, 600 (S.D.Tex.2003) ("[T]his Court finds that two or three days, certainly less than a week, constitute a reasonable period to measure the contemporaneity of a defendant's and a plaintiff's trades under § 20A."); *In re Musicmaker.com Sec. Litig.*, No. CV00–2018, 2001 WL 34062431, at *27 (C.D.Cal. June 4, 2001) (observing that the House of Representatives' Report concerning Section 20A suggests that an appropriate time period might be less than a week).

[32] Because Plaintiffs have alleged trades within five days of trades by defendants***643** Katen and LaMattina, and within six days of trading by McKinnell, (*see* CCAC, Ex. A (showing that Lead Plaintiff TRSL traded on March 2, 2004, within five days—note that 2004 was a leap year—of LaMattina's and Katen's trades of February 26, 2004, and within six days of McKinneU's February 25, 2004 trades)), Plaintiffs' Section 20A claims are sufficiently pled.

Defendants' motion to dismiss is denied with respect to Count VII.

VII. State Claims

Finally, Lead Plaintiff TRSL and a subclass allege that Defendants committed common law fraud and violated unspecified state securities laws.

A. Common Law Fraud

[33] The elements of common law fraud under New York law are "essentially the same" as those required to state a claim under Section 10(b) and Rule 10b–5. *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 122 F.Supp.2d 407, 425–26 (S.D.N.Y.2000), *abrogated on other grounds*, *In re IPO Sec. Litig.*, 241 F.Supp.2d 281, 352 n. 85 (S.D.N.Y.2003). Defendants contend that Plaintiffs have failed to properly plead reliance because the fraud-on-the-market theory cannot be used to satisfy the reliance requirement of a common law fraud claim under New York law. There is an "open question" in this Circuit as to whether the fraud-on-the-market theory can be used in this way, *Sumitomo Copper Litig. v. Credit Lyonnais Rouse, Ltd.*, 262 F.3d 134, 142 (2d Cir.2001), although the Second Circuit has observed that "federal courts repeatedly have refused to apply the fraud on the market theory to state common law cases despite its wide acceptance in the federal securities fraud context." *Sec. Investor*

Protection Corp. v. BDO Seidman, LLP, 222 F.3d 63, 73 (2d Cir.2000).

Federal and state courts outside of New York have generally rejected use of the fraud-on-the-market theory when evaluating common law securities fraud claims. *See, e.g., Peil v. Speiser*, 806 F.2d 1154, 1163 n. 17 (3d Cir.1986) ("While the fraud on the market theory is good law with respect to the Securities Acts, no state courts have adopted the theory, and thus direct reliance remains a requirement of a common law securities fraud claim." (citation omitted)); *see also Gaffin v. Teledyne, Inc.*, 611 A.2d 467, 474 (Del.1992) ("A class action may not be maintained in a purely common law ... fraud case since individual questions of law or fact, particularly as to the element of justifiable reliance, will inevitably predominate over common questions of law or fact."); *Antonson v. Robertson*, 141 F.R.D. 501, 508 (D.Kan.1991) ("[W]ith respect to plaintiffs' common law fraud claims, in the absence of an analogous state law doctrine of fraud on the market, each individual plaintiff would be required to prove his or her individual reliance, causing individual questions of fact to predominate in the case."). Indeed, in one of the most extensive opinions on the subject, the Supreme Court of California rejected the use of the fraud-on-the-market theory in common law fraud claims, concluding in part that permitting use of the theory in the broad realm of common law fraud—which, for example, requires no purchase or sale of securities—could invite "exceedingly speculative" fraud theories and would be unnecessarily duplicative of federal and state statutory law. *Mirkin v. Wasserman*, 5 Cal.4th 1082, 1097–1108, 23 Cal.Rptr.2d 101, 858 P.2d 568 (Cal.1993). "In summary, to incorporate the fraud-on-the-market doctrine into the common law of deceit would only bring about difficulties that the state Legislature and the federal courts have apparently attempted to avoid..... Under these circumstances, there is insufficient***644** justification for upsetting the policy choices that the existing laws reflect." *Id.* at 1108, 23 Cal.Rptr.2d 101, 858 P.2d 568.

[34] Faced with the question, courts in this district have generally refused to allow plaintiffs to use the fraud-on-the-market theory to support common law fraud claims. *See Hunt v. Enzo Biochem, Inc.*, 530 F.Supp.2d 580, 598–99 n. l38 (S.D.N.Y.2008) (citing *In re Marsh & Mclennan Cos., Inc.*, 501 F.Supp.2d 452, 495 (S.D.N.Y.2006); *Feinberg v. Katz*, No. 01 Civ. 2739, 2007 WL 4562930, at *6 (S.D.N.Y. Dec. 21, 2007)); *cf. In re Blech Sec. Litig.*, 961 F.Supp. 569, 587 (S.D.N.Y.1997) (holding that while the fraud-on-the-market theory is not available for common law fraud claims based upon misrepresentations or omissions, the theory is available for fraud claims based upon market manipulation). *But see Minpeco S.A. v. Hunt*, 718 F.Supp. 168, 176 (S.D.N.Y.1989); *see also Ackerman v. Price Waterhouse*, 252 A.D.2d 179, 683 N.Y.S.2d 179, 191–92 (App. Div. 1st Dep't 1998). In *Basic Inc. v. Levinson*, the Supreme Court distinguished "common-law deceit and misrepresentation claims" from Rule 10b–5 claims, noting that the latter "are in part designed to *add* to the protections provided investors by the common law." 485 U.S. 224, 244 n. 22, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988) (emphasis added). By sanctioning the use of the fraud-on-the-market theory in *Basic*, the Supreme Court increased the availability of a presumption of reliance in securities claims brought under federal law; securities claims brought pursuant to common law, however, were unchanged. Because New York has not yet recognized the fraud-on-the-market theory and continues to require that fraud claims allege reliance and be stated in detail, *Vermeer Owners, Inc. v. Guterman*, 78 N.Y.2d 1114, 1116, 578 N.Y.S.2d 128, 585 N.E.2d 377, 378–79 (1991), the Court concludes that the fraud-on-the-market theory is unavailable to Lead Plaintiff TRSL and the subclass. Here, Plaintiffs have only included general allegations of direct reliance. (CCAC ¶¶ 331, 337–38.) Their pleadings are thus insufficient and Plaintiffs' common law fraud claims must be dismissed. *Cf. Hunt*, 530 F.Supp.2d at 599 (holding that plaintiffs' allegations of direct reliance on statements made at a presentation plaintiffs attended sufficed to plead

direct reliance with particularity).

B. Violations of State Securities Laws

[35] The claims of Lead Plaintiff TRSL and the subclass for violations of "those state securities laws that have a private right of action of each of the states in which the members of the subclass are located," (CCAC ¶ 335), must also satisfy the particularity requirements of Rule 9(b). In *Chrysler Capital Corp. v. Century Power Corp.*, the court dismissed plaintiffs' claims for violations of unspecified "Applicable State Securities Laws" because Rule 9(b) "requires Plaintiffs to indicate the state statutes under which they seek relief." 778 F.Supp. 1260, 1270 (S.D.N.Y.1991). Because the CCAC similarly fails to identify the state securities laws that were allegedly violated, the claims must be dismissed. While the Court will allow Plaintiffs to replead their state law claims pursuant to Rule 15(a) of the Federal Rules of Civil Procedure, it observes that the CCAC's use of subclassing and contemplated application of numerous state laws may create intractable choice-of-law, commonality, manageability, and superiority problems at the class certification stage. *See, e.g., Matter of Rhone–Poulenc Rorer, Inc.*, 51 F.3d 1293, 1300 (7th Cir.1995) (rejecting lower court's attempt to blend the negligence laws of numerous jurisdictions into a single "Esperanto instruction"); *see also* Sue–Yun Ahn, ***645** CAFA, Choice–of–Law, and the Problem of Legal Maturity in Nationwide Class Actions, 76 U. Cin. L.Rev. 105, 110–11 (2007) ("But while subclassing among the plaintiff class by states with similar laws has been suggested in some circumstances, subclassing is often seen as detrimental to the manageability of the class under Rule 23(b)(3)'s superiority requirement." (citations omitted)).

Defendants' motion to dismiss is granted with respect to Counts IV and V.

CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss (docket entry # 56) is granted as to Counts II, IV, V, and VI, with leave to re-plead all Counts except for Count VI, and is denied in all other respects. Plaintiffs' motion to strike (docket entry # 68) is denied as moot. The Clerk of Court is respectfully requested to terminate Docket Entry Nos. 56 and 68. Any amended consolidated class action complaint must be filed and served by July 21, 2008, with a courtesy copy provided for chambers, and Defendants' response must be served and filed, with a courtesy copy provided for chambers, by August 4, 2008. An order scheduling a pretrial conference will be issued.

SO ORDERED.

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programs and poured over them, redlining and rewriting, such "intentional dissimilarity" is permissible. *See* NIMMER, *supra*, § 1302[B][1][b], at 13–69; *see also Bucklew*, 329 F.3d at 930.

IV. CONCLUSION

The Court is not blind to the reality that this case is about market share. SMS undoubtedly believed that the years of labor that went into producing these products gave it the right to exclude ASP and others. But as the Supreme Court observed in *Feist*, "[t]he primary objective of copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.' Art. I, § 8, cl. 8." *Feist*, 499 U.S. at 349, 111 S.Ct. 1282 (alteration omitted). If SMS wants to keep ASP or any other company out of the marketplace, then it will have to negotiate a successful agreement to realize its innovision.

The Court finds that ASP copied SMS's works. Nevertheless, the Court concludes that the copying is not actionable because ASP's works are not substantially similar. Judgement therefore enters for ASP.

SO ORDERED.

2007 DNH 156

In re TYCO INTERNATIONAL, LTD. MULTIDISTRICT LITIGATION.

Case No. 02–md–1335–PB.

United States District Court,
D. New Hampshire.

Dec. 19, 2007.

Background: Parties to securities fraud class action sought approval of settlement, creating common fund of $3.2 billion for payment of claims, and calling for attorney fees representing 14.5% of recovery.

Holdings: The District Court, Paul Barbadoro, J., held that:

(1) notice of award was adequate;

(2) proposed settlement was fair, reasonable and adequate;

(3) allocation of payment was fair, reasonable and adequate; and

(4) legal fees would be approved.

Settlement approved.

See, also, 2007 WL 2682763.

1. Compromise and Settlement ⚿68

Adequacy of notice requirement, for settlement of securities fraud class action, was satisfied through mailing of 2.4 million notice packets, solicitation of nominee shareholders to find names of beneficial owners, repeated efforts to remail returned packets, publication of notice in eight national and regional newspapers, and establishment of website and toll-free telephone hotline. Fed.Rules Civ.Proc. Rule 23(c)(2)(B), (e)(1), 28 U.S.C.A.

2. Compromise and Settlement ⚿70

There is a presumption in favor of approving a class action settlement, if the parties negotiated it at arms-length, after conducting meaningful discovery. Fed. Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

3. Compromise and Settlement ⚿57

Determination that proposed class action settlement is fair, reasonable and adequate involves assessment of (1) the risk, complexity, expense and duration of the case, (2) comparison of the proposed settlement with the likely result of continued litigation, (3) reaction of the class to the settlement, (4) the stage of the litigation and the amount of discovery completed, and (5) the quality and conduct of counsel during litigation and settlement negotiations. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

4. Compromise and Settlement ⚿65

Risk, complexity, expense and duration of lawsuit weighed in favor of determination that proposed securities fraud class action settlement, in which corporation would pay into common fund $2.975 billion plus interest and accountants $225 million plus interest, was fair, reasonable and adequate; case was very complex, involving analysis of accounting treatment of 100 acquisitions, issue of loss causation would be extremely close, case had been defended vigorously by able counsel, raising every possible nonfrivolous issue, and establishment of damages in event of liability determination would be uncertain, involving dueling experts. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

5. Compromise and Settlement ⚿65

Comparison of securities fraud class action settlement offer with possible recovery weighed in favor of determination that offer of corporation to pay into common fund $2.975 billion plus interest and accountants $225 million plus interest was fair, reasonable and adequate; recovery represented 27% of claims, which would be subject to risk of not prevailing, very heavy legal expenses, and delays. Fed. Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

6. Compromise and Settlement ⚿65

Reaction of class weighed in favor of determination that proposed settlement of securities fraud class action suit, in which corporation agreed to pay into common fund $2.975 billion plus interest and accountants $225 million plus interest, was fair, reasonable and adequate; institutional investors agreed that amount was excellent recovery, and small number of individual objectors overstated provable damages to class. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

7. Compromise and Settlement ⚿65

Stage of litigation and amount of discovery completed weighed in favor of determination that proposed settlement of securities fraud class action, involving payment by corporation into common fund of $2.975 billion plus interest and accountants $225 million plus interest, was fair, reasonable and adequate; 82.5 million pages of documents were reviewed and 220 depositions taken, leaving parties well positioned to understand merits of case. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

8. Compromise and Settlement ⚿65

Quality of counsel and conduct of counsel and parties during settlement negotiations in securities fraud case weighed in favor of finding proposed settlement involving payment by corporation into common fund of $2.975 billion plus interest and accountants $225 million plus interest to be fair, reasonable and adequate; counsel was able, and prepared to litigate if settlement proved fruitless, and class representatives had shown unusual interest and participation in litigation. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

9. Compromise and Settlement ⚿65

Requirement for approval of class action settlement, that plan of allocation of payments in class action be fair, reasonable and adequate, was satisfied in securities fraud class action involving proposed payment by corporation into common fund of $2.975 billion plus interest and by accountants $225 million plus interest; expert had devised method of payment to investors compensating them according to nature and timing of their transactions, and plan provided for distribution of excess from fund, left after costs of distributions began to exceed amount of claims, through final distribution in accordance with cy pres principles under consideration by American Law Institute. Fed.Rules Civ. Proc.Rule 23(e), 28 U.S.C.A.

10. Attorney and Client ⚿155

Method for determining appropriate legal fees, in connection with settlement of securities fraud class action involving creation of common fund, involves establishment of suitable percentage of payment fund, cross checked by lodestar computation consisting of reasonable hours expended multiplied by reasonable hourly rates. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

11. Attorney and Client ⚿155

In determining appropriate legal fees award, in connection with settlement of securities fraud class action involving creation of common fund, consideration should be given to (1) fee awards in similar cases, (2) complexity, duration, and risk involved in litigation, (3) manner in which fee request was negotiated between co–lead counsel and lead plaintiffs, (4) reaction of class, and (5) public policy considerations. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

12. Attorney and Client ⚿155

In determining reasonableness of legal fees award, to be made out of $3.2 billion common fund created for settlement of securities fraud class action, appropriate comparison was with other large securities fraud settlements involving several millions of dollars, where proposed legal fee as percentage of recovery was seventh out of seventeen, rather than with subset of legal fees paid where settlement funds exceeded one billion dollars or more, where fee as percentage of recovery was highest of seven cases; lodestar percentage reflective of effort expended, computed by multiplying reasonable hours by reasonable rates, was substantially higher than all but one of billion dollar recovery cases, and was more in line with list of seventeen cases. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

13. Attorney and Client ⚿155

Complexity, duration and risk factors favored approval of legal fees request, as part of settlement of securities fraud class action, representing 14.5% of $3.2 billion common fund; case was very complex, generating 82.5 million pages of discovery material, and co-lead counsel had gambled that they would recover lodestar amount of $172 million in legal fees as result of successful resolution of suit. Fed.Rules Civ. Proc.Rule 23(e), 28 U.S.C.A.

14. Attorney and Client ⚿155

Negotiation procedure followed in arriving at amount of attorney fees weighed in favor of approving 14.5% of common fund created by proposed settlement agreement; two former federal judges were retained to evaluate attorney fees claims and make determination of amount to be included in final class action settlement approval request. Fed.Rules Civ. Proc.Rule 23(e), 28 U.S.C.A.

15. Attorney and Client ⚿155

Reaction of the class favored approval of attorney fees award, in securities fraud class action, amounting to 14.5% of 3.2 billion settlement common fund; there were only 11 objections, out of 2.4 million settlement notices, and these were merely based on generalized concerns about magnitude of fees. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

16. Attorney and Client ⚿155

Public policy considerations favored approval of legal fees comprising 14.5% of proposed $3.2 billion common fund settlement of securities fraud class action suit; attorneys for class expended 488,000 billable hours in pursuing suit against vigorous defense, finally creating payment fund vindicating public interest in curtailing securities improprieties. Fed.Rules Civ.Proc. Rule 23(e), 28 U.S.C.A.

17. Attorney and Client ⚿155

Cross checking of proposed attorney fees award in class action securities fraud case, constituting 14.5% of $3.2 billion common fund settlement payment, with lodestar amount determined by multiplying agreed upon reasonable hours by reasonable rates, weighed in favor of approving fees request; recovery based on percentage of funds was 2.697 of lodestar amount, placing proposed settlement in 12th place among fees award in large securities fraud cases. Fed.Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

18. Attorney and Client ⚿155

Time spend by lead counsel in securities fraud class action suit, in seeking lead counsel status and in recruiting lead plaintiffs, was chargeable as part of fees awarded in connection with settlement of suit involving creation of common fund. Fed. Rules Civ.Proc.Rule 23(e), 28 U.S.C.A.

19. Attorney and Client ⚿155

Work done by contract attorneys, in securities fraud class action suit, was properly compensated as attorney fees, out of common fund created by settlement agreement, and was not required to be billed as reimbursable expenses. Fed.Rules Civ. Proc.Rule 23(e), 28 U.S.C.A.

MEMORANDUM AND ORDER

PAUL BARBADORO, District Judge.

Lead Plaintiffs [1] brought this class action against Tyco International, Ltd. ("Tyco"), its former auditor, PricewaterhouseCoopers, LLP ("PwC"), and five individual defendants: former Tyco Chief Executive Officer L. Dennis Kozlowski, former Chief Financial Officer Mark H. Swartz, former General Counsel Mark A. Belnick, and former directors Frank L. Walsh and Michael A. Ashcroft (collectively the "Individual Tyco Defendants"). They successfully negotiated a proposed settlement with Tyco and PwC, and now petition for final approval of the proposed settlement. The law firms representing Lead Plaintiffs ("Co–Lead Counsel") have also applied for an award of attorneys' fees and reimbursement of expenses incurred in connection with the prosecution and settlement of this action. For the reasons discussed herein, I approve both motions.

I. *BACKGROUND*

I describe below only those facts and events necessary to place this settlement in context. The full extent of the alleged problems at Tyco during the relevant time period are described in detail in my orders certifying the class and disposing of defendants' motions to dismiss. *See generally In re Tyco Int'l, Ltd. Multidistrict Litig.,* 236 F.R.D. 62 (D.N.H.2006); *In re Tyco Int'l, Ltd. Multidistrict Litig.,* No. MDL–02–1335–B, 2004 WL 2348315 (D.N.H. Oct. 14, 2004). In brief, plaintiffs allege that during the class period of December 13, 1999, through June 7, 2002, defendants misrepresented the value of multiple companies that Tyco acquired and misreported Tyco's own financial condition in ways that artificially inflated the value of Tyco stock. These fraudulent accounting practices, plaintiffs allege, enabled the Individual Tyco Defendants to reap enormous profits by looting the company through a combination of unreported bonuses, forgiven loans, excessive fees, and insider trading. The looting, in turn, allegedly fostered a coverup by means of continued accounting fraud, materially false and misleading

1. Lead Plaintiffs are the Plumbers and Pipefitters National Pension Fund ("Plumbers"), United Association General Officers Pension Plan ("UAGO"), United Association Local Union Officers & Employees Pension Fund ("UALOE"), Teachers' Retirement System of Louisiana ("TRSL"), and the Louisiana State Employees' Retirement System ("LASERS").

statements, and the omission of material information in various registration statements to cover up the misconduct, all of which further violated the federal securities laws. Meanwhile, PwC allegedly failed to conduct its audits of Tyco's financial statements in accordance with Generally Accepted Auditing Standards ("GAAS") and falsely certified that Tyco's financial statements were fairly presented in accordance with Generally Accepted Accounting Principles ("GAAP").

A. *Consolidated Complaint*

Lead Plaintiffs filed their Consolidated Class Action Complaint making the allegations described above on January 28, 2003. They did so about a year after this court dismissed a previous lawsuit against Tyco making similar allegations regarding the inflation of Tyco stock during the period from October 1, 1998, through December 8, 1999. *See generally In re Tyco Int'l, Ltd., Sec. Litig.,* 185 F.Supp.2d 102 (D.N.H.2002) ("*Tyco I*") (granting Tyco's motion to dismiss the original action).

B. *Motion to Dismiss*

In 2004, Tyco and PwC filed motions to dismiss, adopting a "divide and conquer" strategy that treated the looting allegations and fraudulent accounting allegations as two separate, unrelated schemes. As to the looting allegations, defendants argued that the looting and attendant misconduct was mere self-dealing by the individual defendants at Tyco's expense, that it was not undertaken "in connection with" the purchase of a sale or security, that the scienter of the individual defendants could not be attributed to Tyco, and that Tyco was not required to disclose the looting. As to the accounting fraud allegations, defendants argued that the allegations were not pled in sufficient detail to survive a motion to dismiss—particularly with respect to loss causation. On October 14, 2004, after careful consideration, I denied the bulk of defendants' motions to dismiss, allowing plaintiffs to proceed on their theory that the looting and the accounting fraud were interconnected.

In July 2005, after the Supreme Court clarified the requirements for establishing loss causation in securities fraud actions, *see Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005), defendants moved to revisit the motions to dismiss on the question of loss causation. Under *Dura,* defendants argued, plaintiffs' theory of loss causation (that revelations of looting by the corporate principals caused investors to conclude that they could no longer credit the company's denials of accounting misconduct) was no longer sufficient. I denied this motion.[2]

C. *Class Certification*

Plaintiffs moved to certify the class on January 14, 2005. Among Tyco's objections to certification was a novel "equity conflict" argument regarding the class members who presently hold a greater share of Tyco's stock than they did during the class period. Tyco argued that these "equity holders" stood to lose more as shareholders than they had to gain as class members because any payment by Tyco to the class would correspondingly reduce the value of their present holdings. Thus, argued Tyco, the interest of equity holders in protecting their present holdings conflicted with the interest of Lead Plaintiffs in recovering damages, and should therefore

2. PwC also filed a motion for summary judgment on loss causation. After briefing and oral argument, I denied this motion. PwC then filed a motion for certification of an interlocutory appeal of this ruling, which had not yet been resolved when PwC agreed to settle.

defeat class certification. I denied this motion because the equity holders (even though they had an interest in preventing others from recovering) nevertheless had a strong interest in recovering on their own claims against Tyco and, more fundamentally, because this potential harm to a subgroup of the class should not bar the remaining class members from being able to proceed as a class. Tyco then filed an unsuccessful appeal of my class certification order in the Court of Appeals for the First Circuit. *See In re Tyco Int'l, Ltd. Sec. Litig.,* No. 06–8022 (1st Cir. Sept. 22, 2006).

D. *Discovery and Other Motion Practice*

It would be difficult to overstate the volume of discovery in this case. Co–Lead Counsel propounded over 700 requests for admission, documents requests, and interrogatories; participated in over 220 depositions in New York, Florida, Massachusetts, and New Hampshire; and reviewed some 82.5 million pages of documents produced by defendants. This volume of discovery was necessitated by the breadth of plaintiffs' allegations, which spanned more than one hundred different allegedly fraudulent corporate acquisitions by Tyco. Moreover, because of the complexity of the alleged fraud, Co–Lead Counsel needed to retain expert consultants and forensic accountants to assist them in interpreting the information they obtained through discovery.

This discovery process was paired with aggressive, skillfully argued, and unusually challenging motion practice. Defense counsel matched the tenacity of Co–Lead Counsel, missing no opportunity to raise nonfrivolous objections or file nonfrivolous appeals of adverse decisions. This motion practice frequently explored complex, cutting-edge issues in which the state of the law changed even as this case was being litigated. In particular, the parties heavily litigated loss causation when the law in this area was in a state of flux. Plaintiffs' theory of the case requires the fact finder to draw a causal connection between the revelations of apparent corporate looting by Tyco's principals (amounts that were only a small portion of Tyco's corporate profits) and the precipitous decline in Tyco stocks. This theory is novel and exposed plaintiffs to a nontrivial risk of dismissal at the 12(b)(6) stage.

E. *Settlement Negotiations*

On January 13, 2004, Judge Donald E. Ziegler, retired U.S. District Judge for the Western District of Pennsylvania, assisted with an initial mediation attempt between Lead Plaintiffs and Tyco. That mediation failed because of the tremendous gap between Lead Plaintiffs' request for multibillion-dollar damages and Tyco's desire to settle for mere nuisance damages.

Starting in the fall of 2005, Lead Plaintiffs and Tyco agreed to a new mediator and a new mediation process. The new mediator was Judge Stanley Sporkin, retired U.S. District Judge for the District of Columbia and former Director of the Enforcement Division of the Securities and Exchange Commission ("SEC").[3] After some initial failures to bridge the gap, Judge Sporkin adopted a new mediation strategy, appointing Eugene R. Sullivan, former chief judge of the U.S. Court of Appeals (Armed Forces), as "advocate" for Tyco and Marvin E. Jacob, certified mediator in the U.S. Bankruptcy and District Courts for the Southern District of New York and a former Associate Regional Ad-

3. Judge Sporkin has numerous other qualifications that are not necessary to recite here. He has received numerous awards and honors during his long and distinguished career in government service. His expertise in this area is widely acknowledged.

ministrator for the New York Regional Office of the SEC, as "advocate" for plaintiffs.

The parties engaged in multiple mediation sessions under this new mediation setup, some lasting multiple days. In March 2007, after several relatively small moves by each side over time, Judge Sporkin made another serious push to resolve the case, working with each side in an effort to bring the decision-makers to the bargaining table. Although the March 2007 mediation did not immediately result in a settlement agreement, both sides continued discussions until May 15, 2007, when they reached an agreement in principle to settle the claims for $2.975 billion in cash.

Lead Plaintiffs then used their agreement with Tyco in new negotiations with PwC mediated by Judge Nicholas Politan, retired U.S. District Judge for the District of New Jersey. In June of 2007, Lead Plaintiffs and PwC reached an agreement in principle to settle for the sum of $225 million.

F. *Damages Calculations*

During the settlement negotiations, Dr. Mark E. Zmijewski [4] prepared a report for plaintiffs estimating the damages suffered by the class. I describe his report in some detail because it is relevant to my analysis of the settlement.

Dr. Zmijewski used an event study methodology to quantify "abnormal" stock and bond movements that could support plaintiffs' argument for loss causation and measure how and when Tyco's equities and bonds were trading at artificially inflated prices. He first disaggregated market-wide inflationary effects from firm-specific effects, and then determined whether the firm-specific effects on each trading day were statistically significant.

Based on plaintiffs' theory of the case, which posited that both revelations of accounting fraud and revelations of corporate looting could qualify as corrective disclosures, Dr. Zmijewski identified eight corrective disclosure dates [5]: January 3, 2002; January 23, 2002; January 29, 2002; April 25, 2002; May 28, 2002; June 3, 2002; June 6, 2002; and June 7, 2002. He then weighted each corrective disclosure based on an estimate of the degree to which other confounding factors (e.g., lowered earnings forecasts, reported losses, or other stock-deflating news announced on the same day as doubts about Tyco's accounting procedures) influenced the market on the day of the disclosure. Dr. Zmijewski then identified inflation-creating dates, i.e., those dates on which Tyco's stock rose and defendants' alleged fraud resulted in the disclosure of false information. Using the corrective disclosure and inflation-creating dates, Dr. Zmijewski calculated inflation per share on a daily basis for the entire class period. He did this by assuming that the stock price was "clean" or uninflated at the end of the class period and then working backward day by day to the beginning of the class period.

Dr. Zmijewski used the same methodology, with adjustments to reflect the differing availability of data, for estimating bond inflation. There were two broad types of Tyco debt instruments traded during the class period: coupon debt (consisting of thirty-two instruments) and zero-coupon

4. Dr. Zmijewski is the Leon Carroll Marshall Professor of Accounting and Deputy Dean at the University of Chicago Graduate School of Business. He formerly served as Executive Director of the Center for Research in Securities Prices at the University of Chicago Graduate School of Business.

5. A corrective disclosure date is one on which information that defendants allegedly withheld fraudulently from the market became known to the market and the stock price experienced a corresponding, statistically significant downward movement.

debt (consisting of two instruments). Because the price series for most Tyco bonds were missing some information, Dr. Zmijewski selected one bond from each of these two groups that had the most complete price series and used this to conduct the event study. To properly account for the difference in price level for some of the bonds, he measured the inflation in constant percentage terms. Dr. Zmijewski then used the same corrective disclosure/inflation-creating date method to calculate inflation on a daily basis, with the added adjustment of capping the percentage inflation of the bonds so that bond inflation did not exceed stock inflation. He treated one bond—the Tyco Liquid Yield Option Note—separately from the others, because this instrument tracked Tyco's stock price rather than debt prices.

Dr. Zmijewski then used the stock and bond inflation estimates to calculate aggregate damages. He calculated stock inflation damages according to two different models: an institutional model and an individual model. The institutional model relied on quarterly holdings information and estimated damages from each institution. Based on the assumption that gains from a particular share within an institution should not be netted against losses on other shares or opening balances at the beginning of the class period, Dr. Zmijewski estimated total institutional equity damages of $7.1 billion. The individual model relied on the "actual trader model," using empirical trading data from brokerage accounts of individual traders to predict individual trader behavior. By combining the total non-institutional trading volume on each day with his trader behavior model, Dr. Zmijewski was able to simulate the trading pattern that occurred. This simulation yielded an estimate of $3.7 billion in equity damages for individual stock traders. For bonds, he multiplied the face value of the debt issued times the inflation at the time of issuance, yielding aggregate bond damages of $905 million. Combining the institutional and individual equity damages with the bond damages yielded total measurable aggregate damages of $11.73 billion.

Dr. Zmijewski also calculated an alternative, far more conservative damages model based only on Tyco's earning restatements, which he speculated would be similar to defendants' preferred damages model.[6] The earning restatements model merely looked at the difference between Tyco's actual stock price and Tyco's stock price had its financials been reported accurately, without estimating damages caused by interaction between accounting fraud, management looting, and loss of investor confidence in the company. Accordingly, the earning restatements model yielded the far smaller estimate of $2.7 billion in equity damages, or $8.1 billion less than the $10.8 billion in equity damages produced by the event study model.

G. *Settlement Terms*

As agreed upon by the parties, the proposed settlement provides for the payment by Tyco of $2.975 billion in cash, plus interest, and the payment by PwC of $225 million in cash, plus interest. Tyco's payment will be the largest cash payment ever made by a corporate defendant in the history of securities litigation. PwC's payment will be the second-largest auditor settlement in securities class action history. In all, the proposed settlement is the third largest securities class action recov-

6. Had the case proceeded to trial, defendants represent that they would have offered expert witnesses to show that the class suffered no damages or only minimal damages. Defendants' brief in support of final approval of this settlement did not, however, provide specific alternative calculations.

ery in history, behind only *Enron* and *WorldCom*.

The proposed settlement also provides for the assignment to Tyco of the class's claims against the Individual Tyco Defendants Kozlowski, Swartz, and Walsh (none of whom are part of the settlement). In return for this assignment, Tyco agreed that 50% of any net recovery against those individuals, both on its own claims and on the class's assigned claims, will be transferred to the settlement fund.

H. *Plan of Allocation*

The settlement fund has already been paid into escrow accounts at a number of major banks. Under the proposed plan of allocation, the settlement funds (less administrative and notice costs, taxes and related expenses, and attorneys' fees and expenses, but plus the interest earned by the fund) will be distributed to class members who submit timely, valid Proof of Claim forms. The Garden City Group ("GCG"), a claims administrator retained by Co–Lead Counsel, will calculate each claimant's share according to the information on the Proof of Claim forms, apportioning each recovery according to Dr. Zmijewski's damages calculations.

Co–Lead Counsel retained two additional independent experts, R. Alan Miller [7] and Dr. Kenneth D. Gartrell [8], to opine on the reasonableness and fairness of the plan of allocation. Mr. Miller and Dr. Gartrell both opined that the Plan is reasonable and fair from the perspective of investors who acquired Tyco stock during the class period.

I. *Notice to the Class*

After contacting nominee purchasers (i.e. banks, brokers, and other purchasers of record who bought and sold Tyco securities on behalf of others) to identify the beneficial owners on whose behalf the nominees acted, GCG (the claims administrator retained by Co–Lead Counsel) mailed some 2.4 million claim packets containing the Notice of Proposed Settlement to class members and their nominees. For claim packets that were returned undelivered, GCG followed up by periodically searching for the recipients' new addresses and re-mailing the packets until the packets were successfully delivered.

In addition to the mailed claim packets, GCG published summary notices in *USA Today, The New York Times, The Wall Street Journal, The Financial Times, South Florida Sun–Sentinel, Palm Beach Post, Chicago Times, The Union Leader* (Manchester, NH), and over the *PR Newswire*. GCG also set up a website and toll-free telephone hotline to assist class members in submitting their claims and provide answers to their questions regarding the settlement.

J. *Reaction of the Class to the Notice*

Proof of Claim forms are due by December 28, 2007, so the Proof of Claim numbers are not final. Keeping that in mind, out of the 2.4 million copies of the Notice mailed to potential class members, GCG had received 74,655 Proof of Claim forms as of October 12, 2007, and 288 requests for exclusion from the class as of the September 28, 2007 deadline for exclusion.

7. Mr. Miller is President of the Philadelphia Investment Banking Company (''PIBC''), which he co-founded in 1983. Among other things, PIBC frequently performs evaluations of businesses and securities for investors. Mr. Miller regularly testifies as an expert witness on securities-related issues.

8. Dr. Gartrell is a financial economist and economic consultant. He formerly served as a Managing Director at LECG, LLC, an international economic consulting firm, was the founding partner of Ken Gartrell & Company, and was a Principal in the economic consulting firms of The Brattle Group and Putnam, Hayes & Bartlett.

The court has received twenty-eight objections to the proposed settlement. Of these, four are from institutional investors and the remainder are from individual investors, a handful of whom are not actually members of the class. These objections are described and discussed individually in the analysis section below.

K. *Fairness Hearing*

The Fairness Hearing took place on November 2, 2007. Co–Lead Counsel appeared, as did counsel for additional plaintiffs. Counsel for Tyco, PwC, Belnick, and Ashcroft were also present. Counsel for two objectors, the Commonwealth of Pennsylvania State Employees' Retirement System and Public School Employees' Retirement System ("SERS/PSERS") and U.S. Trust, requested and were given the opportunity to be heard.

II. *ANALYSIS*

A. *Adequacy of Notice*

[1] The Federal Rules of Civil Procedure require, upon certification of the class, that "the best notice that is practicable under the circumstances" be given, "including individual notice to all members who can be identified through reasonable effort." Fed.R.Civ.P. 23(c)(2)(B). The Federal Rules of Civil Procedure further require, upon the successful negotiation of a proposed settlement, that notice be given "in a reasonable manner to all class members who would be bound by the proposal." Fed.R.Civ.P. 23(e)(1). The Due Process Clause requires that notice be "reasonably calculated to reach potential class members." *In re Compact Disc Minimum Advertised Price Antitrust Litig.,* 216 F.R.D. 197, 203 (D.Me.2003); *see also Eisen v. Carlisle & Jacquelin,* 417 U.S. 156, 174, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974); *Mullane v. Cent. Hanover Bank & Trust Co.,* 339 U.S. 306, 315, 70 S.Ct. 652, 94 L.Ed. 865 (1950). Additionally, the Private Securities Litigation Reform Act ("PSLRA") requires that the notice of settlement provide statements of plaintiff recovery, potential outcome of the case, attorneys' fees or costs, identification of plaintiffs' representatives, and the reasons for settlement. 15 U.S.C. § 78u–4(a)(7).

In this case, Co–Lead Counsel and GCG jointly developed an effective notice program. As detailed above, the notice program involved pre-mailing contacts with nominee purchasers, repeated efforts at mailing the claim packets to class members, publication notice in eight national and regional newspapers, and a website and toll-free telephone hotline.

This notice program compares favorably with the notice programs in other securities cases. *See In re Cabletron Sys., Inc. Sec. Litig.,* 239 F.R.D. 30, 35–36 (D.N.H. 2006) (approving a notice program that distributed notice packets to individual investors and nominees, published a summary notice in one national newspaper, and provided a toll-free telephone hotline); *see also In re WorldCom, Inc. Sec. Litig.,* 388 F.Supp.2d 319, 332–33 (S.D.N.Y.2005) (approving a notice program that distributed notice packets to potential class members and published summary notices in two national newspapers and over two wire services). Accordingly, I find that Co–Lead Counsel's notice program met or exceeded all relevant requirements. To the extent that any objectors have claimed that the notice program was not adequate, I overrule their objections. I further find that the contents of the notice packets were acceptable and met all relevant requirements.

B. *Adequacy of the Settlement*

Under Rule 23(e) of the Federal Rules of Civil Procedure, I may approve this class action settlement only if I conduct a fairness hearing and find that the terms of

the settlement are "fair, reasonable, and adequate." Fed.R.Civ.P. 23(e)(2). In the First Circuit, this requires a wide-ranging review of the overall reasonableness of the settlement that relies on neither a fixed checklist of factors nor any specific litmus test. *See In re Lupron Mktg. & Sales Practices Litig.*, 228 F.R.D. 75, 93 (D.Mass.2005) ("[T]he First Circuit has not established a formal protocol for assessing the fairness of a settlement."); *Compact Disc*, 216 F.R.D. at 206 ("There is no single test in the First Circuit for determining the fairness, reasonableness and adequacy of a proposed class action settlement."); *Bussie v. Allmerica Fin. Corp.*, 50 F.Supp.2d 59, 72 (D.Mass.1999) ("This fairness determination is not based on a single inflexible litmus test but, instead, reflects its studied review of a wide variety of factors bearing on the central question of whether the settlement is reasonable in light of the uncertainty of litigation.").

[2] Although the district court must carefully scrutinize the settlement, there is a presumption in favor of the settlement if the parties negotiated it at arms-length, after conducting meaningful discovery. *City P'ship Co. v. Atl. Acquisition Ltd. P'ship*, 100 F.3d 1041, 1043 (1st Cir.1996); *Nilsen v. York Cty.*, 382 F.Supp.2d 206, 212 (D.Me.2005); *Compact Disc*, 216 F.R.D. at 207. Moreover, public policy generally favors settlement—particularly in class actions as massive as the case at bar. *See WorldCom*, 388 F.Supp.2d at 337.

Some courts have relied on the Second Circuit's *Grinnell* factors to determine the fairness of a settlement:

> (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.

City of Detroit v. Grinnell Corp., 495 F.2d 448, 463 (2d Cir.1974) (internal citations omitted); *see also In re Cendant Corp. Litig.*, 264 F.3d 201, 232 (3d Cir.2001) (*Cendant I*) (applying the *Grinnell* factors, as is required in the Third Circuit); *WorldCom*, 388 F.Supp.2d at 337 (applying the *Grinnell* factors, as is required in the Second Circuit); *Lupron*, 228 F.R.D. at 93 (applying the *Grinnell* factors as a matter of preference).

In *Compact Disc*, the District of Maine recently used a modified version of the *Grinnell* factors:

> (1) comparison of the proposed settlement with the likely result of litigation; (2) reaction of the class to the settlement; (3) stage of the litigation and the amount of discovery completed; (4) quality of counsel; (5) conduct of the negotiations; and (6) prospects of the case, including risk, complexity, expense and duration.

Compact Disc, 216 F.R.D. at 206.

[3] Although I have the discretion to use the *Grinnell* list of factors verbatim, I find that a more concise list of the considerations at play, modeled on those used in *Compact Disc*, best fits the facts of this case. Accordingly, I discuss the following considerations in turn: (1) risk, complexity, expense and duration of the case; (2) comparison of the proposed settlement with the likely result of continued litigation; (3) reaction of the class to the settlement; (4) stage of the litigation and the amount of discovery completed; and (5)

quality of counsel and conduct during litigation and settlement negotiations.

1. *Risk, Complexity, Expense, and Duration of the Case*

[4] It is difficult to overstate the complexity of this case. As the depth and breadth of discovery suggests, the facts were not easy to ascertain. Plaintiffs had to scrutinize documents from more than one hundred different corporate acquisitions by Tyco to identify whether those acquisitions involved fraudulent accounting, how the transactions were audited by PwC, and what measures defendants may have taken to cover up the fraudulent accounting.

This was not just a complex case, however. It was also a risky case for both sides, in large part because of an uncertain legal environment. Plaintiffs' theory of the case put them at the cutting edge of a rapidly changing area of the law. In particular, the still-developing law of loss causation in securities cases created significant risk and uncertainty for plaintiffs. According to plaintiffs' theory, the misstatements by Tyco and PwC proximately caused investors' losses, as shown by drops in Tyco's stock prices following the eight corrective disclosures. None of those disclosures, however, involved a specific admission of fraud by Tyco or PwC. Instead, the disclosures mostly related to the integrity of Tyco's management. Although I denied defendants' motion to dismiss and PwC's motion for summary judgment, I did so only after careful consideration and extensive briefing. Moreover, the law remains in flux and it is by no means certain that plaintiffs would have prevailed if they had taken the case to trial and attempted to defend any favorable verdict on appeal.

This case involved a greater risk of nonrecovery than other multibillion-dollar securities class action settlements. *WorldCom* involved a number of complex issues, but the fraud was so extensive that there were many targets to pick off, providing funds for continued litigation. *Cendant* was, as the Third Circuit observed, a "simple case in terms of liability with respect to Cendant, and the case was settled at a very early stage, after little formal discovery," which made the risks of non-recovery negligible. *Cendant I,* 264 F.3d at 286. In *AOL Time Warner,* the risks were "above-average" and loss causation was a similarly unsettled issue, but the chain of causation involved fewer logical leaps and was therefore easier to prove than in this case. *See In re AOL Time Warner, Inc. Sec. & "ERISA" Litig.,* No. 02 Civ. 5575(SWK), 2006 WL 3057232, at *16, 2006 U.S. Dist. LEXIS 78101, at *47–*48 (S.D.N.Y. Sept. 28, 2006). Reflecting these risks and complexities, the parties on both sides necessarily incurred considerable expense in litigating the case.

Counsel for both Tyco and PwC made it clear by their words and deeds during the course of the litigation that they intended to vigorously contest plaintiffs' claims. Defendants selected several of the country's most skilled advocates as their representatives and those advocates responded by uncovering and effectively advancing every non-frivolous legal argument that could conceivably be presented on their clients' behalf. In short, the case took nearly five years to resolve because it was factually complex, turned on several novel and difficult legal issues, and was aggressively and effectively litigated by defendants who were determined to spare no expense in protecting their interests.

If the case survived summary judgment and went to trial, plaintiffs would face additional risk, uncertainty, and delay. Proving loss causation would be complex and difficult. Moreover, even if the jury agreed to impose liability, the trial would likely involve a confusing "battle of the

experts" over damages. If, faced with conflicting expert testimony, the jury chose to embrace the most conservative estimate of damages, then the ultimate award might turn out to be less than the proposed settlement. Defendants would appeal any adverse verdicts and those appeals would further delay the resolution of the case. In a case as complex as this one, any appeal would present the plaintiffs with a substantial risk of reversal.

In addition to being risky and complex, this was a lengthy and expensive undertaking for Co–Lead Counsel. Over the past five years, Co–Lead Counsel have put in more than 488,000 hours of attorney time at a market value of over $172 million. They have also incurred more than $29 million in yet-to-be-reimbursed expenses. Continued litigation would drive costs even higher. Thus, risk, complexity, expense, and duration all weigh in favor of approving the proposed settlement.

2. *Comparison of the Proposed Settlement with the Likely Result of Continued Litigation*

[5] Assuming that all eligible shareholders file claims and that Dr. Zmijewski's event study model accurately characterizes the damages to the class, the proposed settlement represents approximately 27% of the alleged damages to the class. In light of the substantial risk, uncertainty, and delay associated with proceeding to summary judgment and trial, the $3.2 billion settlement amount is an outstanding recovery for the class.

3. *Reaction of the Class to the Settlement*

[6] The reaction of the class to the settlement has been almost entirely positive. None of the institutional investors have objected to the size of the settlement; indeed, even the institutional investors who objected to other aspects of the settlement at the Fairness Hearing lauded this as an excellent recovery for the class.

Only a small number of individual investors have argued that the settlement should be larger. As discussed in more detail below, however, these objections are based on calculations that overstate the provable damages to the class and are without merit.

4. *Stage of the Litigation and the Amount of Discovery Completed*

[7] This settlement came after extensive discovery and motion practice. As stated above, plaintiffs reviewed 82.5 million pages of documents and conducted over 220 depositions. At this stage, they have most of the crucial facts in their possession, making them well-positioned to understand the merits of their case. Had the parties not agreed on this settlement, the next steps would be summary judgment and (assuming that plaintiffs survived summary judgment) trial.

5. *Quality of Counsel and Conduct During Litigation and Settlement Negotiations*

[8] This settlement was the product of arms-length negotiations by highly skilled and diligent counsel on both sides, and Lead Plaintiffs ably discharged their responsibilities to monitor Co–Lead Counsel and ensure that Co–Lead Counsel acted in the best interests of the class. As Judge Sporkin observed in his statement summarizing the settlement negotiations, "the advocacy on both sides of the case was outstanding," and both sides were prepared to try the case if settlement talks failed. Moreover, Judge Sporkin was impressed by "the deep involvement of the class representatives in overseeing the prosecution of the case, and with their commitment to that obligation." I concur

with Judge Sporkin's assessments on both points.

In summary, I find that the settlement is fair, reasonable, and adequate.

C. *Reasonableness of the Plan of Allocation*

[9] Like the settlement itself, the plan of allocation must be fair, reasonable, and adequate. *WorldCom,* 388 F.Supp.2d at 344. Co–Lead Counsel have established that the plan of allocation, which compensates class members according to the nature and timing of their Tyco securities transactions, has a reasonable basis. It is calculated according to Dr. Zmijewski's model, and was reviewed by experts R. Alan Miller and Dr. Kenneth D. Gartrell, who concluded both that the underlying methodology was sound and that the distribution plan was fair and reasonable. The fact that these independent experts evaluated the plan of allocation and agreed that it was fair weighs strongly in its favor.

The plan of allocation also deals appropriately with the issue of what to do with excess funds. The plan calls for the continued re-distribution of unclaimed funds to class members according to their pro rata shares, until the costs of such redistributions make it economically unfeasible to continue doing so. If and when that point is reached, then the balance of the fund will be subject to a *cy pres* remedy designated by Co–Lead Counsel with the consent of Tyco and PwC. This approach is consistent with the latest draft of the American Law Institute's Principles of the Law of Aggregate Litigation. *See* American Law Institute, *Principles of the Law of Aggregate Litigation,* Discussion Draft No. 2, § 3.07 (Apr. 6, 2007) (recommending that a *cy pres* approach be used only if individual distributions of the surplus to class members are not economically viable or individual class members cannot easily be identified). Although the settlement agreement does not specifically require that I approve the chosen beneficiary of any *cy pres* remedy, Co–Lead Counsel have assured me that they will submit the planned remedy for my review should a *cy pres* remedy become necessary, and I will require them to obtain my approval before proceeding with any such plan.

Based on the foregoing, I find that the plan of allocation is fair and reasonable.

D. *Objections to the Settlement and Plan of Allocation*

None of the institutional investors have objected to either the size of the settlement or the allocation plan. Some individuals, however, have raised objections. I discuss these below.

Some objectors agreed to withdraw their objections after Co–Lead Counsel offered to compensate them for their services to the class from any attorneys' fees award. If I approve these objectors' stipulations of withdrawal, it is because the final resolution is fair to the class, without regard to any compensation the objectors may receive. Nevertheless, Co–Lead Counsel remain free to pay such compensation from the fee award if they so choose, and I need not approve such compensation for it to take place.

1. *Objections to the Terms of the Proposed Settlement*

Chris Andrews (Doc. No. 1108) objected to the settlement because he disagreed with certain strategic decisions made by Co–Lead Counsel, who had retained Andrews as a consultant to investigate certain factual matters. Andrews has since resolved this dispute with Co–Lead Counsel and has stipulated to the withdrawal of his objection. Had Andrews pursued this objection, I would have overruled it, so I approve his stipulated withdrawal.

James Hill (Doc. No. 1130) objected to the settlement because it could be interpreted to release claims against the Boston Stock Exchange arising from alleged stock market manipulation of Tyco securities traded on that exchange. In response to Hill's concerns, Co–Lead Counsel clarified the terms of the release and Hill withdrew his objection. I approve his stipulated withdrawal.

Peter and Rita Carfagna and Barry Friedman (Doc. No. 1121) objected to the 50/50 split between the class and Tyco for successful prosecution by Tyco of any officer assigned claims. After Co–Lead Counsel clarified the strategic reasons for this decision (namely, the split serves the interests of the class because Tyco has more information regarding the fraud perpetrated by the officer defendants than plaintiffs, and it would be difficult for plaintiffs to collect judgments on the officers' assets), the Carfagnas and Friedman withdrew their objection. I approve their stipulated withdrawal.

James Hayes (Docs. No. 1134 and 1169) argues that the recovery is inadequate because, he alleges, Tyco's stock was artificially inflated by $51 per share at its peak, not the $8.29 per share calculated by Dr. Zmijewski. Hayes' calculation is overly simplistic; although it does adjust for the overall decline in the market, it fails to account for other confounding factors such as the Tyco split plan, Tyco's credit problems, and poor performance by Tyco subsidiaries. Hayes' estimate therefore does not conform to the stringent requirements that plaintiffs would have had to meet to establish loss causation. *See Dura*, 544 U.S. at 346, 125 S.Ct. 1627. Because Hayes' calculation overestimates the provable damages and his objection generally fails to cast doubt on Dr. Zmijewski's event study methodology, I overrule his objection.

Richard and Maryann Wronko (Doc. No. 1132) argue that the recovery is inadequate because it does not fully capture the decrease in value of their Tyco stock and does not include the "likely punitive damages that would have been awarded." The Wronkos' calculation of likely compensatory damages, however, grossly overestimates the potential recovery because it does not account for any possible confounding factors. *See Dura*, 544 U.S. at 346, 125 S.Ct. 1627. Their argument as to punitive damages is problematic because punitive damages are not available for violations of the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78bb(a) ("no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of"); *Manchester Mfg. Acquisitions, Inc. v. Sears, Roebuck & Co.*, 802 F.Supp. 595, 605 (D.N.H.1992). The Wronkos also make two unrelated objections.[9] These objections also have no merit. I therefore overrule the Wronkos' objections.

2. *Objections to the Class Period*

Joel Douglas (Doc. No. 1105), Richard Dayton (Doc. No. 1115), David Kaiser (Doc. No. 1109), Susan Schaffer (Doc. No. 1138), Marvin and Sonia Greenbaum (Doc. No. 1136), and M.A. Hartley (Doc. No. 1141) objected to the class period, arguing that it should start earlier, end later, and/or include holder claimants. After Co–Lead Counsel explained the basis for

9. Specifically, the Wronkos object to the fact that they received the Notice of Proposed Settlement only one week before the deadline for objections, and also that the settlement's termination options give PwC more favorable treatment than Tyco if PwC chooses to withdraw from the settlement.

the existing class period, all but Kaiser and Hartley withdrew their objections. Kaiser offers no principled reason for modifying the class period, and his proposal to include holder claimants in the class has no legal merit. *See Dura,* 544 U.S. at 346, 125 S.Ct. 1627 (describing the requirements for establishing loss causation); *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 737–38, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975) (denying standing to holder claimants in private federal securities actions). I therefore overrule his objection. Hartley's objection was untimely and, for the same reasons as Kaiser's, has no legal merit. I therefore overrule Hartley's objection as well. Had Douglas, Dayton, Schaffer, and the Greenbaums pursued their objections, I would have overruled them, so I approve their stipulated withdrawals.

3. *Objections to the Plan of Allocation*

Robert and Patricia Weinberg (Doc. No. 1110) objected to the *cy pres* provisions of the settlement because these provisions do not call for input by members of the class. The Weinbergs withdrew their objection after Co–Lead Counsel agreed to consult with Mr. Weinberg regarding what charitable organizations should receive *cy pres* funds. Weinberg, who is a leader and prominent member of the District of Columbia bar, is well-positioned to offer useful advice to Co–Lead Counsel on this issue. Moreover, because any proposed plan for the distribution of *cy pres* funds must be submitted to me for approval, there is an additional layer of review protecting the interests of the class if such a distribution becomes necessary. I therefore approve the Weinbergs' stipulated withdrawal.

John Nemfakos (Doc. No. 1137) objects to the different treatment of call options and put options.[10] He also objects to the provision limiting losses from option trading to 1% of the total settlement amount. I overrule both objections. Call options are discounted relative to put options because the purchase of a call option includes a time premium—a wasting asset that will evaporate even if the stock price remains steady. The limitation of losses from option trading is because these derivative securities suffer from much greater volatility than stocks and bonds, making it more difficult to establish loss causation.

4. *Miscellaneous Objections*

H. Paul Block and Bernice Block (Doc. No. 1156), who assert that they held previously-acquired Tyco stock during the class period but made no transactions during the class period, have filed a late objection to the settlement. Although their objection is untimely, I consider it on the merits. Based on their initial premise that the Securities Litigation Uniform Standards Act ("SLUSA") forces *federal* law claims to be pre-empted by *state* law claims, they argue that: (1) holder claimants—although not included as class members—should have standing to object to the proposed settlement; (2) SLUSA should extinguish the federal claims and allow the state claims to move forward; and (3) the proposed settlement should be declared invalid. Their arguments rest on a faulty foundation, however, because their concept of preemption is backward. SLUSA preempts a broad range of *state* law class-action claims in favor of *federal* law claims. As the Supreme Court recently held in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,* 547 U.S. 71, 126 S.Ct. 1503,

10. A call option is a right to purchase a security at a price and date certain in the future. A put option gives the buyer the right to *sell* the security to the counter-party at a price and date certain in the future.

164 L.Ed.2d 179 (2006), SLUSA does so even when extinguishing those state claims would deny any remedy at all to certain classes of plaintiffs. *See id.* at 82–89, 126 S.Ct. 1503. For holder claimants like the Blocks, who have no remedy under federal law, this is a harsh result, but the law is clear on this point. *See Blue Chip Stamps,* 421 U.S. at 737–38, 95 S.Ct. 1917 (denying standing to holder claimants in private federal securities actions). Because all three of the Blocks' arguments rely on their incorrect understanding of preemption, none of them have merit. I therefore overrule their objection.

Frank DeCiancio (Doc. No. 1176) filed a late objection to the settlement, asserting that Co–Lead Counsel's calculations of Tyco stock inflation appear illogical. His concerns are adequately addressed by Dr. Zmijewski's detailed description of how he made his damage calculations. Accordingly, I overrule DeCiancio's objection.

E. *Attorneys' Fees and Expenses*

An attorney who recovers a common fund for the benefit of others is entitled to "a reasonable attorney's fee from the fund as a whole." *Boeing Co. v. Van Gemert,* 444 U.S. 472, 478, 100 S.Ct. 745, 62 L.Ed.2d 676 (1980). By assessing attorneys' fees and litigation expenses against a common fund, the court spreads these costs proportionately among those benefitted by the suit. *Id.* Moreover, providing adequate compensation encourages capable plaintiffs' attorneys to aggressively litigate complex, risky cases like this one rather than settling lower and earlier than would be in the best interests of the class members they represent. *See In re GMC Pick–Up Truck Fuel Tank Prods. Liab. Litig.,* 55 F.3d 768, 801–02 (3d Cir.1995) (discussing the theoretical foundations for fee awards in class action cases). In this case, Co–Lead Counsel, after negotiations with Lead Plaintiffs, have requested attorneys' fees amounting to 14.5% of the settlement fund. They also seek reimbursement for $28,938,412.74 in expenses. I address the fees and the expenses separately, and conclude that both merit approval.

1. *Fees*

[10] In line with PSLRA cases in other circuits and past common fund cases in this circuit, I use the percentage of fund ("POF") method [11] with a lodestar [12] cross-check to evaluate the fee request. *In re Rite Aid Corp. Sec. Litig.,* 396 F.3d 294, 305–06 (3d Cir.2005); *United States v. 8.0 Acres of Land,* 197 F.3d 24, 33 (1st Cir. 1999); *In re Thirteen Appeals Arising out of the San Juan Dupont Plaza Hotel Fire Litig.,* 56 F.3d 295, 307–08 (1st Cir.1995). The POF method is appropriate in common fund cases because it "rewards counsel for success and penalizes it [counsel] for failure." *GMC Pick–Up Truck,* 55 F.3d at 821. Using a lodestar cross-check ensures that the fees are also reasonable in light of the actual amount of work performed. *Vizcaino v. Microsoft Corp.,* 290 F.3d 1043, 1050 (9th Cir.2002).

(a) *POF Method*

[11] A district court in the First Circuit has "extremely broad" latitude to determine an appropriate fee award under the POF method. *Thirteen Appeals,* 56 F.3d at 309. Unlike the Second and Third Circuits, the First Circuit does not require

11. Under the POF method, the fee award is calculated as a reasonable percentage of the settlement amount. *In re Thirteen Appeals Arising out of the San Juan Dupont Plaza Hotel Fire Litig.,* 56 F.3d 295, 305 (1st Cir. 1995).

12. The lodestar ordinarily is calculated by multiplying the number of hours reasonably incurred by the reasonable hourly rate for the services rendered. *Gisbrecht v. Barnhart,* 535 U.S. 789, 802, 122 S.Ct. 1817, 152 L.Ed.2d 996 (2002).

courts to examine a fixed laundry list of factors. *See id.* at 307–09. *Cf. Rite Aid*, 396 F.3d at 301; *Goldberger v. Integrated Res., Inc.*, 209 F.3d 43, 47 (2d Cir.2000). I therefore draw loosely on the factors employed by the Second and Third Circuits that are most relevant to my analysis. In particular, I consider: (1) fee awards in similar cases, (2) the complexity, duration, and risk involved in the litigation, (3) the manner in which the fee request was negotiated between Co–Lead Counsel and Lead Plaintiffs, (4) the reaction of the class, and (5) public policy considerations. Based on the totality of these factors, I conclude that the requested 14.5% award is reasonable and appropriate.

(i) Comparison to Other Cases

[12] Co–Lead Counsel argue that I should compare their fee request with the fees that were awarded in connection with the sixteen post-PSLRA securities fraud cases with settlements at or above $400 million. These cases, listed according to the size of the recovery for the class, are: *WorldCom* ($6.13 billion), *Cendant* ($2.19 billion), *AOL Time Warner* ($2.65 billion), *Nortel I* ($1.14 billion), *Royal Ahold* ($1.09 billion), *Nortel II* ($1.04 billion), *McKesson* ($960 million), *Lucent* ($517 million), *BankAmerica* ($485 million), *Dynegy* ($474 million), *Raytheon* ($460 million), *Waste Management II* ($457 million), *Adelphia* ($455 million), *Global Crossing* ($448 million), *Freddie Mac* ($410 million), and *Qwest* ($400 million).[13]

Two objectors—SERS/PSERS and U.S. Trust—appeared at the Fairness Hearing and argued that I should limit my comparative analysis to a subset of cases in which the settlements exceeded $1 billion. These "super mega-fund" cases are: *WorldCom*, *Cendant*, *AOL Time Warner*, *Nortel I*, *Royal Ahold*, and *Nortel II*. The objectors contend that the comparison set should be limited to such cases because super mega-fund cases are a distinct subclass in which the size of the recovery is explained more by the size of the class than the work expended by counsel. As a result, the objectors argue, super mega-fund cases—Tyco included—require comparatively lower POF awards to fairly compensate counsel than will be required in cases with smaller settlements.

A comparison of Table 1 with Table 2 explains why this argument is potentially significant. Table 1, which lists the POF awards for the top securities fraud settlements in descending order, reveals that the POF award requested in this case is in

13. *See generally In re Nortel Networks Corp. Sec. Litig.*, No. 01–CV–1855 (RMB) (S.D.N.Y. Jan. 29, 2007) (order and final judgment) (*Nortel I*); *In re Nortel Networks Corp. Sec. Litig.*, No. 05–MD–1659 (LAP) (S.D.N.Y. Dec. 26, 2006) (order and final judgment) (*Nortel II*); *In re Adelphia Communs. Corp. Secs. & Derivative Litig.*, No. 03 MDL 1529 (LMM), 2006 U.S. Dist. LEXIS 84621 (S.D.N.Y. Nov. 16, 2006); *In re Royal Ahold N.V. Sec. & ERISA Litig.*, 461 F.Supp.2d 383 (D.Md. 2006); *Ohio Pub. Employees Ret. Sys. v. Freddie Mac*, No. 03–CV–4261 (JES) (S.D.N.Y. Oct. 26, 2006) (order and judgment); *AOL Time Warner*, 2006 WL 3057232, 2006 U.S. Dist. LEXIS 78101; *In re Qwest Communs. Int'l, Inc. Sec. Litig.*, No. 01–cv–01451–REB–CBS, 2006 U.S. Dist. LEXIS 71267 (D.Colo. Sept. 28, 2006); *In re McKesson HBOC, Inc., Sec. Litig.*, No. 99–CV–20743 RMW (PVT) (N.D. Ca. Feb. 24, 2006) (order awarding attorney's fees and reimbursement of expenses); *WorldCom*, 388 F.Supp.2d 319; *In re Dynegy, Inc. Sec. Litig.*, No. H–02–1571 (S.D.Tex. Jul. 08, 2005) (order awarding attorneys' fees and reimbursement of expenses); *In re Raytheon*, No. 99–12142–PBS (D.Mass. Dec. 6, 2004) (order and final judgment); *In re Global Crossing Sec. & ERISA Litig.*, 225 F.R.D. 436 (S.D.N.Y.2004); *In re Lucent Techs., Inc. Sec. Litig.*, 327 F.Supp.2d 426 (D.N.J.2004); *In re Cendant Corp. Litig.*, 243 F.Supp.2d 166 (D.N.J.2003) (*Cendant II*); *In re BankAmerica Corp. Sec. Litig.*, 228 F.Supp.2d 1061 (E.D.Mo.2002); *In re Waste Mgmt., Inc. Sec. Litig.*, No. H–99–2183 (S.D.Tex. May 10, 2002) (findings of fact and conclusions of law) (*Waste Mgmt. II*).

line with the POF awards for the other cases in the class (seventh out of seventeen). In contrast, Table 2, which lists the POF awards only in super mega-fund cases, suggests that this case is an outlier when it is compared only with the other cases in the subclass (first out of seven). Thus, it is important to determine whether the objectors are correct in contending that I should limit my comparative analysis to super mega-fund cases.

Table 1

Case Name	POF
Adelphia	21.40%
Freddie Mac	20.00%
BankAmerica	17.83%
Lucent	17.00%
Global Crossing	16.18%
Qwest	15.00%
Tyco (proposed)	*14.50%*
Royal Ahold	12.00%
Raytheon	9.00%
Dynegy	8.73%
Nortel II	8.00%
Waste Mgmt. II	7.93%
McKesson	7.79%
AOL Time Warner	5.57%
WorldCom	5.48%
Nortel I	3.00%
Cendant	1.73%

Table 2

Case Name	POF
Tyco (proposed)	*14.50%*
Royal Ahold	12.00%
Nortel II	8.00%
AOL Time Warner	5.57%
WorldCom	5.48%
Nortel I	3.00%
Cendant	1.73%

The objectors' contention that super mega-fund cases warrant lower POF awards than smaller cases because they require proportionally less work may well be true as a general matter. *See generally In re Prudential Ins. Co. Am. Sales Practice Litig. Agent Actions,* 148 F.3d 283, 339 (3d Cir.1998) ("the basis for this inverse relationship [between the settlement amount and the appropriate POF] is the belief that in many instances the increase [in recovery] is merely a factor of the size of the class and has no direct relationship to the efforts of counsel" (internal quotations omitted)). However, the generalization on which the objectors' argument depends does not hold in this case. The best measure of the effort required to produce a particular result in a given case is the lodestar. In this case, the lodestar expressed as a percentage of the settlement amount is 5.38%. As Appendix 1 demonstrates, this "lodestar percentage" is substantially higher than the lodestar percentages for all but one of the super mega-fund cases and it is much more closely aligned with the lodestar percentages in the larger set of cases that Co–Lead Counsel have proposed for comparison purposes. In other words, whether or not super mega-fund cases generally require proportionally less effort than smaller cases, the generalization is not true in this case. Accordingly, the record does not support the objectors' contention that the proposed POF award should be compared only with the POF awards in super mega-fund cases.[14]

14. Neither Co–Lead Counsel nor the objectors argue that I should compare the POF award requested in this case with POF awards in the still-larger class of all securities fraud settlements. While I could perform such an analysis, it is unlikely that it would produce significant new information. If anything, expanding the set of comparable cases to include all securities fraud settlements would tend to favor Co–Lead Counsel more,

In summary, I agree with Co–Lead Counsel that the appropriate set of securities fraud settlements to use for comparison purposes is a set of the sixteen largest settlements rather than a subset of only super mega-fund cases. When I compare the proposed POF award with the POF awards in this set of cases, the proposed POF award does not stand out as unusual.[15]

(ii) Complexity, Duration, and Risk

[13] I have already described the factual and legal complexity of this case in explaining why I approved the settlement. The same considerations apply here. This was an enormously complex case, and counsel assumed substantial risk in pursuing it. The number of mergers and acquisitions that were scrutinized and the novelty and difficulty of the legal issues that were presented leave this case with few comparable precedents. Moreover, it is unsurprising that the case took five years to resolve given its difficulty and the fact that plaintiffs were opposed by determined and well-funded adversaries who were represented by highly skilled counsel.

It is noteworthy that three different plaintiffs' firms—entities that generally would not work together unless they found it absolutely necessary—had to work cooperatively, spreading the risk among themselves so that they would have the collective resources required to carry this case through to completion. Co–Lead Counsel, it must be remembered, took this case on a wholly contingent basis. Had they lost on summary judgment or fallen short of establishing liability at trial, they would have lost the tens of millions of dollars in expenses and all of the attorney time that they collectively invested in the case. The $172 million lodestar that Co–Lead Counsel gambled on this case was more than twice as big as in *WorldCom* ($83 million lodestar), more than four times as big as in *AOL Time Warner* ($40 million lodestar), and more than twenty-one times as big as in *Cendant* ($8 million lodestar). It would be inappropriate for me to ignore these differences in evaluating the risk that Co–Lead Counsel assumed in taking on this case.

It is also important to bear in mind that the sheer amount of discovery in this case was staggering. The document production alone—82.5 million pages—dwarfs every other major securities class action. In comparison, *AOL Time Warner* involved a mere 15.5 million pages of document production. *See AOL Time Warner,* 2006 WL 3057232, at *3, 2006 U.S. Dist. LEXIS 78101, at *9. Indeed, Co–Lead Counsel had to review, catalog, and analyze so many documents that, partway through the discovery process, they were forced to hire a technology firm to develop more advanced computerized metrics for sorting through the production.

Accordingly, the unusual complexity, duration, and risk involved in this case are all factors that weigh in favor of the proposed fee award.

(iii) Negotiation of Fee Request

[14] The 14.5% fee request was not unilaterally selected by Co–Lead Counsel.

not less, because POF awards are typically higher in the group of substantially smaller settlements that would be added to the comparison set. *See Prudential,* 148 F.3d at 339.

15. I do not attach undue significance to this factor. Settlement size is at best a crude indicator of comparability. Each case, regardless of its size, presents its own set of challenges. The work required to resolve the case, the risk of an adverse result, and the quality of the outcome will all vary from case to case. Whether the proposed POF award is reasonable ultimately will depend on an assessment of these largely subjective factors. *See Rite Aid,* 396 F.3d at 303 (cautioning against ''overly formulaic approaches in assessing and determining the amounts and reasonableness of attorneys' fees'').

Instead, at the direction of Lead Plaintiffs, Co–Lead Counsel retained two retired judges—Judge Abner J. Mikva (retired Chief Judge of the Court of Appeals for the D.C. Circuit, former White House Counsel, and former Member of Congress) and Judge Alfred M. Wolin (retired U.S. District Judge for the District of New Jersey)—to evaluate Co–Lead Counsel's proposed fee request. Judges Mikva and Wolin carefully considered Lead Plaintiffs' allegations, the duration and procedural history of the case, the amount of completed discovery, the hours spent and expenses incurred by Co–Lead Counsel, and the legal issues at play in the case. Based on their evaluation of this information, Judges Mikva and Wolin concluded that a 14.5% fee would be reasonable. Lead Plaintiffs agreed with this recommendation, Co–Lead Counsel assented to it, and the recommendation became the fee proposal now before me.

This deliberative process is, so far as I know, unique. It is, however, an innovation that is consistent with the spirit of the PSLRA. Under the PSLRA's scheme, the court relies on properly-selected lead plaintiffs to act as agents for the class. *See Cendant I,* 264 F.3d at 282 (in cases governed by the PSLRA, "lead plaintiff is in the best position, under the PSLRA's scheme, to determine (at least initially) what its lead counsel's fee should be"). The fact that the 14.5% recommendation stems from such a process weighs strongly in favor of its reasonableness.

(iv) Reaction of the Class

[15] Only a tiny percentage of the class has objected to the proposed fee request. Of the 2.4 million Notice recipients, only eleven raised objections, and only four of those objections were filed by institutions. The eleven objections were almost all based on more generalized concerns about the magnitude of the fees and do not require further analysis. To the extent that they raise more specific issues, the objections lack merit, as is discussed in more detail below. Thus, the reaction of the class weighs in favor of approval.

(v) Public Policy Considerations

[16] As I have noted, POF awards generally decrease as the amount of the recovery increases. *See Rite Aid,* 396 F.3d at 302; *Prudential,* 148 F.3d at 339. This is because the magnitude of the recovery in many instances is due principally to the size of the class and "has no direct relationship to the efforts of counsel." *Prudential,* 148 F.3d at 339 (internal quotations omitted); *see also* Theodore Eisenberg & Geoffrey P. Miller, *Attorney Fees in Class Action Settlements: An Empirical Study,* 1 J. Empirical Legal Stud. 27, 64 (2004) (study of class action fees from 1993 to 2002, finding that as a general rule, the fee percent decreases as client recovery increases, and attributing this pattern to the economies of scale that result from aggregating smaller claims into a single larger action). Other factors may also weigh in favor of a reduced POF award in a particular case. For example, if a settlement is induced by groundwork laid by state regulators and other government entities, rather than the efforts of plaintiffs' counsel, it would be appropriate to reduce the percentage award as the recovery increases. *See Prudential,* 148 F.3d at 338, 342. Similarly, where a case settles at an early stage, before plaintiffs' counsel have expended hundreds of thousands of hours of work on discovery and motion practice, it is appropriate to reduce the percentage award accordingly. *See Cendant II,* 243 F.Supp.2d at 172 (where the case was "a simple case in terms of liability" and settled "at a very early stage, after little formal discovery," fee awarded was 1.73% POF with a 6.875 lodestar multiplier).

In this case, countervailing public policy considerations weigh against any reduction of the POF award. This was an extraordinarily complex and hard-fought case. Co–Lead Counsel put massive resources and effort into the case for five long years, accumulating nearly $29 million in yet-to-be-reimbursed expenses and expending more than 488,000 billable hours (constituting a lodestar of over $172 million) on a wholly contingent basis. But for Co–Lead Counsel's enormous expenditure of time, money, and effort, they would not have been able to negotiate an end result so favorable for the class. Because Co–Lead Counsel's continued, dogged effort over the past five years is a major reason for the magnitude of the recovery, and because this case could not have reached a similarly satisfactory resolution earlier, public policy favors granting counsel an award reflecting that effort.

Without a fee that reflects the risk and effort involved in this litigation, future plaintiffs' attorneys might hesitate to be similarly aggressive and persistent when faced with a similarly complicated, risky case and similarly intransigent defendants. *See WorldCom,* 388 F.Supp.2d at 359 ("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, it is necessary to provide appropriate financial incentives."). Of course, not every case needs to proceed as far as this one did to reach a good result for the class. *See, e.g., Cendant II,* 243 F.Supp.2d at 173 ("Lead Counsel's efforts to settle this matter at a relatively early stage has proved to be prescient .... waiting to reach settlement might have resulted in many years of delay in the class members' recovery."). But for cases like this one, in which a satisfactory settlement only became possible after years of hard-fought motion practice and searching discovery, it would be against public policy for me to set an unreasonably low POF award that would encourage future plaintiffs' attorneys to settle too early and too low. Additionally, approving this fee award is unlikely to open the floodgates to ever-higher levels of attorney compensation. Few cases will involve the combination of incredible legal and factual complexity, high risk, massive lodestar, and multibillion-dollar recovery that characterized this case. Accordingly, I find that it would be inappropriate to artificially reduce the percentage award based on the size of the recovery alone.

(b) *Lodestar Cross–Check*

[17] Several circuit courts have encouraged district judges to use the lodestar method as a cross-check on proposed POF awards. *See, e.g., Rite Aid,* 396 F.3d at 305; *Vizcaino,* 290 F.3d at 1043; *Goldberger,* 209 F.3d at 43. When the lodestar is used in this way, the focus is not on the "necessity and reasonableness of every hour" of the lodestar, but on the broader question of whether the fee award appropriately reflects the degree of time and effort expended by the attorneys. *See Thirteen Appeals,* 56 F.3d at 307. Such a results-oriented focus "lessens the possibility of collateral disputes [regarding time records] that might transform the fee proceeding into a second major litigation." *Id.*

In the present case, the lodestar cross-check confirms that the proposed POF award is reasonable. First, I am satisfied that the time charges and hourly rates that were reported in Co–Lead Counsel's fee application are reasonable. I reach this conclusion based on: (1) Co–Lead Counsel's detailed submissions; (2) my familiarity with the work that the case required; (3) the fact that the institutional objectors pointedly declined to challenge either counsels' hourly rates or the time expended (except for certain very specific objections that I resolve below); and (4)

Co–Lead Counsel's representation at the Fairness Hearing, which was not contradicted by defense counsel, that Tyco's counsel's lodestar was equal to or higher than Co–Lead Counsel's lodestar.

Second, taking the lodestar amount as an accurate indication of the work that was reasonably required to produce the settlement, the resulting lodestar multiplier [16] of 2.697 appropriately compensates counsel for the risk that they assumed in litigating the case. As Table 3 indicates, the lodestar multiplier in this case is among the lowest of the lodestar multipliers for the top securities fraud settlements (twelfth of seventeen). Because, as I have explained, the risk of an adverse result in this case was higher here than in many of the other large securities fraud cases, the relatively low lodestar multiplier in this case is a good indication that the proposed award is not excessive.

Table 3

Case Name	Lodestar Multiplier
Cendant	6.875
Waste Mgmt. II	5.296
Nortel II	4.773
Lucent	4.341
Dynegy	4.070
WorldCom	4.040
AOL Time Warner	3.690
Qwest	3.235
Raytheon	3.146
BankAmerica	3.000
Adelphia	2.890
Tyco (proposed)	*2.697*
Royal Ahold	2.569
Global Crossing	2.566
McKesson	2.400
Freddie Mac	2.319
Nortel I	2.058

Finally, the proposed POF award also appears to be reasonable when cross-checked against the lodestar percentage.[17] As the scatter plot depicted in Appendix 2 illustrates, there is a strong positive correlation between lodestar percentage and the POF award for the top securities fraud settlements. Assuming that within this comparison set, counsel faced comparable risks and obtained comparably favorable results, cases that fall close to the regression line depicted on the scatter plot have typical fee awards relative to their peers. Because the proposed POF in this case falls below the regression line, the result obtained was outstanding, and the risk that counsel assumed in litigating the case was at least as great as the risk faced by counsel in the comparable cases, this cross-check also suggests that the proposed fee award is reasonable.

2. *Objections to Fees*

(a) *Institutional Objectors*

SERS/PSERS and U.S. Trust, joined by the Public Employee Retirement System of Idaho and the West Virginia Investment Management Board, were the only institutional objectors to the fee award. Although the institutional objectors are uniformly pleased with the proposed settlement, they object to the size of the fee

16. In the context in which I use the term in this case, lodestar multiplier is calculated by dividing the fee award by the lodestar amount. *In re AT & T Corp. Secs. Litig.,* 455 F.3d 160, 164 (3d Cir.2006).

17. I have found no other reported decision that cross-checks a proposed POF award against the lodestar percentage. In cases where lodestar data is available, however, this type of cross-check is potentially useful because the lodestar percentage is an important factor in analyzing the reasonableness of the award and it is strongly correlated with the POF awards in the largest securities fraud cases.

award. In addition to their objections to the comparison set of settlements supplied by Co–Lead Counsel, the objectors raise generalized concerns about the danger that a 14.5% award in this case will create a new trend toward ever-higher compensation for plaintiffs' attorneys. This is a legitimate concern—particularly for institutional investors who are likely to be class members in other securities class actions in the future. Nevertheless, as I have described above, the unusual complexity, great legal uncertainty, high risks, massive but justifiable lodestar, high amount of work done in relation to the recovery for the class, and historic magnitude of the recovery in this case put it in a category of its own. Accordingly, the risks that this fee award would drive attorney compensation ever higher in future cases are minimal.

[18] SERS/PSERS also argues that the time spent on the state cases and on seeking Lead Plaintiff and Lead Counsel status should not be counted toward the lodestar because these activities did not benefit the class. This objection lacks merit. First, both activities were of at least some benefit to the fund. *See BankAmerica*, 228 F.Supp.2d at 1068 (stating that, to recover fees from a common fund, "attorneys must demonstrate that their services were of some benefit to the fund or enhanced the adversarial process." (quoting *Petrovic v. Amoco Oil Co.*, 200 F.3d 1140, 1156 (8th Cir.1999))). In particular, the state actions provided additional settlement leverage that Co–Lead Counsel used to negotiate a higher overall recovery from Tyco. The time spent recruiting Lead Plaintiffs also assisted the class because, as Judge Sporkin observed, the Lead Plaintiffs ultimately selected were knowledgeable institutional investors who worked diligently to ensure that Co–Lead Counsel proceeded efficiently and with maximum benefit to the class as a whole. In any event, the time spent on these two sets of activities collectively comprise less than 2% of the lodestar, making them inconsequential for purposes of the lodestar cross-check.

[19] SERS/PSERS argues that the work done by contract attorneys should be treated as an expense to be reimbursed, rather than being included in the lodestar. This objection lacks merit. The lodestar calculation is intended not to reflect the costs incurred by the firm, but to approximate how much the firm would bill a paying client. An attorney, regardless of whether she is an associate with steady employment or a contract attorney whose job ends upon completion of a particular document review project, is still an attorney. It is therefore appropriate to bill a contract attorney's time at market rates and count these time charges toward the lodestar. *See Sandoval v. Apfel*, 86 F.Supp.2d 601, 609–11 (N.D.Tex.2000) (holding that under a fee-shifting statute, the fees of contract attorneys and paralegals are compensable at market rates as part of the attorneys' fees, not just as overhead expenses of the firm); *see also Missouri v. Jenkins*, 491 U.S. 274, 286–88, 109 S.Ct. 2463, 105 L.Ed.2d 229 (1989) (using the same reasoning to conclude that market-rate billing of paralegal hours should count toward an attorney fee award).

Alternatively, SERS/PSERS argues that the lodestar contributions of contract attorneys were excessive, in that much of the work done by contract attorneys should have been performed by lower-billing paralegals. First, as the Supreme Court has noted, there are many types of work that lie "in a gray area of tasks that might appropriately be performed either by an attorney or a paralegal." *Jenkins*, 491 U.S. at 288 n. 10, 109 S.Ct. 2463. Depending on the particular circumstances, it may or may not be cost-efficient to preclude

attorneys from doing such work, particularly if it is intermingled with work that only an attorney can perform. Second and more importantly, even if I assumed that all of the contract attorney work done on behalf of Milberg Weiss LLP and Schiffrin Barroway Topaz & Kessler LLP (the two heaviest users of contract attorneys in this case) should have been billed at legal assistant rates,[18] this would reduce the overall lodestar by only about 12.5%, shifting the lodestar multiplier from 2.697 to 3.083. This minor change would not make any practical difference in the lodestar cross-check. *See Rite Aid*, 396 F.3d at 306 ("The lodestar cross-check calculation need entail neither mathematical precision nor bean-counting."); *Thirteen Appeals*, 56 F.3d at 307 (the lodestar cross-check does not demand that the judge "determine the necessity and reasonableness of every hour expended"). Accordingly, the objection lacks merit.

(b) *Individual Objectors*

Chris Andrews (Doc. No. 1108), Carfagnas/Friedman (Doc. No. 1121), Lynne Sell (Doc. No. 1126), Vondell Tyler and Ernest J. Browne (Doc. No. 1133), Rinis Travel Service, Inc. (Doc. No 1136), and the Weinbergs (Doc. No. 1110) objected to the fee award based on generalized concerns that the fees were too high. Some also sought assurances that Co–Lead Counsel would continue to be involved as necessary after the settlement is concluded. All of these objections were withdrawn after Co–Lead Counsel provided further assurances to the objectors and informed the objectors of the reduction in the fee request from the 17.5% fee described in the Notice of Proposed Settlement to the 14.5% fee that is now being sought. In light of these assurances, I find that there is no need to address these withdrawn objections further.

Charles L. Glass is the only individual objector to the fee award who has not withdrawn his objection. His objection consists entirely of generalized concerns about the magnitude of the award that are addressed by my discussion above. I therefore overrule his objection.

(c) *Allegations by Phillip Crawford*

Phillip Crawford, Jr. has made numerous allegations in many separate letters addressed to this Court (Docs. No. 1161, 1163, 1165, 1166, 1167, 1168, and 1175). Although not a class member, Crawford was a contract attorney employed by Peak Counsel, which conducted document review for Milberg Weiss LLP, one of the three firms that acted as Co–Lead Counsel in this case. Most of his allegations are either clearly irrelevant or clearly incorrect, and need not be addressed. Crawford's two remaining allegations are: first, that the fee award is inappropriate because Milberg Weiss allegedly failed to police overbilling by its contract attorneys, and second, that some of the work done by contract attorneys could have been performed by non-lawyers and therefore should have been billed at a lower rate.

Neither allegation has merit. Regarding Crawford's first allegation, Milberg Weiss has submitted affidavits from the relevant personnel at their firm. Together, these affidavits establish that Milberg Weiss conducted a thorough investigation of Crawford's allegations of overbilling by contract attorneys, removed from their fee application all time billed by both Crawford and the one contract attorney whose records were apparently inconsistent, and instituted appropriate procedures to police the billing of contract attorneys. These affidavits satisfy me that Milberg Weiss took all reasonable measures to ensure that their fee application accurately re-

18. Based on my review of the firms' lodestar calculations, legal assistants are billed at about two-thirds of the average rate for contract attorneys.

flected the work put into the case. As for Crawford's second allegation, it fails for the same reason as SERS/PSERS's similar objection, *supra.* Even if true, his second allegation would not decrease the lodestar enough to call into question the appropriateness of either the lodestar multiplier or the lodestar percentage cross-check.

In summary, none of the objections made to the proposed fee award cause me to question my determination that the proposed award is reasonable.

3. *Expenses*

Co–Lead Counsel have requested reimbursement of $28,938,412.74 in expenses. In the exhibits to their fee and expense request, Co–Lead Counsel have provided detailed breakdowns of their expenses. They have also provided summary tables, breaking the expenses down by category. They are not seeking reimbursement for computer research charges, overtime, secretarial services, rental space related to document review, supplies, press releases, or certain other miscellaneous expenses. I find that Co–Lead Counsel have provided sufficient documentation of their expenses and that, in light of the legitimate needs arising from the size and complexity of this case, the expense request is reasonable. *See In Re San Juan Dupont Plaza Hotel Fire Litig.,* 111 F.3d 220, 233–38 (1st Cir. 1997). Accordingly, I approve reimbursement of the requested amount.

4. *Objections to Expenses*

Three class members objected to the expense request. Andrews (Doc. No. 1108) objected mainly based on his belief that the case should have been settled earlier and higher, before Co–Lead Counsel incurred significant expenses. Carfagnas/Friedman (Doc. No. 1121) objected to the reimbursement of certain categories of expenses. Rinis Travel (Doc. No. 1135) objected to the lack of detail in the initial expense request. All of these objections have since been withdrawn. Moreover, to the extent these objections may have had merit, they were mooted by Co–Lead Counsel's decision not to pursue reimbursement for certain expenses and their provision of a detailed, well-organized breakdown of expenses in their fee and expense request.

III. *CONCLUSION*

For the foregoing reasons, I:

(1) Overrule the objections to the proposed settlement, plan of allocation, and award of attorney's fees and expenses;

(2) Approve the Settlement Agreement (consisting of the terms and conditions of the Stipulation of Settlement dated July 6, 2007, including Amendment No. 1 as filed with the Court on July 12, 2007 and Amendment No. 2 as filed with the Court on October 24, 2007) and the plan of allocation; and

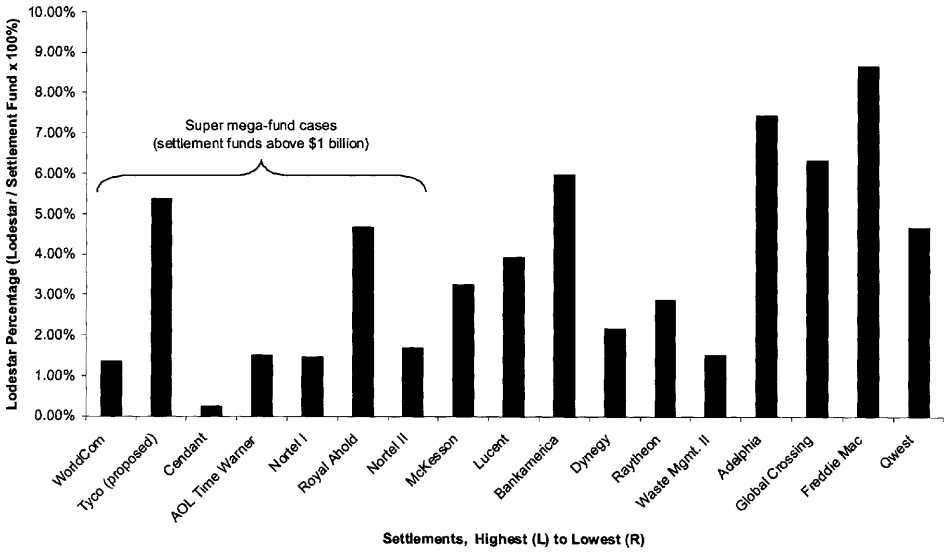
(3) Approve attorneys' fees of 14.5% of the settlement, plus reimbursement of $28,938,412.74 in expenses.

A more detailed final judgment will issue along with this Memorandum and Order.

SO ORDERED.

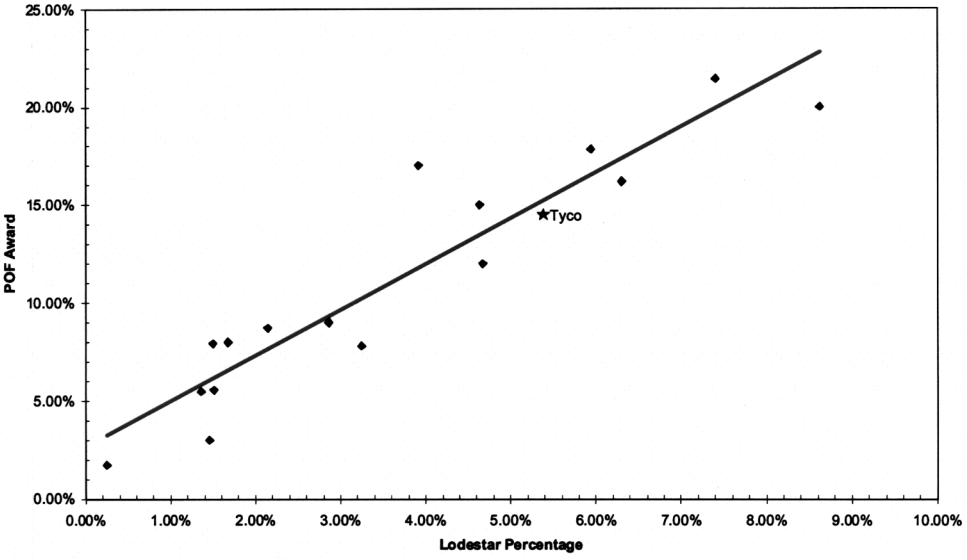
APPENDIX A

Lodestar Percentages for Tyco and the Previous Top Securities Class Action Settlements



APPENDIX B

Lodestar Percentage vs. POF for Tyco and the Previous Top Securities Class Action Settlements*



APPENDIX B—Continued

* The regression line in the above plot was calculated according to the previous top sixteen securities settlements, not including *Tyco*. This regression line has a coefficient of determination (R^2) of 0.8768, indicating that the data is well-fitted to the line. The Pearson's correlation coefficient (R) for lodestar percentage and POF (again, for the previous top sixteen securities settlements, not including *Tyco*) is 0.936, indicating that the two variables are strongly correlated with one another.

Elizabeth RIVERA–ROCCA, Plaintiff

v.

RG MORTGAGE CORPORATION, Defendants.

Civil No. 06–1570(SEC).

United States District Court,
D. Puerto Rico.

Feb. 25, 2008.

Background: Employee brought employment discrimination action against her employer, alleging that she was discriminated against because of her age, disability, and reasonable accommodation requests. Employer moved for summary judgment and to deem as admitted its statement of uncontested facts.

Holdings: The District Court, Salvador E. Casellas, Senior District Judge, held that:

(1) employer's statement of uncontested facts would be deemed admitted;

(2) employee was not disabled within meaning of the Americans with Disabilities Act (ADA);

(3) employee was not regarded as disabled by employer;

(4) employer did not fail to accommodate employee's alleged disability in violation of the ADA; and

(5) employee's transfer did not violate the Age Discrimination in Employment Act (ADEA).

Motions granted.

1. Federal Civil Procedure ⚿2547.1

Employer's statement of uncontested facts on summary judgment would be deemed admitted in employment discrimination action, where employee attempted to create controversy as to employer's statement of facts by simply proposing additional facts mingled together with her opposition to employer's statement of facts, in clear contravention of local rule providing that party opposing a motion for summary judgment must admit, deny, or qualify the facts by reference to each numbered paragraph and set forth additional facts in separate section in separate numbered paragraphs. U.S.Dist.Ct.Rules D.P.R., Civil Rule 56(c).

2. Civil Rights ⚿1218(3)

Employee's impairments, i.e., depression and panic disorder, did not affect her major life activities and were not substantial and permanent, and, thus, employee was not disabled within meaning of the ADA, where she had no limitations of functional capacity, and her only limitations were that she was able to engage only in limited stress situations and engage in only limited interpersonal relations. Americans with Disabilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.; 29 C.F.R. Part 1630 App., § 1630.1 et seq.

3. Civil Rights ⚿1019(2)

In determining whether a plaintiff meets the definition of disability under the ADA, the court must determine whether: (1) the plaintiff suffers a physical or mental impairment; (2) the life activity limited

Case Name:

Komarnicki v. Hurricane Hydrocarbons Ltd.

Between
Hurricane Hydrocarbons Ltd., Hurricane Kumkol Limited, Hurricane Overseas Services Inc. and Hurricane Investments CJSC, Applicants (Respondents/Plaintiffs),
and
John J. Komarnicki, Respondent (Appellant/Defendant)
Between
Hurricane Hydrocarbons Ltd., Hurricane Kumkol Limited, Hurricane Overseas Services Inc. and Hurricane Investments CJSC, Applicants (Respondents/Plaintiffs),
and
John J. Komarnicki, Respondent (Appellant/Defendant)
Between
John J. Komarnicki, Respondent (Appellant/Defendant),
and
Hurricane Hydrocarbons Ltd., Hurricane Kumkol Limited, Hurricane Overseas Services Inc. and Hurricane Investments CJSC, Applicants (Respondents/Plaintiffs)

[2007] A.J. No. 1243

37 C.B.R. (5th) 1

2007 CarswellAlta 1521

2007 ABCA 361

425 A.R. 182

162 A.C.W.S. (3d) 880

Docket: 0701-0086-AC

Action Nos. 0101-04991, 0101-5441 and 0001-16208

Registry: Calgary

Alberta Court of Appeal
Calgary, Alberta

E.A. McFadyen, C.D. Hunt and P.A. Rowbotham JJ.A.

Heard: November 15, 2007.
Judgment: filed November 19, 2007.

(18 paras.)

Insolvency law -- Claims -- Disallowance of -- Application by Hurricane Hydrocarbons for order striking out former employee's appeal on the basis that he failed to obtain leave pursuant to s. 13 of the Companies' Creditors Arrangement Act allowed and appeal struck -- Former employee of company under protection not permitted to continue wrongful dismissal action where action not resolved by drop dead date of five years from approval of plan of arrangement -- Employee attempting to prosecute wrongful dismissal claim when it had already been deemed to be extinguished -- Employee failed to obtain leave to appeal as required -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 13.

Insolvency law -- Proposals -- Effect of proposal -- Application by Hurricane Hydrocarbons for order striking out former employee's appeal on the basis that he failed to obtain leave pursuant to s. 13 of the Companies' Creditors Arrangement Act allowed and appeal struck -- Former employee of company under protection not permitted to continue wrongful dismissal action where action not resolved by drop dead date of five years from approval of plan of arrangement -- Employee attempting to prosecute wrongful dismissal claim when it had already been deemed to be extinguished -- Employee failed to obtain leave to appeal as required -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36., s. 13.

Civil procedure -- Appeals -- Leave to appeal -- Application by Hurricane Hydrocarbons for order striking out former employee's appeal on the basis that he failed to obtain leave pursuant to s. 13 of the Companies' Creditors Arrangement Act allowed and appeal struck -- Former employee of company under protection not permitted to continue wrongful dismissal action where action not resolved by drop dead date of five years from approval of plan of arrangement -- Employee attempting to prosecute wrongful dismissal claim when it had already been deemed to be extinguished -- Employee failed to obtain leave to appeal as required -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 13.

Application by Hurricane Hydrocarbons for an order striking out Komarnicki's appeal on the basis that he failed to obtain leave pursuant to s. 13 of the Companies' Creditors Arrangement Act (CCAA.) Hurricane received creditor protection in 1999. A plan of arrangement was approved by voting creditors in 2000. The Plan deemed extinguished and cancelled the claims of creditors not

resolved within five years of the Plan implementation date, March 31, 2000. Komarnicki brought an action against Hurricane for wrongful dismissal in October 2000. The claim was not resolved by the drop dead date of March 31, 2005. Hurricane also brought two actions against Komarnicki for costs or damages resulting from Hurricane's defence of various claims. Komarnicki filed a defence and counterclaim in March 2006, also outside the drop dead date. The chambers judge dismissed the wrongful dismissal action, struck the counterclaim and refused to allow the addition of a counterclaim to the first Hurricane action.

HELD: Application allowed and appeal struck. The chambers judge's order was a decision made under the Act because its operation affected a claim submitted in the CCAA proceedings. Komarnicki submitted a claim in the CCAA for wrongful dismissal. His claim was disputed, was not excluded from the Plan, was not resolved before the drop dead date and no extension of that deadline was obtained. The action and counterclaims all were based on the same alleged wrongful dismissal that Komarnicki claimed in the CCAA proceedings. The chambers judge correctly recognized that Komarnicki was attempting to prosecute his wrongful dismissal claim when it had already been deemed to be extinguished, terminated and cancelled by the terms of the Plan. Thus, Komarnicki was required to obtain leave to appeal the decision of the chambers judge.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 13

Counsel:

R.F. Steele: for the Applicants.

L.W. Scott, Q.C.: for the Respondent.

Memorandum of Judgment

Application to Strike the Appeal

The following judgment was delivered by

1 THE COURT:-- The applicants, Hurricane Hydrocarbons Ltd., Hurricane Kumkol Limited, Hurricane Overseas Services Inc. and Hurricane Investments CJSC (collectively, the Hurricane companies), apply to strike the appeal of the respondent, Komarnicki, on the basis that he failed to obtain leave pursuant to s. 13 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (CCAA). The application is granted and the appeal is struck.

Factual background

2 The applicants, Hurricane Hydrocarbons Ltd. and Hurricane Overseas Services Inc., received creditor protection under the CCAA on May 14, 1999. The respondent submitted a notice of claim in the CCAA proceedings alleging wrongful dismissal from employment with Hurricane Hydrocarbons Ltd. and Hurricane Overseas Services Inc., which they disputed.

3 No determination was made on the merits of the disputed claim prior to February 28, 2000 when the Plan of Compromise and Arrangement (Plan) received court approval. The Plan provided that any disputed claim not resolved by March 31, 2005 was deemed to be forever extinguished, terminated and cancelled.

4 In October 2000, the respondent commenced a claim in the Court of Queen's Bench seeking damages for wrongful dismissal from Hurricane Hydrocarbons Ltd. and Hurricane Overseas Services Inc.

5 On February 28, 2001, the Hurricane companies commenced an action in the Court of Queen's Bench seeking indemnity from the respondent for costs or damages resulting from the Hurricane companies' defence of various claims (Hurricane #1 action). Because counsel for the Hurricane companies did not immediately receive a filed copy of the statement of claim, out of an abundance of caution to avoid expiry of a limitation period, a second identical statement of claim was filed on March 1, 2001 (Hurricane #2 action). The Hurricane #1 action was served in January 2002 and the Hurricane #2 action was never served. The Hurricane #1 and #2 actions were not claims within the CCAA proceedings.

6 On August 9, 2002, Hurricane Hydrocarbons Ltd. and Hurricane Overseas Services Inc. filed a statement of defence to the respondent's wrongful dismissal action. On August 14, 2002, the respondent filed a statement of defence to the Hurricane #1 action.

7 The March 31, 2005 drop dead date passed without resolution of the respondent's wrongful dismissal claim.

8 On March 22, 2006, almost one year past the drop dead date, the respondent filed a statement of defence and counterclaim in the Hurricane #2 action. The counterclaim is virtually identical to the wrongful dismissal action. On October 13, 2006, the respondent applied to the Court of Queen's Bench for a declaration that he was entitled to take the next step in his wrongful dismissal action and counterclaim in Hurricane #2 action, and sought to add to the Hurricane #1 action a counterclaim, which was, again, virtually identical to the wrongful dismissal action and the counterclaim in the Hurricane #2 action. The Hurricane companies applied to strike the wrongful dismissal action and the counterclaim in Hurricane #2 action, and opposed the addition of a counterclaim in the Hurricane #1 action.

9 The chambers judge dismissed the wrongful dismissal action, struck the counterclaim and

refused to allow the addition of a counterclaim to the Hurricane #1 action.

10 The respondent filed a notice of appeal in this Court and was advised by the Deputy Registrar that leave pursuant to section 13 of the CCAA might be required. The Hurricane companies brought this motion to strike the appeal.

Issue

11 Does section 13 of the CCAA apply to the respondent's wrongful dismissal action and counterclaim?

Relevant legislation

12 Section 13 of the CCAA provides:

> Except in Yukon, any person dissatisfied with an order or a decision made under this Act may appeal from the order or decision on obtaining leave of the judge appealed from or of the court or a judge of the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

Decision

13 The requirement for leave furthers the objects and purpose of the CCAA which has been described by Farley J. in *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 at para. 31 (Ont.Gen. Div.) as follows:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court.

14 To further the goal of enabling a company to deal with creditors in order to continue to carry on business, the CCAA proceedings seek to resolve matters and obtain finality without undue delay. A drop dead date is one means of bringing disputed claims to an end and allowing a company to move forward. The requirement for leave to appeal similarly reinforces the finality of orders made under a CCAA proceeding and prevents continuing litigation where there are no serious and arguable grounds of significance to the parties. As noted by numerous courts, delay and uncertainty caused by appeals is a matter of concern in a CCAA proceeding: *Luscar Ltd. v. Smoky River Coal Ltd.*, 1999 ABCA 62, [1999] A.J. No. 185 at para. 22, citing *Re Pacific National Holding Corp.* (1992), 15 C.B.R. (3d) 265 (B.C.C.A.).

15 The scope of CCAA proceedings has been interpreted expansively by the courts and may even include non-judicial proceedings because the objective is to include proceedings that may work against the interests of creditors and render impossible the achievement of effective arrangements: *Luscar Ltd. v. Smoky River Coal Ltd.*, 1999 ABCA 179, 237 A.R. 326 at para. 31.

16 Before us, the respondent conceded that the wrongful dismissal action was a "claim" in the CCAA proceeding and that leave is required. However, the respondent says that the counterclaims ought not to be considered "claims" because they were filed in the Hurricane #1 and #2 actions which were not CCAA proceedings. The respondent submits that it would be unfair to permit Hurricane to pursue its actions, but to prevent him from advancing his counterclaim.

17 We conclude that the decision of the chambers judge is an order or decision made under the CCAA because its operation affects a claim submitted in the CCAA proceedings. The respondent submitted a claim in the CCAA for wrongful dismissal. His claim was disputed; it was not excluded from the Plan, was not resolved before the drop dead date and no extension of that deadline was obtained. The Court of Queen's Bench action and the counterclaims are all based on the same alleged wrongful dismissal that the respondent claimed in the CCAA proceedings. The chambers judge recognized that the respondent was attempting to prosecute his wrongful dismissal claim when it has already been deemed to be extinguished, terminated and cancelled by the terms of the Plan.

18 It follows that the respondent must obtain leave to appeal the decision of the chambers judge. There was no proper application for leave before us and we make no decision in that regard. Accordingly, the application is granted and the appeal is struck.

E.A. McFADYEN J.A.
C.D. HUNT J.A.
P.A. ROWBOTHAM J.A.

cp/e/qlgxc/qllkb/qlbrl/qljxl/qlcas

Case Name:

Marcantonio v. TVI Pacific Inc.

Between
Joe Marcantonio, Plaintiff, and
TVI Pacific Inc., Clifford M. James, Robert C. Armstrong, C. Brian Cramm, Jan R. Horejsi, Peter C.G. Richards, and John W. Adkins, Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992

[**2009] O.J. No. 3409**

82 C.P.C. (6th) 305

2009 CarswellOnt 4850

179 A.C.W.S (3d) 761

Court File No. CV-08-35806100CP

Ontario Superior Court of Justice
Toronto, Ontario

J.L. Lax J.

Heard: June 17, 2009.
Judgment: August 10, 2009.

(38 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Settlements -- Approval -- Costs -- Particular items -- Counsel fees -- Particular circumstances -- After discontinuance of action -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Class Proceedings Act, 1992, s. 33.

Legal profession -- Barristers and solicitors -- Compensation -- Contingency agreements -- Fair and reasonable -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Professional responsibility -- Self-governing professions -- Remuneration -- Contingency fees -- Professions -- Legal -- Barristers and solicitors -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Securities regulation -- Civil liability -- Public statements or release of documents by influential persons -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Securities Act, s. 138.

Motion by all parties to certify an action as a class proceeding for settlement purposes. The action was launched against TVI, a publicly-traded mining company, and its directors and officers by shareholders who alleged the defendants conspired to issue materially false or misleading financial statements and otherwise contravening securities law. The action proceeded in Ontario and Quebec. On the eve of the due date for the defendants to file materials in response to the certification record, settlement negotiations were initiated. They resulted in a settlement agreement under which TVI would pay $2.1 million, would try to re-price certain outstanding stock options, and would adopt corporate governance measures to prevent future options manipulation. The parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees for the Ontario class of plaintiffs, defined as those who acquired TVI securities during the defined class period and held those securities on August 9, 2007, as well as exempt Quebec class members. The experienced class counsel retained by the representative plaintiff recommended approval of the settlement as it was half of what the plaintiffs were limited to achieve at trial, and would avoid the time and expense of trial which would significantly erode the benefits to the class members of the ultimate award. Litigation would have been complex because of recent changes to securities law. Class counsel sought approval for fees totalling $525,000, or 25 percent of the settlement amount. The retainer agreement provided for this sum.

HELD: Motion allowed. The pleadings disclosed a cause of action in negligence, negligent and fraudulent misrepresentation and conspiracy. There was ain identifiable class of plaintiffs. The claims raised common issues. Individual litigation of each plaintiff's claim would be difficult, time-consuming and expensive. The representative plaintiff had no interests in conflict with those of the other Ontario class members. The settlement was the product of arm's length bargaining by experienced counsel and presumed fair. In light of the risks faced by the plaintiffs, the range of damages they stood to recover, and the recommendations of class counsel, the court approved the settlement. Legal fees were awarded to class counsel as claimed, because they were fair and reasonable.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 33

Securities Act, R.S.O. 1990, c. S.5, s. 138.3, s. 138.5, s. 138.8(1)

Counsel:

A. Dimitri Lascaris and *Monique L. Radlein*, for the Plaintiff.

Eric R. Hoaken, for the Defendants.

ENDORSEMENT

1 **J.L. LAX J.**:-- This is a securities class action brought pursuant to the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 ("CPA") arising from alleged misrepresentations and stock options manipulation. The parties settled the action on April 22, 2009, and brought a motion for, among other things, an order certifying the action as a class proceeding for settlement purposes, approving the settlement and approving class counsel fees. I granted the order with reasons to follow. These are my reasons.

Nature of the Claim

2 TVI Pacific Inc. ("TVI") is a publicly-traded mining company with its shares listed on the Toronto Stock Exchange ("TSX"). The individual defendants were directors of TVI. This action is brought on behalf of an Ontario class of persons and entities who acquired TVI securities on or after March 30, 2006, and held some or all of the securities on August 9, 2007. It is alleged that during the class period the defendants (1) conspired and breached their duty of care to TVI shareholders by issuing materially false and/or inaccurate audited financial statements for years ended 2005 and 2006 and interim unaudited financial statements for the quarter ended March 31, 2007; and (2)

granted in-the-money stock options in contravention of TVI's Stock Option Plan, TSX rules and securities legislation in Ontario and Quebec. With respect to the financial statements, TVI subsequently issued two corrective disclosures on August 9, 2007 and December 18, 2007.

3 On March 3, 2008, Siskinds LLP filed a class proceeding against the defendants on behalf of Mr. Florent Audette, a Quebec resident. At that time, no Ontario resident had come forward to represent the interests of the class in Ontario. On April 10, 2008, this action was filed on behalf of Mr. Joe Marcantonio, an Ontario resident, alleging claims similar to those made in the Audette Ontario action. On July 25, 2008, the Quebec affiliate of Siskinds, filed the Petition styled *Audette c. TVI Pacific Inc. et al*, [2009] J.Q. no 4647, in Quebec Superior Court and Mr. Audette gave instructions to hold the Audette Ontario action in abeyance. After the settlement was reached, Mr. Audette instructed Siskinds to request the discontinuance of the Audette Ontario action.

4 Mr. Marcantonio served his certification record in October 2008. On the eve of the due date for the filing of the defendants' responding materials, the defendants initiated settlement discussions. Following several months of negotiations, the parties concluded a settlement agreement that provides for:

(a) a gross settlement fund of $2.1 million;
(b) TVI's agreement to make efforts to re-price certain outstanding stock options; and
(c) the adoption of corporate governance measures designed to prevent future options manipulation.

5 As a result of the settlement, the parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees and disbursements on behalf of an Ontario class defined as:

> All persons and entities, who acquired securities of TVI during the Class Period, and who held some or all of those securities on August 9, 2007, other than Excluded Persons and Quebec Class Members, but specifically including the Exempt Quebec Members.

Certification

6 Numerous cases hold that where certification is sought for the purposes of settlement, the certification requirements must be met, but are not applied as stringently. Perell J. has helpfully gathered the authorities together and they can be found in *Corless v. KPMG LLP*, [2008] O.J. No. 3092 at para. 30 (S.C.J.) (QL).

7 For settlement purposes, I am satisfied that each of the criteria for certification is satisfied. The pleadings disclose a cause of action against the defendants for negligence, negligent and fraudulent misrepresentation, and conspiracy. The pleading asserts that the plaintiff intends to seek leave under

s. 138.8(1) of the *Securities Act*, R.S.O. 1990, c. S.5 ("OSA") to amend the Statement of Claim to plead the cause of action in s. 138.3 of the *OSA*. There is an identifiable class defined by objective criteria that (a) identifies persons with a potential claim, (b) describes who is entitled to notice, and (c) defines those who will be bound by the result: *Bywater v. Toronto Transit Commission*, [1998] O.J. No. 4913 at para. 10 (Gen. Div.) (QL).

8 The claims of the class members raise the following common issue:

> Did the defendants, or any of them, breach duties of care owed to the Ontario class, by reason of the alleged acts, omissions, disclosures or non-disclosures relating to the issuance and/or restatement of TVI's audited consolidated financial statements for the years ended December 31, 2005 and 2006, and its interim unaudited consolidated financial statements for the quarter ended March 31, 2007, and or to TVI's stock option practices during or prior to the Class Period?

9 Individual litigation of securities cases can be difficult, time-consuming and expensive. Many claims would never be advanced because they are uneconomic for an individual investor to pursue. A class action is the optimal method of procuring a remedy for a group of investors who allege they have been harmed in similar ways as a single determination of the defendants' liability eliminates duplication of fact-finding and legal analysis. Further, a class action has the potential to act as an essential and useful supplement to the deterrent effects of regulatory oversight. It enhances the incentive for directors and officers to ensure that their disclosures to the investing public are materially accurate, thereby enhancing investor protection. Consequently, a class proceeding is the preferable procedure because it provides a fair, efficient and manageable method of determining the common issue, and advances the proceeding in accordance with the goals of access to justice, judicial economy and behaviour modification.

10 Mr. Marcantonio is a member of the proposed Ontario class and would fairly and adequately represent its interests. He does not have, regarding the common issues or any issues arising out of the common issues, any interests in conflict with the interests of other Ontario class members. He has an understanding of the issues and allegations raised in the Ontario action and has actively participated in the litigation and the settlement process.

Settlement Approval

11 To approve a settlement, the court must find that the settlement is fair, reasonable and in the best interests of the class as a whole: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 at para. 9 (Gen. Div.) (QL); *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 at paras. 68-69 (S.C.J.) (QL). To be approved, the settlement must fall within a zone or range of reasonableness: *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130 at para. 89 (S.C.J.), Winkler J. (now C.J.O.).

12 In determining whether to approve a settlement, the court uses the following factors as a

guide, although some will have more or less significance than others and some may not be present in a particular case: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) the settlement terms and conditions; (d) the recommendation and experience of counsel; (e) the risk, future expense and likely duration of litigation; (f) the recommendation of neutral parties, if any; (g) the number of objectors and nature of objections; (h) the presence of good faith, arm's length bargaining and the absence of collusion; (i) the information conveying to the court the dynamics of, and the positions taken by the parties during the negotiations; and (j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation. See *Parsons v. Canadian Red Cross Society*, *supra* at paras. 71-72.

13 Before the court is a comprehensive affidavit of Mr. Charles Wright who is a Siskinds' partner and an experienced class action lawyer. He was directly involved in the prosecution and resolution of this action. His evidence points to a number of factors that commend this settlement as fair and reasonable and in the best interests of the class. I review some of these below.

14 Securities class actions are not that common perhaps because there are substantial risks in prosecuting them. Unlike purchasers in the primary market, who are provided a right of action under the *OSA*, until recently, secondary market purchasers had to persuade the court that the defendants owed them a duty of care. In response, defendants have argued, and courts have often held, that secondary market purchasers have to demonstrate that they actually relied upon the defendants' misrepresentations. On December 31, 2005, Bill 198, now embodied in Part XXIII.1 of the *OSA*, came into force. It was a response to the perceived failure of the common law to provide an effective remedy for secondary market misrepresentation. Part XXIII.1 removes the reliance requirement through the creation of a statutory right of action. However, the right of action is subject to obtaining leave of the court and there has never been a leave decision under the new legislation.

15 In addition to the uncertainty surrounding the ability to advance the statutory cause of action, the plaintiff in this action also faced the risk of not being able to establish (i) that the representations or omissions were materially misleading; (ii) that the class had incurred the damages claimed; and (iii) to the extent necessary for purposes of the common law claims, detrimental reliance.

16 Class counsel's estimate of class damages was $16 million. In the course of settlement discussions, class counsel retained Mr. Paul Mulholland, an expert in the measurement of securities class action damages, to assess actual damages suffered by the class during the class period. It is Mr. Mulholland's opinion that class damages as assessed by a court would not approach this number, but rather would likely fall between the lowest and highest estimates of the statutorily established limits on the defendants' liability, as explained below.

17 The statutory claim under Part XXIII.1 of the *OSA* is subject to liability limits. It caps the issuer's liability at the greater of 5% of the pre-misrepresentation market capitalization of the

defendant issuer and $1 million. The statute directs how market capitalization is to be calculated. Class counsel performed this calculation and determined that TVI's liability limit fell within the range of about $2.8 million to $4.2 million.

18 Part XXIII.1 of the *OSA* also sets caps on the liability of directors and officers. Class counsel performed this calculation and determined that these liability limits were $189,500 (rounded to $200,000). The application of the liability limits (absent proof of fraud) would thus limit total recovery from the defendants to a range of approximately $3 million to $4.4 million. As a result, even if the plaintiff and class members were completely successful at trial, they would have had difficulty obtaining damages greater than $4.4 million, and could be limited to damages of as little as $3 million.

19 The caps discussed above do not apply to the common law claims for damages arising from negligence and negligent and fraudulent misrepresentation. However, as I have mentioned, the damages assessment of Mr. Mulholland is that these damages, if proved, would fall within the statutory limits. Moreover, as noted earlier, misrepresentation claims can be difficult to certify as reliance is a necessary element of proof: *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. As well, the defendants had due diligence and reasonable reliance defences available to them and there was a risk that these defences would succeed.

20 The court requires sufficient evidence in order to exercise an objective, impartial and independent assessment of the fairness of the settlement: *Dabbs, supra* at para. 15. However, it is not necessary for formal discovery to have occurred at the time of settlement, and settlements reached at an early stage of the proceedings can be appropriate. In this case, no discoveries or other examinations were completed, but I am satisfied that class counsel had significant information about the case as a result of their own investigations and the information that was obtained from the defendants in the course of settlement discussions. In particular, the defendants provided to class counsel an expert opinion which they had obtained. The defendants' expert concluded that the damages of the class were negligible as all or virtually all of the share price decreases resulted from news affecting the mining industry as a whole and were unrelated to the erroneous financial statements. Although class counsel disputed this, it was in light of this opinion that Mr. Mulholland was retained.

21 The settlement amount of $2.1 million represents a substantial portion of the potentially recoverable damages of between $3 million and $4.4 million assessed by Mr. Mulholland. As a percentage of gross recovery, it represents between 48% and 70% of his assessment of loss. On a net recovery basis, taking into account class counsel's requested fees and administration expenses, which together are in the amount of $809,287.17, the class would recover between 29% and 43% of the loss. This recovery is fair and reasonable and compares very favourably with the percentage net recovery in other securities class action settlements, such as *Mondor v. Fisherman*, [2002] O.J. No. 1855 (S.C.J.) (QL), and *Lawrence et al. v. Atlas Cold Storage et al*. (February 12, 2009), Toronto 04-CV-263289CP (S.C.J.) where net recovery was in the range of 20%.

22 With respect to the options-related allegations, the information provided by the defendants made it clear that many of the problems were a result of poor procedures, rather than intentional fault. It also became clear that any benefits to the defendants were negligible due to the decrease in TVI's share price. This resulted in certain options becoming substantially out-of-the-money.

23 Nonetheless, in order to address the allegations concerning the granting of in-the-money stock options, the settlement agreement provides that TVI will make all reasonable efforts to effect the re-pricing of these options. In addition, it provides that TVI will develop and implement corporate governance measures as specified in the agreement to address its stock option granting practices. For the purpose of obtaining advice concerning the recommended corporate governance measures, class counsel retained and relied on advice from Dr. Richard Leblanc, Assistant Professor of Law, Corporate Governance & Ethics at York University. In the opinion of class counsel, these reforms are productive enhancements of significant value to shareholders.

24 Although Ontario class counsel received a number of inquiries about the settlement following publication of the notices approved by the court, there are no objectors. The distribution protocol harmonizes the plaintiff's theory of damages with s. 138.5 of the *OSA*. The result is a formula that takes into account the two corrective disclosures and is designed to fairly and rationally allocate the proceeds of the net settlement amount among authorized claimants based on the relative strength of the class members' claims as the class period progressed and damages were incurred.

25 At the time of settlement, the action was still in the early stages of litigation. Without a settlement, the plaintiff would have faced the expense of a leave motion under the new secondary market liability provisions of the *OSA*, a contested certification motion, discovery, a trial of the common issues, and inevitable appeals at each stage. Absent a settlement, there would have been no payment to class members for a number of years. A settlement brings the significant benefit of finality and an immediate payment to class members.

26 This settlement is the product of arm's length bargaining by very experienced counsel. There is a strong initial presumption of fairness when a proposed class settlement, which was negotiated at arm's length by class counsel, is presented for court approval. As Justice Sharpe (as he then was) stated in *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 2811 (Gen. Div.) (QL) at para. 32:

> ... The recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line. ...

27 In light of the risks the plaintiff faced, the possible range of damages recoverable, the substantial benefit available to class members, and the recommendation of class counsel who have extensive experience in litigating class actions and particular expertise in securities class actions and stock options manipulation, I am satisfied that the settlement is fair, reasonable and in the best interests of the class. For these reasons, it was approved.

Class Counsel Fees

28 The fees of class counsel are to be fixed and approved on the basis of whether they are fair and reasonable in all of the circumstances. This is determined in light of the risk undertaken and the degree of success or result achieved: *Maxwell v. MLG Ventures Ltd.* (1996), 30 O.R. (3d) 304 (Gen. Div.); *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.); *Serwaczek v. Medical Engineering Corp.*, [1996] O.J. No. 3038 (Gen. Div.); *Parsons v. Canadian Red Cross Society* (2000), 49 O.R. (3d) 281 (S.C.J.). This approach was approved in *Gagne v. Silcorp Ltd.* (1998), 41 O.R. (3d) 417 at 423 (C.A.).

29 In the context of the *CPA*, a premium on fees is the reward for taking on meritorious but difficult matters. The courts have recognized that the objectives of the *CPA* - judicial economy, access to justice and behaviour modification - are dependent, in part, upon counsel's willingness to take on class proceedings, which in turn depends on the incentives available to counsel to assume the risks and burden of class proceedings: *Gagne, supra*; *Parsons, supra*; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2005] O.J. No. 1117 (S.C.J.) (QL).

30 The need for a meaningful premium on fees is particularly important in cases involving more modest damage amounts where the maximum potential upside to class counsel is limited. Otherwise, there is a risk that counsel would decline to pursue cases giving rise to modest damages and smaller issuers would effectively become immunized from class litigation. This need is heightened in the context of the evolving practice of securities class actions where notice and administration costs are fixed expenses whether the settlement amount is $20 million or $2 million. As a result, in smaller settlements, costs and legal fees represent a larger percentage of the settlement fund. For example, in this case, these administrative costs (roughly $210,000) together with the requested fees of 25% of the settlement amount represent 39% of gross recovery, whereas in a $20 million settlement, the same costs with the same fee request would represent 27% of gross recovery.

31 Class counsel request fees in accordance with a written fee agreement dated April 10, 2008. It provides that legal fees will be charged on a percentage basis in an amount representing 25% of "all benefits obtained for the class members, including costs, notice and administration," plus disbursements and GST. Ontario class counsel and Quebec class counsel agreed to request legal fees such that their cumulative requests for legal fees do not exceed 25% of the settlement amount plus disbursements and applicable taxes. They estimated that the Ontario class constitutes 90% of the class defined in the settlement agreement, and that the Quebec class constitutes 10% of the class. As a result, Ontario class counsel request legal fees in the amount of $472,500, which represents 25% of the portion of the settlement amount allocated to the Ontario class, plus GST and disbursements in the amount of $42,667.69. Quebec class counsel will request legal fees in the amount of $52,500. The combined legal fee requests total $525,000 or 25% of the monetary settlement benefit of $2.1 million. The amount requested is consistent with the retainer agreement and in line with percentage contingency fees that have been awarded in other class actions.

32 In *VitaPharm, supra* at para. 67, Justice Cumming summarized some of the factors to be considered by the court when fixing class counsel's fees: (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 fees; and (j) the opportunity cost to class counsel in the expenditure of time in pursuit of the litigation and settlement.

33 The risks in undertaking this litigation include the following:

(a) that the court would dismiss certain of the claims on a preliminary motion;
(b) that there has never been a leave decision under the new investor protection legislation under Part XXIII.1 of the *OSA*, and the court may not have granted leave to plead causes of action under s. 138.3;
(c) that the court would not certify the action, or would not certify a national class;
(d) that the plaintiff would not be able to establish actionable misrepresentations, or would fail to establish a causal connection between the misrepresentations and some or all of the losses alleged; and
(e) that any judgment in favour of the plaintiff and the class would be appealed, so that the benefits of any such judgment would be significantly delayed.

34 In determining a fee award, the court may consider the manner in which counsel has conducted the proceeding. Whether counsel have agreed to indemnify the representative plaintiff against an adverse costs award, thereby saving the class from having to pay the statutory 10% to the Class Proceedings Fund, is a relevant factor in fixing fees: *Bellaire v. Daya*, [2007] O.J. No. 4819 at para. 81 (S.C.J.) (QL). Counsel in this case have done this. The class also benefits from class counsel having requested and reviewed fixed-fee quotations from several Administrators to ensure the most cost-effective administration of the settlement agreement.

35 In assessing the success achieved, I have already noted that the settlement amount of $2.1 million represents recovery of a substantial portion of the damages sustained by the class. The implementation of the corporate governance measures and the re-pricing of stock options also provide a benefit to class members and future TVI shareholders. Counsel are not asking the court to attach value to this aspect of the settlement, even though the retainer agreement provides for legal fees to be calculated as a percentage of "all benefits obtained for the class" and these are benefits obtained for the class. Further, class members benefit from a settlement term that required the defendants to pay the settlement amount into an escrow account which is earning interest. This will increase the net settlement amount available to class members. It will also decrease the fee request as a percentage of the recovery because class counsel do not seek interest on their legal fees and

disbursements.

36 The method of determining fees set out in s. 33 of the *CPA* - the 'lodestar' method - has been the subject of judicial and academic criticism. Justice Cullity recently commented on its deficiencies in *Martin v. Barrett*, [2008] O.J. No. 2105 at paras. 38-39 (S.C.J.) (QL); see also, *Endean v. Canadian Red Cross Society*, [2000] B.C.J. No. 1254 at paras. 15-16, 19 (S.C.) (QL); Benjamin Alarie, "Rethinking the Approval of Class Counsel's Fees in Ontario Class Actions" (2007) 4(1) *Canadian Class Action Review* 15 at 37-38.

37 A multiplier can reward lawyers who accumulate unnecessary time and punish those who are able to do things effectively in less time. I do not have to grapple with these difficulties in this case as the retainer agreement does not provide that fees are to be calculated by applying a multiplier and none is requested. Nonetheless, based on time included in the evidence on the motion, and based on consideration of only the monetary benefits obtained for the class, by the time the litigation is concluded and interest accrues on the settlement amount, counsel estimate the multiplier will be approximately 2.5. This settlement was achieved at an early stage, but if a multiplier were to be applied, I consider a multiplier in this range to be acceptable having regard to the risks assumed and the results obtained for class members in the circumstances of this case.

38 For these reasons, I concluded that the fees requested were fair and reasonable and I awarded legal fees in the amount of $472,500, plus applicable taxes, and disbursements in the amount of $42,667.69 to Ontario class counsel. The settlement that I approved settles the claims asserted in this action and the Audette Ontario action. As the classes are identical, the interests of the class proposed in the Audette Ontario action are resolved by the settlement of the Ontario action. Accordingly, the discontinuance of the Audette Ontario action does not prejudice the putative class in that action and an order was granted discontinuing that action.

J.L. LAX J.

cp/e/qllxr/qljxr/qlaxw/qlced/qljyw/qlcal

Case Name:

Martin v. Barrett

Between
Marsha Martin and Fern Camirand, Plaintiffs, and Michael Barrett, John Rebry, Lloyd Crawford, William Demerling, Claude Gauthier, Clare Hayes, Jim Madill, Michael Stevens, Brian Ashford, John Black, John Hill, Charles Macdaid, Joseph Martin, June McFarlane, Larry Melnyk, John Stafford, as trustees of the Participating Co-operatives of Ontario Trusteed Pension Plan (FSCO Reg. No. 345736), The Canada Trust Company, CIBC Mellon Trust Company, CIBC Mellon Global Securities Services Company, Canadian Imperial Bank of Commerce, Mark Edward Whittacatt carrying on business as Whittacatt Consulting Associates, Whittacatt Holdings Ltd., Turnbull and Turnbull Ltd., the Estate of John A. Turnbull, deceased, Louis Ellement, Anthony F. Cooper and Anthony F. Cooper Actuarial Services Ltd. and Torys LLP, Defendants

[**2008] O.J. No. 2105**

67 C.C.P.B. 102

2008 CarswellOnt 3151

55 C.P.C. (6th) 377

168 A.C.W.S. (3d) 643

Court File No.: 03-CV-244195 CP

Ontario Superior Court of Justice

M.C. Cullity J.

Heard: April 16-17, 2008.
Judgment: May 29, 2008.

(57 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Procedure -- Settlements -- Approval -- Settlement of class action arising as a consequence of serious under-funding of a pension plan approved by the court -- The court had no doubt that the settlement, including the entitlement of the 80 members of the Plan who purported to revoke their elections to opt out, was fair and reasonable in the circumstances and ought to be approved in the interests of the class members.

Legal profession -- Barristers and solicitors -- Compensation -- Contingency agreements -- Measure of compensation -- Reasonable charges, reasonably performed -- Settlement of a class action approved, while counsel's fee put forth at $4,750,000 was reduced to $4,086,748 -- The time expended was inordinately high, and the base fee charged was reduced from $2,116,354 to $1,634,748 -- However, the multiplier was increased from 2 to 2.5, which was more reflective of the risk incurred, and the highly professional and expert manner in which the proceedings were conducted.

Professional responsibility -- Professions -- Legal -- Lawyers -- Settlement of a class action approved, while counsel's fee put forth at $4,750,000 was reduced to $4,086,748 -- The time expended was inordinately high, and the base fee charged was reduced from $2,116,354 to $1,634,748 -- However, the multiplier was increased from 2 to 2.5, which was more reflective of the risk incurred, and the highly professional and expert manner in which the proceedings were conducted.

Motion for approval of a class settlement and for approval of class counsel's fees. The claims asserted by the plaintiffs arose as a consequence of a serious under-funding of the Participating Co-Operatives of Ontario Trusteed Pension Plan that occurred after June 1, 1994. The plaintiffs claimed, among other things, restitution, or alternatively damages, for significant investment losses to the Plan allegedly caused by the negligence, breach of trust and breach of fiduciary duty of the current and former trustees, current and former Plan custodians, actuaries, former legal counsel, and a former investment consultant and asset manager of the Plan. Under the proposed settlement, the remaining defendants other than Workman and Whittacatt Holdings Ltd., were to pay $13,926,196 in return for releases of all claims against them. After counsel fees and the levy payable to the Class Proceedings Fund were paid, the balance was to be paid into the Plan and be used to provide the benefits that Plan members would be entitled to as of the Wind-Up date. Counsel proposed a base fee of $2,116,354 for their work plus $219,000 for the work of a firm retained to advise on securities issues. This included 7,900 hours worked, plus 627 hours for the second firm. The combined fee requested was $4,750,000 before GST, with a multiplier of approximately two.

HELD: settlement approved. Counsel approved at $4,086,748. The settlement was recommended by experienced class counsel, and the court had no reason to believe it was negotiated other than as a result of arm's length bargaining and an absence of collusion. It was supported by each of the

representative plaintiffs as being in the best interests of the class. The court had no doubt that the settlement, including the entitlement of the 80 members of the Plan who purported to revoke their elections to opt out, was fair and reasonable in the circumstances and ought to be approved in the interests of the class members. The fees requested were 34 per cent of the total recovery, which was unduly high. While the time expended was inordinately high, there was no doubt that the legal and factual issues were complex, counsel assumed complete responsibility for the prosecution of action, the matter was of the utmost importance to the plaintiffs and the class, and a very high degree of skill and competence was demonstrated by counsel. The primary firm had over-lawyered. Their approach to providing their services in this and other class proceedings had departed quite radically from that traditionally adopted by solicitors representing clients in other litigation. The discipline imposed by the normal constraints in acting for a client who would be personally liable for the fees had been abandoned. A reduction of 30 per cent from the total base fee claimed would not be unfair to counsel or unreasonable. The base fee was set at $1,634,748. The multiplier would be 2.5, which was more reflective of the risk incurred, and the highly professional and expert manner in which the proceedings were conducted. The fee would be roughly $4 million, which was 29 per cent of the gross recovery.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 29(2), s. 32, s. 33

Law Society Act, R.S.O. 1990, c. L.8,

Counsel:

Kirk Baert, Michael Mazzuca and ***Nicole D. Brown***, for the Moving Parties/Plaintiffs.

Graeme Mew, Boyd Balogh, David E. Leonard and ***A. Salyzyn***, for the Trustees Respondents/Defendants.

J.A. Prestage, for the defendants Canadian Imperial Bank of Commerce and CIBC Mellon Global Securities Services Company.

Mark Gelowitz, for the Respondent/Defendant The Canada Trust Company.

Jessica Kimmel, for the Respondent/Defendant Torys LLP.

Mark Bailey, for the Superintendent of Financial Institutions.

R.J. Walker, for Participating Co-operatives.

Lori E.J. Patyk, for the Minister of Finance of Ontario.

REASONS FOR DECISION

1 **M.C. CULLITY J.**:-- A hearing to determine whether a settlement of this class action should be approved was held on April 16, 2008. A motion for the approval of class counsel's fees was heard on the following day. After hearing from counsel, and considering the submissions from class members in writing and orally, I indicated at the end of the hearing on April 16 that I considered the settlement to be fair and reasonable and in the interests of class members in the circumstances of the case, and that there would be an order approving it. Brief oral reasons were given to be supplemented in writing.

2 I reserved my decision on the fees of class counsel pending a hearing of a motion by the Law Foundation of Ontario on April 30, 2008 for directions with respect to the correct calculation of the levy payable to the Class Proceedings Fund pursuant to Regulation 771/92 under the *Law Society Act*, R.S.O. 1990, c. L.8, as amended. The decision on that motion was released on May 12, 2008. In what follows I will expand on my comments relating to the approval of the settlement, and will then deal with the motion in respect of the fees of class counsel.

BACKGROUND

3 The action was commenced by notice of action issued under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 ("CPA") on February 19, 2003 in which the plaintiff sought to represent a class of current and deferred vested members, pensioners and beneficiaries of the Participating Co-operatives of Ontario Trusteed Revised Pension Plan, Registration No. 0245726 (the "Plan"). The Plan was established on October 1, 1959 for employees and former employees of participating agricultural co-operatives in Ontario.

4 The action was certified by order of Winkler R.S.J., dated February 10, 2005, under which the plaintiffs were appointed to represent a class comprising -

> All persons, wherever resident, who, after June 1, 1994, were entitled to payments, current or deferred, under the Participating Co-Operatives of Ontario Trusteed Pension Plan.

5 The claims asserted by the plaintiffs arose as a consequence of a serious under-funding of the Plan that occurred after June 1, 1994. The plaintiffs claimed, among other things, restitution, or alternatively damages, for significant investment losses to the Plan allegedly caused by the negligence, breach of trust and breach of fiduciary duty of the current and former trustees, current and former Plan custodians, actuaries, former legal counsel, and a former investment consultant and asset manager of the Plan. Pursuant to the order certifying the proceeding, the claims against two of

the trustees - Michael Barrett and John Rebry - were dismissed, as well as the claims against CIBC Mellon Trust Company. The claims against Turnbull and Turnbull Ltd., the Estate of John A. Turnbull, Louis Ellement, Anthony F. Cooper and Anthony F. Cooper Actuarial Services Limited were discontinued.

6 The plaintiffs claimed that the acts, errors and omissions of the defendants caused the Plan's financial position to decrease by $29.4 million on a going concern basis and by $30.4 million on a solvency basis between September 1997 and September 2001. By September 2002, the Plan's solvency liabilities are alleged to have exceeded its assets by approximately $56 million.

7 By this time, the Financial Services Commission of Ontario ("FSCO") had commenced an examination of the Plan's investment policies and practices and, in January 2003, its Examinations Unit identified a number of concerns including:

> (a) a lack of operational investment policies and procedures, particularly in investments involving derivatives;
> (b) an apparent lack of internal monitoring to ensure directions given by the administrator were being followed;
> (c) inadequate supervision of agents;
> (d) areas of potential conflicts of interest involving agents;
>
> > (d) an apparent lack of an independent review of fees paid to investment agents of the administrators; and
>
> (f) a potential contravention of the *Pension Benefits Act* arising from the apparent investment of some assets not in the Plan's name.

8 Subsequently, in 2003, the trustees of the Plan, on the advice of the Plan's actuary, concluded that the Plan was no longer financially viable, proposed certain amendments to reduce benefits to retirees, and survivors' benefits, by 50 per cent, and announced the Wind-Up of the Plan effective March 31, 2003 (the "Wind-Up date"). As of that date, the Plan provided benefits to approximately 2,421 present and former employees of 24 agricultural co-operatives and other employers in Ontario. The Plan's membership then comprised approximately 921 active members and 1,500 former members, including 971 retired members. The largest constituent group of members was made up of retirees, whose average age at that time was approximately 75 years old. The average annual pension for retired members was approximately $8,000, reduced in 2003 to $4,000. After the Wind-Up date, the financial position of the Plan continued to deteriorate; some of the contributing employers became insolvent, or ceased to carry on business; and more than 181 Plan members died.

9 From the outset, the defendants indicated that they intended to defend the claims and allegations against them in this proceeding and, initially, to contest certification. Extensive productions were reviewed and written and oral examinations for discovery were conducted. The discovery process has not been completed.

10 Settlement conferences with Winkler R.S.J. took place in 2004 and, again, in March 2006. In April, 2006 the settlement process was assisted significantly when the Superintendent of Financial Services issued a notice of proposal to the trustees and 19 employers who participated in the Plan. The Superintendent proposed to make orders refusing to approve the Wind-Up report filed by the trustees, or to register the proposed amendments to the Plan. It was also proposed to order the participating employers to make payments into the Plan to eliminate the Plan's funding deficiency.

11 In December, 2006, after the trustees and some of the employers had requested a hearing before the Financial Services Tribunal, a mediation of the issues before the Tribunal commenced with Ms. Leslie Macleod, appointed by the Ontario Ministry of Finance, as the mediator. Although the proceeding was separate from this action, the class members had a substantial interest in the mediation and its outcome. Class counsel represented a number of class members who were named parties in the proceeding before the Tribunal and participated actively in the mediation.

12 Negotiations for the settlement of the two proceedings were conducted in tandem throughout 2007, and agreements in principle were reached by the end of the year.

13 The agreement with respect to the FSCO proceeding provided for the wind-up of the Plan as of the Wind-Up date and a payment of approximately $14.5 million into the Plan by the settling employers, less amounts paid by them since the Wind-Up date. Other employers would remain liable for their share of the funding deficiencies. The agreement was conditional on the settlement of the class action. In addition - but subject to the same condition - the government of Ontario agreed to contribute a further $20 million to the Plan.

14 On February 13, 2008, I approved notices to be mailed to members of the Plan, and to be inserted in 13 newspapers, informing the members that the motions to approve the settlement of the class action and the fees of class counsel would be heard on April 16 and 17, and that the members were entitled to make submissions on the fairness and adequacy of the settlement, and the fees, in writing, or orally at the hearing. The terms of the settlement were summarized in the notices and class members were informed that they could obtain copies of the entire document from class counsel.

15 The formal terms of settlement in the FSCO proceeding, and the settlement agreement in this action, were executed on, or as of, March 28, 2008, and April 11, 2008, respectively.

SETTLEMENT APPROVAL

16 Under the proposed settlement of this action - subject to a condition that I will mention - the remaining defendants other than Mark Edward Workman and Whittacatt Holdings Ltd., are to pay $13,926,195.50 in return for releases of all claims against them. After the fees of class counsel and the levy payable to the Class Proceedings Fund have been paid, the balance of the amount is to be paid into the Plan and is to be used to provide the benefits that Plan members would be entitled to as of the Wind-Up date. Such benefits are to be determined by an administrator appointed by the

Superintendent of Financial Services.

17 Mr. Workman is believed to be a resident of the Cayman Islands and is alleged to own and control Whittacatt Holdings Ltd. He did not participate in the settlement negotiations and the claims against him and his corporation remain outstanding.

18 The condition referred to above relates to 85 members of the putative class who opted out of the class proceeding and who, in consequence, are not members of the class. From the viewpoint of the trustees it was crucial to any settlement that the claims of virtually all these members should be released. The trustees were unpaid volunteers of whom a number are members of the Plan with limited financial resources other than $10 million of insurance coverage. It was a condition of the settlement that all the opted-out members of the Plan - or all of them other than those whose shortfall in their benefits is less than $25,000 in the aggregate - should agree in writing to be part of the class so that they will be bound by the settlement. I was informed that, of the 85 opted-out Plan members, all but five have now, in writing, purported to revoke their exercise of the election to opt out and that the shortfall suffered by the remaining five members does not exceed $25,000.

19 I indicated at the hearing that I did not find it necessary to confront the question whether elections to opt out of a class proceeding can be revoked. It is proposed that the 80 members will be entitled to participate in the benefits under the settlement. In these circumstances, I believe that I am entitled to treat the purported revocations as agreements to release the settling defendants and to be bound by the settlement in return for a share of the benefits it provides. I am satisfied, also, that, if approval of the settlement is otherwise in the best interests of the class members, I can approve the inclusion of the 80 opt-outs in order to assure the consent of the settling defendants.

20 The required approach to the approval of a settlement pursuant to section 29(2) of the CPA is not in dispute. The overriding principle is whether the settlement is fair, reasonable and in the best interests of the class as a whole, and not whether it meets the demands of a particular member. There is a strong initial presumption of fairness when a settlement is negotiated at arms-length: *Ford v. F. Hoffman-La Roche* (2005), 74 O.R. (3d) 758 (S.C.J.), at paras. 113-114. In determining whether to grant approval, the court is not expected to dissect the provisions of the settlement with an eye to perfection in every aspect. It is sufficient if it falls within a zone or range of reasonableness.

21 The factors that may be relevant to the application of the general principle have been discussed in numerous cases including *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) and *Frohlinger v. Nortel Networks Corporation*, [2007] O.J. No. 148 (S.C.J.). Of particular relevance in this case is the likelihood of success in the proceeding and the likely degree of success. The former requires a consideration of the litigation risks of proceeding to trial. In a case such as this, the latter involves not only a consideration of the amount - discounted for risks - of any judgment that might be obtained, but also the amount that is likely to be recoverable from the defendants.

22 Other factors that should bear on the decision in this case are the future expense and likely duration of the proceedings. In cases involving pension benefits for retired persons, long delays are particularly adverse to their interests.

23 The settlement here is recommended by class counsel who are experienced both in class proceedings and pension matters and I have no reason to believe that it was negotiated other than as a result of arm's-length bargaining and an absence of collusion. It is supported by each of the representative plaintiffs as being in the best interests of all of the class members.

24 Counsel filed with the court a lengthy affidavit, and a factum, which discussed at length the factors that they consider support their recommendation. They estimated that the plaintiffs' case against the settling defendants was strongest against the trustees, and weakest against the corporate defendants whose resources for satisfying a judgment would be greatest. This disparity in resources must, of course, be discounted by the fact that any degree of negligence of a corporate defendant would make it jointly and severally liable with the trustees for the full amount of any damages. Success against the corporate defendants, and legal advisers, was, however, by no means assured.

25 In addition to the litigation risks, there is the fact that the benefits under the FSCO Settlement, and the amount to be paid by the Government of Ontario, are expressly conditioned on the settlement of this action, and there is no guarantee that the same benefits will be forthcoming if this matter proceeds to trial.

26 In looking at the degree of success achieved - when compared with the amount that might have been recovered in the action - I believe counsel were correct in their submission that, from the viewpoint of the class members, this was a battle that was advanced on two - and, perhaps, three - fronts. The benefits under the settlement complement those provided in the FSCO Settlement and the $20 million to be provided by the government of Ontario, and cannot fairly be weighed in isolation.

27 In counsel's submission, a gross recovery of $48.5 million when the litigation risks and the amount likely to be recovered if those risks are overcome, falls well within the required zone of reasonableness. In accepting his submission at the hearing, I was also strongly influenced by my belief that, in the circumstances of the case, it is very much in the interests of the class members that the delay and expense of proceeding to trial should be avoided.

28 This consideration was also foremost in the mind of two members, or beneficiaries, of the Plan who expressed their disappointment at the size of the settlement amount, but refrained from objecting to the settlement.

29 Counsel's time summaries indicate that, throughout the proceeding, they have had frequent and extensive communications with class members. I was informed that it is counsel's understanding that the settlement is accepted by an overwhelming majority of the class members as the best that can reasonably be achieved in the circumstances. Despite the extensive notice given to

the members, only one formal objection was received. This objection arose out of an attempt by the trustees to make deductions from the objector's pension benefits to compensate for a previous overpayment made as a result of a miscalculation by the Plan's former actuary who is now deceased and is no longer a party to this proceeding. The proposed deductions amount to approximately $60,000. At the hearing, I agreed with the submission of class counsel that this question was not in issue in the litigation. It may possibly be addressed in the future administration of the Plan by the administrator or, if necessary, by the Financial Services Tribunal.

30 Overall, I have no doubt that the settlement - including the entitlement of the 80 members of the Plan who purported to revoke their elections to opt out - is fair and reasonable in the circumstances and should be approved in the interests of the class members. It is inevitable in a case of this kind that class members will be disappointed that the amounts recovered will not compensate them fully for losses for which they were in no way responsible. That, however, is the invariable consequence of any settlement that involves a compromise of issues of law and fact that are in dispute between the parties.

FEES OF CLASS COUNSEL

31 Koskie Minsky LLP ("Koskie Minsky") and Groia & Company Professional Corporation ("Groia and Company") moved for an order approving their retainer agreement with the representative plaintiffs; an order approving their fees and disbursements plus taxes as applicable; and an order for the fees and disbursements to be paid out of the settlement proceeds. Additionally, they requested an order for the payment to the Class Proceedings Fund of the undisputed part of the levy to which the Law Foundation is entitled. The disputed part of the levy would be retained by class counsel in trust pending any appeal, or appeals, from my decision released on May 12, 2008. No issue was raised in connection with these additional orders and, subject to a final determination of the relevant amounts as a consequence of my decision on counsel's fees, they will be granted.

32 Koskie Minsky were the original solicitors of record and I will refer to them as "class counsel". Groia & Company were originally retained by class counsel to assist with securities-related matters as was permitted by the retainer agreement. I was informed that they were subsequently appointed as co-counsel.

33 The retainer agreement executed by the representative plaintiffs and class counsel is dated March 26, 2003. It provides for fees payable to counsel only in the event that judgment on the common issues is obtained in favour of some or all class members, or that there is a settlement that benefits one or more of them. The fees are up to be calculated by applying a multiplier approved by the court to a base fee determined by the usual hourly rates of the lawyers and other legal professionals who worked on the case multiplied by the number of hours worked.

34 Although the multiplier is to be selected by the court, the parties "provisionally" agreed that it should be at least the sum of 3.0 and 0.01 for every month between the date of the agreement and the date of either a final judgment, or the approval of any settlement of the action.

35 The motion for approval of the agreement assumes that, notwithstanding the adoption of the fee calculation method set out in section 33 of the CPA, the provisions of section 32 that require fee agreements - including contingency fee agreements - to be approved are applicable. I believe this is a correct interpretation of the statute and that no grounds for refusing approval are evident. The representative plaintiffs have sworn affidavits deposing to their execution of the retainers and, in my opinion, they comply with the provisions of section 32 and 33 of the CPA.

36 Section 33 is as follows:

> 33(1) Despite the *Solicitors Act* and *An Act Respecting Champerty*, being chapter 327 of the Revised Statutes of Ontario, 1897, a solicitor and a representative party may enter into a written agreement providing for payment of fees and disbursements only in the event of success in a class proceeding.
>
> (2) For the purpose of subsection (1), success in a class proceeding includes,
>
> (a) a judgment on common issues in favour of some or all class members; and
> (b) a settlement that benefits one or more class members.
>
> (3) For the purposes of subsection (4)2(7),
>
> "base fee" means a result of more applying the total number of hours worked by an hourly rate;
>
> "multiplier" means a multiple to be applied to a base fee.
>
> (4) An agreement under subsection (1) may permit the solicitor to make a motion to the court to have his or her fees increased by a multiplier.
>
> (5) A motion under subsection (4) shall be heard by a judge who has,
>
> (a) given judgment on common issues in favour of some or all class members; or
> (b) approved a settlement that benefits any class member.

(6) Where the judge referred to in subsection (5) is unavailable for any reason, the regional senior judge shall assign another judge of the court for the purpose.

(7) On a motion of a solicitor who has entered into an agreement under subsection (4), the court,

(a) shall determine the amount of the solicitor's base fee;
(b) may apply a multiplier to the base fee that resolves in fair and reasonable compensation to the solicitor for the risk incurred in undertaking and continuing the proceeding under an agreement for payment only in the event of success; and
(c) shall determine the amount of disbursements to which the solicitor is entitled, including interest calculated on the disbursements incurred, as totalled at the end of each six-month period following the date of the agreement.

(8) In making a determination under clause (7)(a), the court shall allow only a reasonable fee.

(9) In making a determination under clause (7)(b), the court may consider the manner in which the solicitor conducted the proceeding.

37 The agreement recognizes and does not purport to oust the jurisdiction of the court to determine the appropriate multiplier - or, in my opinion, to determine the amount of a reasonable base fee - and I interpret the provisional agreement for a multiple of 3.6 (on the facts of this case) accordingly. In this motion, the multiple counsel have requested to be applied to the base fee they propose is approximately 2.

38 The method of determining fees in accordance with section 33 - the "lodestar" method - was imported into the CPA from the United States. It has no counterparts in other Canadian jurisdictions and has been expressly rejected in British Columbia as an "undesirable and unnecessary" approach: *Endean v. Canadian Red Cross Society*, [2000] B.C.J. No. 1254 (S.C.); *Pearson v. Boliden Ltd.*, [2006] B.C.J. No. 1512 (S.C.). In *Endean*, the court accepted the strong criticisms of the lodestar method enumerated in the report of a taskforce set up by a federal court in the United States. These criticisms were as follows:

1) It increases the workload on an already overtaxed judicial system; 2) the elements of the process are insufficiently objective and produce results that are far from homogeneous; 3) the process creates a sense of mathematical precision

> that is unwarranted in terms of the realities of the practice of law; 4) the process is subject to manipulation by judges who prefer to calibrate fees in terms of percentages of the settlement Fund or the amounts recovered by the plaintiffs or of an overall dollar amount; 5) the process, although designed to curb abuses, has led to other abuses, such as encouraging lawyers to expend excessive hours engaging in duplicative and unjustified work, inflating their normal billing rates, and including fictitious hours; 6) it creates a disincentive for the early settlement of cases; 7) it does not provide the ... court with enough flexibility to reward or deter lawyers so that desirable objectives, such as early settlement, will be fostered; 8) the process works to the particular disadvantage of the public interest bar because, for the example, the lodestar is set lower in civil rights cases than in securities and anti-trust cases; and 9) despite the apparent simplicity of the lodestar approach, considerable confusion and lack of predictability remain in its administration.

39 I am not aware of anything in the experience in this jurisdiction that would suggest that the above criticisms are not equally applicable under the CPA. Section 33 does, however, remain in the statute and, unlike the position in British Columbia, there is no doubt that counsel here are entitled to adopt the lodestar method. There is also no doubt that in a case like these it presents the court with a task of some difficulty.

40 The practical problems of determining an appropriate fee pursuant to section 33 are by no means confined to the selection of an appropriate multiplier. The factors that should influence the exercise of the court's discretion for this purpose were clearly and authoritatively set out by Goudge J.A. in *Gagne v. Silcorp Ltd.*, [1998] O.J. No. 4182 (C.A.). The requirement in section 33(8) that the court shall allow only a reasonable base fee gives rise to more difficulty in many cases, including this one.

41 Counsel have proposed a base fee of $2,116,354 for their work plus $219,000 for the work of Groia & Company who were retained originally to advise on securities issues as was permitted in the retainer agreement. The time included for class counsel represents approximately 7,900 hours worked and does not include an additional 772 hours spent on the FSCO proceeding for which they have been remunerated, in part, at significantly lower hourly rates than those they usually charge to their clients. The reported fee of Groia & Company is said to represent a further 627 billable hours. The combined fee requested is $4,750,000 before GST is added. This represents a multiplier of approximately 2. If the additional time expended by class counsel on the preparation of the motions were added, the multiplier would be less than 2.

42 In *Gagne*, at paras. 25 and 26, Goudge J.A. recognized that the selection of the appropriate multiplier is an art and not a science and that all relevant factors must be weighed. He continued:

> In the end, these considerations must yield a multiplier that, in the words of

> section 33(7)(b), results in fair and reasonable compensation to the solicitors. One yardstick by which this can be tested is the percentage of gross recovery that would be represented by the multiplied base fee. If the base fee as multiplied constitutes an excessive proportion of the total recovery, the multiplier might well be too high. A second way of testing whether the ultimate compensation is fair and reasonable is to see whether the multiplier is appropriately placed in a range that might run from slightly greater than one to three or four in the most deserving case. Thirdly, regard can be had to the retainer agreement in determining what is fair and reasonable. Finally, fair and reasonable compensation must be sufficient to provide a real economic incentive to solicitors in the future to take on this sort of case and to do it well.

43 Applying the first yardstick mentioned by the learned judge, the fees requested would be approximately 34 per cent of the total recovery which, in this case, I consider to be unduly high - and particularly so if the amounts to be deducted in determining the net recovery for the Plan are also to be considered. Under the second test, no objection could be taken to the proposed multiplier of 2 in the circumstances of this case. The third test would obviously be satisfied and counsel indicated that they believed that the fee requested would give them an appropriate economic incentive to take other cases.

44 In applying section 33, I do not believe it is permissible, or acceptable, to work backward and ask what would be fair and reasonable compensation, and then determine the appropriate multiplier to apply to the hours actually worked at the usual rates of the professionals involved. The starting point must be the determination of a reasonable base fee as this will be an essential, and ever-present, consideration when determining what is fair and reasonable compensation for the risk incurred pursuant to section 33(7)(b). It is the determination of the base fee that has caused the most concern in this, as well as other cases.

45 In *Serwaczek v. Medical Engineering Corp*., [1996] O.J. No. 3038 (Gen. Div.), Winkler J. agreed with, and adopted, the approach to determining a reasonable base fee that had been approved by Ground J. in *Maxwell v. MLG Ventures Ltd*., [1996] O.J. No. 2644 (Gen. Div.) and Sharpe J. in *Windisman v. Toronto College Park Ltd*., [1996] O.J. No. 2897 (Gen. Div.). In these cases, the learned judges concluded that "the proper approach was to proceed by way of analogy to the role of the judge in fixing costs, namely, to determine what the services devoted to the proceeding are worth in light of the submissions of counsel and his own experience.": *Serwaczek*, at para. 15. I understand this to refer to cases in which costs would be determined on the basis of a full indemnity - or what used to be described as costs between a solicitor and his own client - and not according to a lesser scale. The factors relevant to this approach were described by Sharpe J. as -

> ... the usual factors ... namely: (a) the time expended by the solicitors; (b) the legal complexity of the matters to be dealt with; (c) the degree of responsibility assumed by the solicitors; (d) the monetary value of the matters in issue; (e) the

> importance of the matter to the client; (f) the degree of skill and competence demonstrated by the solicitors; (g) the results achieved; (h) the ability of the client to pay; and (i) the client's expectation as to the amount of the fee: (*Windisman*, at para. 8).

46 Applying these factors, while the time expended is, for the reasons I will give, inordinately high in my judgment, there is no doubt that the legal and factual issues were complex; counsel assumed complete responsibility for the prosecution of action; the matter was of the utmost importance to the plaintiffs and the class; and a very high degree of skill and competence was demonstrated by counsel.

47 In considering the results achieved, I do not think I can properly look only to the settlement proceeds and ignore the additional amounts totalling $34.5 million that are to be contributed to the Plan by the government of Ontario, and by employers as a result of the FSCO proceeding. At the hearing, submissions made by, and on behalf of, members of the class suggested that counsel were over-estimating the extent to which these amounts resulted from their efforts, and not from the efforts of others including the employers, and in particular, those of Leslie Macleod, the mediator appointed by the Government of Ontario. I was impressed and assisted by those submissions - and particularly the comments of Mr. Jim Campbell, who is a class member, and those of Ms. Macleod. I am, however, satisfied that counsel's contribution was significant and, to that extent, the additional amounts can reasonably be considered to be attributable in part to their efforts. Ms. Macleod saw the two proceedings as linked and stated that she had thought that neither would be settled without the other.

48 Although the terms of the retainer agreement indicated to the clients the approach that counsel would ask the court to approve, and to that extent reflected their expectations, I would not place great weight on them for the purpose of determining a reasonable base fee, and I do not agree with counsel's tendentious references in their factum to their entitlement under the agreements, or that the "amount owing under the retainer agreement is over $8 million" (para. 81(o)). I know nothing about the circumstances in which the retainer agreements were executed, but I do not interpret them as giving their counsel *carte blanche* to work unnecessary, or an unreasonable number of, hours. The plaintiffs have indicated their agreement with the fees counsel have proposed, but there is nothing to suggest that the plaintiffs had, or have, the knowledge and information that would enable them to determine the reasonableness of the base fee counsel are suggesting or, more generally, to measure the computation of the fees requested by reference to the principles that the court would apply in making the determination referred to in the retainer agreement.

49 For the purpose of evaluating the reasonableness of the base fee that counsel propose, the starting point, and the most important consideration, is the amount of time expended by counsel and the hourly rates applied by them. The latter gave me no concern in this case. The amount of time, however, is, in my judgment, significantly in excess of what counsel might reasonably expect to charge to a client if there was no agreement for a contingency fee and this was not a class

proceeding.

50 I have been provided with 168 pages of time summaries for class counsel alone. These reveal an over-lavish expenditure of the resources of the firm. 58 "lawyers" - in whom, I assume, paralegals and students were included - are said to have worked on the file. Of these, 25 recorded more than 20 hours. Not surprisingly in these circumstances, a very large number of the dockets record communications and discussions internally and the dispatch, receipt and review of e-mails to other lawyers within the firm. Considerable time is recorded in drafting internal memoranda and summarising documents. Approximately $725,000 was recorded for work prior to, and including, certification. Subsequently, one lawyer, alone, recorded 1,460 hours largely spent on organising, reviewing or summarizing documents. This time was valued at $285,551 and included approximately 1,000 hours reviewing, revising, analysing, and drafting memoranda on, the trustees' affidavit of documents.

51 Over-lawyering rarely, if ever, achieves economies of scale *vis-a-vis* particular clients. Delegation of different tasks among numerous partners, associates and others may sometimes be an efficient way for a law firm to deal with many files simultaneously but, as between the firm and any particular client, over-lawyering inevitably involves a duplication of work and an inefficient expenditure of time.

52 A number of factors that distinguish class actions from other proceedings can create obvious temptations for plaintiffs' counsel to exercise less control of the time they spend on a file. First and foremost is the absence of a client who will be directly affected and concerned with the level of the fees claimed. Class members may, at times, express their reservations - and even their shock - at fairness hearings at the size of the fees requested but, because of the absence of any close solicitor-and-client relationship, these are generally somewhat muted. The potential size of the fees that reflect the large amounts at stake in the litigation is also a factor that may lead to an unreasonably extensive expenditure of time. I do not believe one can properly estimate the amount of a reasonable base fee without giving some consideration to the distinctions between productive, and unproductive time, and between work that is reasonably required and that which should be regarded as overkill. Counsel are, of course, perfectly entitled to dot every *i* and cross every *t* more than once if they so choose, and to keep track of every minute of time spent thinking about a file, but it does not follow that all of their time will then be reflected in a reasonable base fee.

53 The charge of over-lawyering does not apply to the same extent to the fees of Groia & Company, but, again, the time recorded is, in my opinion, out of line with what could properly be charged in an ordinary solicitor and client relationship. Apart from the initial work they performed in advising on the securities issues, the firm subsequently assisted class counsel in retaining and instructing experts and conducting examinations for discovery. On these matters they recorded over 540 hours which they valued at $187,195. Of this amount $27,375 was attributed to the time of a student.

54 I am satisfied that the approach of plaintiffs' counsel to the provision of their services in this and other class proceedings has departed quite radically from that traditionally adopted by solicitors representing clients in other litigation. The discipline imposed by the normal constraints in acting for a client who will be personally liable for the fees has been abandoned. The issues in this case were of some complexity but no more so than those that arise in cases in which the plaintiffs represented no one but themselves, and in which the expenditure of over 8,000 hours of preparation would not be considered acceptable.

55 It would undoubtedly take several days - and, possibly, some weeks - to conduct a full assessment of fees as between solicitors and their clients based on the time and work expended by counsel in this case. That is not my function. However, based on the material provided to me, I cannot accept that the amount of $2,335,354 - even if it is not to be augmented by the additional time recently expended - is a reasonable base fee. I am satisfied that a reduction of approximately 30 per cent from the total base fee claimed, representing the exclusion of a portion of time expended, would not be unfair to counsel, or unreasonable in the circumstances. Accordingly the base fee is determined to be $1,634,748. To that I will apply a multiplier of 2.5 which I consider to be more reflective of the risk incurred, and the highly professional and expert manner in which the proceedings were conducted by counsel. On that basis, the fee would be $4,086,870 which is approximately 29 per cent of the gross recovery - a percentage that I consider is not out of line with those awarded in previous cases involving, and not involving, the application of a multiplier. The multiplier is towards the higher end of the range suggested in *Gagne*, and I am satisfied that it is not too low to create any economic disincentive to plaintiffs' counsel in subsequent cases.

56 In determining the amount of the fees that I will approve, I have not made any reduction because of the existence of the levy payable to the Class Proceedings Fund. The retainer agreements contemplated that financial assistance might be obtained from it to cover disbursements. Although class counsel had no obligation to incur disbursements in excess of $25,000 without immediate reimbursement from the Fund, or from class members, they have done so in a total amount of at least $144,047.64 - an amount almost equal to that contributed from the Fund. There is no basis in my opinion for penalising counsel for seeking these contributions. I leave open the possibility that, on other facts, the amount of the levy could be reflected in a disparity between net recovery by class members and the amount of counsel's fees otherwise determined that might justify a reduction in the fees.

57 I have not been able to reconcile the amount of the disbursements, claimed in the affidavit and factum filed in the motion, with the supporting material filed. Further submissions on the disbursements that should be approved may be made at a case conference to be arranged to deal with them and the amendments to the draft order - including the amount of the levy of the Law Foundation of Ontario - that will be required to comply with these reasons.

M.C. CULLITY J.

cp/e/qlmxm/qlclg/qlbrl/qlaxw/qlcxm/qlaxw/qlced

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. Background

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. The Issues

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. The Test for Certification

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) Causes of Action Asserted

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) The Proposed Class

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) The Jurisdiction Issue

A. Introduction

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. Application of jurisdictional tests in this case

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) Is the Class overly broad?

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) Common Issues

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:

> A: 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.
>
> B: 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.

(i) Misrepresentation as a common issue

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 not 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) Preferable Procedure

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. Conclusion

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:

McLaren v. LG Electronics Canada Inc.

Between
W. Donald McLaren, Plaintiff, and
LG Electronics Canada Inc., Defendant
PROCEEDING UNDER the Class Proceedings Act, 1992

[2010] O.J. No. 3840

2010 ONSC 4710

Court File No. 06-CV-313884-PD3

Ontario Superior Court of Justice

P.M. Perell J.

Heard: August 27, 2010.
Judgment: August 31, 2010.

(37 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Settlements -- Approval -- Motion by plaintiffs to certify the action as a class proceeding and to have the proposed settlement approved allowed -- Plaintiffs purchased a refrigerator manufactured by defendant that was defective and caused a fire -- Plaintiffs alleged that defendant negligently designed and manufactured certain refrigerators and failed to warn consumers of defects in refrigerators -- Settlement provided for extended warranty and notice to all class members of defendant's retrofit program -- Criterion for certification satisfied -- Proposed settlement promoted access to justice, judicial economy and behaviour modification.

Motion by the plaintiff to certify the action as a class proceeding and to have the proposed settlement approved. The plaintiffs alleged that the defendant negligently designed, tested, manufactured, and marketed certain refrigerators and failed to warn consumers of defects in the refrigerators. These refrigerators contained faulty capacitors that were prone to malfunction, causing the refrigerator condenser motor fan to fail. The malfunction could cause the refrigerator to overheat and catch fire. The plaintiffs' refrigerator had caught fire and severely damaged their home. A

subsequent investigation indicated that the fire had been caused by a defect in the refrigerator's compressor. During the settlement negations in the present action, the defendant had engaged in a retrofit program to replace the defective parts in the refrigerators at its own expense. Under the settlement, each class member would receive a one-year extended warranty on all functional parts of their refrigerator. Class members would be given notice of the retrofit program. Class counsel and the plaintiffs supported the settlement.

HELD: Motion allowed. For settlement purposes, the criterion for certification had been satisfied. The provision of the extended warranty without the release of any possible claims for property damages represented a settlement that provided real value to all Class Members while maintaining the ability of a Class Member to pursue any property damage claim that had not yet been resolved. The Extended Warranty was not limited to the defects that gave rise to the proposed class action. The proposed settlement promoted access to justice, judicial economy and behaviour modification.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. C.6, s. 5(1)

Competition Act, R.S.C. 1985, c. C-34, s. 52

Counsel:

Megan B. McPhee and Khalid Janmohamed.

Kris Borg-Oliver, for the Defendant.

REASONS FOR DECISION

P.M. PERELL J.:--

Introduction

1 The Plaintiff, W. Donald McLaren, moves to certify this action as a class proceeding, to amend the pleading to add a representative plaintiff, and to have the proposed settlement approved. There is also a motion to approve Class Counsel's fees and disbursements, for which I am reserving judgment to resolve a matter of interpretation of the settlement agreement.

Factual Background

2 The action is a products liability action. Mr. McLaren alleges that the Defendant, LG

Electronics Canada Inc., negligently designed, tested, manufactured, and marketed certain refrigerators and failed to warn consumers of defects in the refrigerators. It is also alleged that LG breached s. 52 of the *Competition Act*, R.S.C. 1985, c. C-34.

3 Between June 2004 and April 2005, LG manufactured and sold in Canada 3-Door Bottom-Mount Refrigerators and 2-Door Top-Mount Refrigerators; namely: (1) LG Brand 3-Door Bottom-Mount Refrigerators - LRFC 21760ST/SW and LRFC 25750SB/ST/SW/TT/WW with serial numbers beginning with 405, 406, 407, 408, 409 and 410; (2) LG Brand 2-Door Top-Mount Refrigerators - GR-729RN, LRTN 18320WW, LRTX 18311WW and LRTX 18321BK/TT/WW with serial numbers beginning with 405, 406, 407, 408, 409 and 410; and, (3) Kenmore Brand 3-Door Refrigerators - 501-75192 and 501-75193 with serial numbers beginning with 405, 406, 407, 408, 409 and 410.

4 Approximately 9,750 refrigerators were sold at prices ranging from $900 to $2,000.

5 These refrigerators contained faulty capacitors that are prone to malfunction, causing the refrigerator condenser motor fan to fail. The malfunction could cause the refrigerator to overheat and catch fire.

6 On March 24, 2006, LG placed full-page ads in major newspapers advising that a faulty component in certain refrigerators may pose a risk of fire.

7 On March 26, 2006, the CBC television program "Marketplace" aired an investigative story about the refrigerators. The story stated that there were approximately 10,000 defective refrigerators and that LG had downplayed and failed to advise consumers about the threat of fire.

8 The proposed representative plaintiffs, W. Donald McLaren, who is a firefighter, and Susan McLaren reside in Bradford, Ontario. In October 2004, the McLarens had purchased a LG refrigerator along with an extended 5-year service plan from Future Shop. The cost of the refrigerator, model number LRTX18311WW, was $599.99 plus applicable taxes, and the cost of the plan was $119.99.

9 On May 6, 2005, the McLaren's refrigerator caught fire and severely damaged the McLaren's home. A subsequent investigation indicated that the fire had been caused by a defect in the refrigerator's compressor.

10 On March 22, 2006, 10 months after the fire, the McLarens received two "Dear Customer" letters from LG, one dated August 8, 2005 and one dated March 13, 2006, advising of safety concerns involving certain LG refrigerators, and of a retrofit program instituted by LG.

11 On May 9, 2006, Mr. McLaren retained the former law firm of Roy Elliot Kim O'Connor to sue LG. He signed a contingency fee agreement.

12 On June 23, 2006, a statement of claim was issued.

13 Between March and May of 2007, a series of amendments were made to the statement of claim. These amendments included the addition of the Mrs. McLaren as a proposed representative plaintiff, the addition of the Kenmore brand refrigerators to the list of refrigerators and particulars of the negligence claims and damages.

14 On April 16, 2008, Mr. McLaren served a Notice of Change of Solicitors appointing Kim Orr as solicitors of record. Mr. McLaren signed a contingency fee retainer agreement with Kim Orr on April 16, 2008. The retainer agreement provides that if a settlement benefits one or more class members, class counsel is entitled to fees by a lump sum, by payment out of the proceeds, or otherwise as may be directed by the court.

15 In the three and a half years that followed the issuance of the statement of claim, the parties engaged in extensive settlement negotiations and finally reached an agreement.

16 During the time of the negotiations, LG engaged in a retrofit program to replace the defective parts in the refrigerators at its own expense. An LG repair technician attended at customer's homes and replaced the capacitor portion of the refrigerator at no cost to the customer. It contacted retailers to obtain lists of customers who purchased the refrigerators and then contacted the customers to repair or replace the defective refrigerator component, and LG attempted to settle all individual claims for property damages.

17 Approximately 80% of the defective refrigerators have been retrofitted.

18 The highlights of the settlement agreement are as follows:

* Each Class Member will receive a one-year extended warranty on all functional, non-cosmetic parts of their refrigerator (the "Extended Warranty") effective from the Opt-Out Deadline.
* Class Members will be given notice of the retrofit program.
* LG agrees to serve as the claims administrator for the purpose of administering the Extended Warranties and making any payment as provided in the Settlement Agreement. LG will be solely responsible for all costs relating to and arising from the claims administration.
* Class Members will provide a release, but the release will not include: (a) payment disputes or claims relating to repair or replacement of parts or units under any existing written warranty a Class Member may have; (b) individual personal injury claims for individual damages and losses only; (c) individual property damage claims for individual damages and losses only; and (d) any claims under the *Family Law Act*.
* Subject to court approval, the McLarens shall receive an honorarium of $2,000.

* LG will be responsible for payment of the legal fees of Class Counsel. It shall, subject to approval by the court, pay the legal fees, disbursements and taxes thereon of Class Counsel in the amount of $250,000.00 on an all-inclusive basis.
* Class Counsel shall not request payment of any legal fees, disbursements, or taxes from Class Members.

19 Class counsel recommends the settlement as fair, reasonable, and in the best interests of Class Members.

20 The McLarens support the settlement.

21 As of August 20, 2010, Kim Orr has received 58 letters and emails and numerous inquiries from Class Members. Of those, 17 Class Members object to the settlement and/or seek additional compensation from LG, including a new refrigerator.

22 As of August 18, 2010, former Class Counsel and current Counsel have work in progress and disbursements inclusive of applicable taxes of $113,440.42 and $229,462.48 respectively. Kim Orr will incur further time and disbursements for the certification and settlement approval motion and in communicating with Class Members following distribution of the notices of certification and settlement approval.

Certification

23 Pursuant to s. 5(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. C.6, the court shall certify a proceeding as a class proceeding if: (a) the pleadings disclose a cause of action; (b) there is an identifiable class; (c) the claims of the class members raise common issues of fact or law; (d) a class proceeding would be the preferable procedure; and (e) there is a representative plaintiff who would adequately represent the interests of the class without conflict of interest and who has produced a workable litigation plan.

24 Where certification is sought for the purposes of settlement, all the criteria for certification must still be met: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 22. However, compliance with the certification criteria is not as strictly required because of the different circumstances associated with settlements: *Bellaire v. Daya*, [2007] O.J. No. 4819 (S.C.J.) at para. 16; *National Trust Co. v. Smallhorn*, [2007] O.J. No. 3825 (S.C.J.) at para. 8; *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065 (S.C.J.) at para. 9.

25 I am satisfied that for settlement purposes, the criterion for certification have been satisfied in the case at bar. In particular: (a) the pleadings disclose a cause of action (negligence, breach of *Competition Act*); (b) there is an identifiable class of two or more persons who will be represented by the representative plaintiff; (c) the claims of the class raise common issues of fact or law, which are set out below; (d) a class proceeding is the preferable procedure; and (e) the McLarens are

suitable representative plaintiffs with adequate Class Counsel.

26 For the purposes of certification, the Class Membership is defined as follows:

> Each and every person, wherever resident, who purchased or otherwise acquired an Affected Refrigerator in Canada (the "Class" or "Class Members") and each and every person normally resident in a dwelling where an Affected Refrigerator is found.

27 The action raises the following common issues:

(a) Did the defendant owe a duty of care to the class members with respect to the marketing, testing, design and manufacture of the Affected Refrigerators? If so, was that duty breached?
(b) Did the defendant owe a duty to warn the class members of the defect in the Affected Refrigerators? If so, was that duty breached?
(c) Did the defendant knowingly or recklessly make representations to the public that were false or misleading, in breach of s. 52 of the *Competition Act*? If so, what remedies or damages, if any, are the Class Members entitled to under that Act?
(d) Can damages, or some of the Class Members' damages, be determined on an aggregate basis on behalf of the Class? If so, in what amount?
(e) Do the actions of the defendant warrant an award of exemplary, punitive and/or aggravated damages? If so, in what amount?
(f) Should the defendant pay special damages to the Class?
(g) Can the Class elect to have damages determined through an accounting and disgorgement of the proceeds of the sale of the Affected Refrigerators? If so, in what amount and for whose benefit is such accounting to be made?
(h) Should the defendant pay the costs of administering and distributing any recovery? If so, in what amount?
(i) Should the defendant be ordered to pay prejudgment interest? If so, how is the prejudgment interest to be calculated and what interest rate will apply?

28 I, therefore, certify this action as a class proceeding.

Settlement Approval

29 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 those affected by it: *Dabbs v. Sun Life Assurance*, [1998] O.J. No. 1598 (Gen. Div.) at para. 9; *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 68-73.

30 In determining whether to approve a settlement, the court, without making findings of facts on

the merits of the litigation, examines the fairness and reasonableness of the proposed settlement and whether it is in the best interests of the class as a whole having regard to the claims and defences in the litigation and any objections raised to the settlement: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 10.

31 When considering the approval of negotiated settlements, the court may consider, among other things: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) settlement terms and conditions; (d) recommendation and experience of counsel; (e) future expenses and likely duration of litigation and risk; (f) recommendation of neutral parties; (g) if any, the number of objectors and nature of objections; (h) the presence of good faith, arms-length bargaining and the absence of collusion; (i) the degree and nature of communications by counsel and the representative parties with class members during the litigation; and (i) information conveying to the court the dynamics of and the positions taken by the parties during the negotiation: *Dabbs v. Sun Life Assurance Company of Canada* (1998), 40 O.R. (3d) 429 (Gen. Div.) at 440-44, aff'd (1998), 41 O.R. (3d) 97 (C.A.), leave to appeal to S.C.C. refused Oct. 22, 1998, [1998] S.C.C.A. No. 372; *Parsons v. The Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 71-72; *Frohlinger v. Nortel Networks Corp.*, [2007] O.J. No. 148 (S.C.J.) at para. 8; *Kelman v. Goodyear Tire and Rubber Co.*, [2005] O.J. No. 175 (S.C.J.) at paras. 12-13; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 117; *Sutherland v. Boots Pharmaceutical plc*, [2002] O.J. No. 1361 (S.C.J.) at para. 10.

32 The provision of the Extended Warranty without the release of any possible claims for property damages represents a settlement that provides real value to all Class Members while maintaining the ability of a Class Member to pursue any property damage claim that has not yet been resolved. The Extended Warranty is not limited to the defects that gave rise to the proposed class action.

33 The proposed settlement promotes the three policy objectives of the CPA: access to justice, judicial economy and behaviour modification.

34 In light of the remedial efforts undertaken by LG and when weighed against the risks and costs of continued litigation, the provision of a one-year extended warranty on all functional, non-cosmetic parts of the Affected Refrigerators is a fair and reasonable settlement that is in the best interest of Class Members

35 I approve the settlement as fair, reasonable, and in the best interest of the Class Members.

36 I approve the Settlement Approval notices and the Notice Plan.

Conclusion

37 The motion is granted. Orders accordingly.

P.M. PERELL J.

cp/e/qllxr/qljxr

Indexed as:

Menegon v. Philip Services Corp.

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36., as amended
AND IN THE MATTER OF the Courts of Justice Act, R.S.O. 1990 c. C-43, as amended
AND IN THE MATTER OF a plan of compromise or arrangement of Philip Services Corp. and the applicants listed on Schedule "A"
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Between
Joseph Menegon, plaintiff, and
Philip Services Corp., Salomon Brothers Canada Inc., Merill Lynch Canada Inc., CIBC Wood Gundy Securities Inc., Midland Walwyn Capital Inc., First Marathon Securities Limited, Gordon Capital Corporation, RBC Dominion Securities Inc., TD Securities Inc., and Deloitte & Touche, defendants

[1999] O.J. No. 4080

11 C.B.R. (4th) 262

39 C.P.C. (4th) 287

Court File Nos. 99-CL-3442 and 4166CP/98

Ontario Superior Court of Justice
Commercial List

Blair J.

August 27, 1999.

(60 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval -- Practice -- Persons who can sue and be sued -- Individuals and

corporations, status or standing -- Class or representative actions -- Conflict of laws -- Bankruptcy.

Motion by the defendant Philip Services for authorization to enter into a proposed settlement under the Class Proceeding Act. Joint motion by the representative plaintiff Menegon and by Philip for certification of class proceedings as against Philip only. Motion by the defendant Deloitte and Touche and by former officers and directors of Philip to declare an insolvency plan unreasonable. Motion by the creditor Royal Bank for a declaration that its claim against Philip under certain leases be determined under Canadian law. Philip was the parent company of a large network of subsidiaries in Canada and the United States. Publicity regarding inventory discrepancies led to a drop in prices of Philip shares, resulting in various class actions which alleged that Philip's financial disclosure contained material misstatements in violation of United States securities laws. The actions were consolidated and ultimately dismissed, though an appeal was pending. Menegon commenced a class proceeding in Ontario for misrepresentation and rescission relating to purchase of Philip shares. The Royal Bank had a claim against Philip under 57 equipment leases governed by Ontario law with respect to equipment located in Ontario. A memorandum of understanding outlined a proposed settlement between Philip and the class action plaintiffs in both the United States and Canadian proceedings. Philip filed for bankruptcy protection in the United States and for protection in Canada under the Companies' Creditors Arrangement Act. The Canadian plan provided that Canadian claimants were to be governed by and treated in the United States proceedings.

HELD: Class proceedings certified as against Philip for settlement purposes only. Deloitte & Touche, the officers and directors, and the Royal Bank were all entitled to assert claims in the Canadian proceedings. Royal Bank was also entitled to a declaration that its claims under the leases were to be determined in Canadian proceedings. Approval of the settlement was premature. Reasonableness of the plan was an issue to be determined at a sanctioning hearing.

Statutes, Regulations and Rules Cited:

Bankruptcy Code.

Class Proceedings Act, 1992, ss. 5(1), 17.

Companies' Creditors Arrangement Act, ss. 5.1(3), 18.6(2), 18.6(5).

Courts of Justice Act, s. 97.

Counsel:

David R. Byers, Sean Dunphy and Colleen Stanley, for the Philip Services Corp. et al.
John McDonald, for the Class Proceedings plaintiffs.
J.L. McDougall, Q.C., B.R. Leonard, for the defendants Deloitte & Touche.

B. Zarnell, for the defendants Merill Lynch Canada Inc., Midland Walwyn Capital Inc., First Marathon Securities Limited, Gordon Capital Corporation and Salomon Brothers Canada Inc. ("The Underwriters")
Hilary Clarke, for the Royal Bank of Canada.
Pamela Huff and Susan Grundy, for the Lenders under the Credit Agreement.
Joseph Groia and Subrata Bhattacharjee, for the certain Directors.
E.A. Sellars, for the defendant CIBC as Account Intermediary.
Steven Graff, for the PHH Vehicle Leasing.

BLAIR J.:--

I - FACTS

Background

1 The issues raised on these Motions touch upon difficult areas in the burgeoning field of cross-border insolvencies.

2 Philip Services Corp. is the ultimate parent company of a network of approximately 200 directly and indirectly owned subsidiaries in Canada, the United States and elsewhere. The operations of this international conglomerate of companies are service oriented, with a primary focus on what are referred to as "Metals Services" and "Industrial Services". The former involves the collection, processing and recycling of scrap metal for steel mills and for the foundry and automotive industries. The latter entails providing such things as cleaning and maintenance services, waste collection and transportation, emergency response services and tank cleaning for major industries ("outsourcing services"), and providing "by-products recovery services", with heavy emphasis on chemical and fuel and polyurethane recycling, for the same industries.

3 The Philips conglomerate - with consolidated revenues in 1988 of U.S. $2 billion, but a consolidated net loss of U.S. $1.587 billion for the period ending December 31, 1998 - has fallen into insolvent circumstances. On June 25, 1999, Philip Services Corp. and its Canadian subsidiaries sought and obtained the protection of this Court under the provisions of the CCAA to enable them to attempt to restructure their affairs. On the same date, Philip Service Corp. and its primary subsidiary for its U.S. operations, Philip Services (Delaware) Inc., together with other U.S. subsidiaries, filed for Chapter 11 protection under the U.S. Bankruptcy Code in United States Bankruptcy Court (District of Delaware). On July 12, 1999, a "Disclosure Statement and a Plan of Reorganization" was filed in the U.S. Bankruptcy Proceedings ("the U.S. Plan"). On July 15th, a Plan of Compromise and Arrangement was filed in the CCAA Proceedings ("the Canadian Plan").

4 As the parties and counsel have done, I shall refer to Philip Services Corp. as "Philip" and to Philip Services (Delaware) Inc. as "PSI". I shall refer to the conglomerate as a whole as "Consolidated Philip."

5 Philip is an Ontario corporation with head offices in Hamilton, Ontario. It is a public company with stock trading on the Toronto Stock Exchange, the Montreal Exchange, and the New York Stock Exchange. Although trading is suspended at the present time, the bulk of trading occurred on the New York Stock Exchange. Eighty-two percent of Philip's issued and outstanding shares are owned by U.S. residents. Moreover, it appears, the majority of Philip's operating assets, and of its operations, are located in the United States. Consolidated Philip carries on business at more than 260 locations, and employs more than 40,000 industrial and commercial customers world-wide. In Canada, there are 94 locations, about 2,000 employees, and annual revenues in the neighbourhood of U.S. $333 million.

6 Philip expanded very rapidly in the past few years - perhaps too rapidly, as it turns out. Consolidated Philip grew by more than 40 new business acquisitions in 1996 and 1997. Associated with this expansion was the negotiation of a U.S. $1.5 billion Credit Agreement with Philip and PSI as borrowers and a syndicate of more than 40 lenders (the "Lenders"). Under the Credit Agreement Philip guaranteed the borrowings of PSI, and PSI guaranteed the borrowings of Philip. In addition, certain subsidiaries of Philip and PSI guaranteed all of the liabilities of Philip and PSI to the lenders, and the guarantees from the subsidiaries were secured by general agreements and specific assignments of assets. In short, the Lenders have security over virtually all of the assets of Consolidated Philip. Moreover, subject to certain specific exceptions, it is first security.

7 During this same period of expansion, Philip raised about U.S. $362 million through a public offering in the U.S. and Canada. Seventy-five percent of these shares were sold in the U.S. As events transpired, these public offerings have led to a series of class actions against Philip both in the U.S. and in Canada. They arose out of certain discrepancies between copper inventory as shown on the books and records of Philip and actual inventory on hand, which were revealed in audits in early 1998. Publicity surrounding the discrepancies led to a drop in the price of Philip shares, which led to various class actions. Eventually, it was determined that Philip's liabilities had been understated by approximately U.S. 35 million. As a result, it was required to file an Amended Form 10-K with the U.S. Securities and Exchange Commission restating its financial results for 1997 to show an additional loss of $35 million. It was also required to revise the amount of pre-tax special and non-recurring charges for that same year.

8 It is said that the unsettling effects of the financial irregularities and the class action proceedings, in conjunction with a general uncertainty in the markets serviced by Consolidated Philip, caused Philip's earnings to drop dramatically. It could not refinance its long-term debt under the Credit Agreement. Its trade credit was curtailed. It lost contracts and, because its bonding capacity was impaired, it was further hampered in its ability to win new contracts. In spite of concerted efforts over a period of nearly a year, Philip was not able to re-finance its debt or to

restructure its affairs outside of the court restructuring context. Cash conservation measures in late 1998 led to defaults under the Credit Agreement. Debt restructuring negotiations with the Lenders since that time led ultimately to the parallel insolvency proceedings in Canada and the U.S. to which I have referred above.

The Class Proceedings

9 Developments in the class action proceedings are what have led specifically to the Motions which are presently before this Court.

10 In February and March of 1998 various class actions were filed in the United States against Philip, certain of its past and present directors and officers, the underwriters of the Company's November 1997 public offering, and the Company's auditors (Deloitte & Touche).[1] The actions, now consolidated, alleged that Philip's financial disclosure for various time periods between 1995 and 1997 contained material misstatements or omissions in violation of U.S. federal securities laws.

11 In May, 1998, a class proceeding was also commenced in Ontario, under the Class Proceedings Act, 1992 ("the CPA Proceeding"). The plaintiff is Joseph Menegon, a retired school teacher living in Hamilton, who had purchased 300 common shares of Philip on the TSE in November, 1998. The CPA Proceedings is an action for misrepresentation, negligent misrepresentation and rescission relating to the purchase of shares of Philip by people in Canada between February 28 and May 7, 1998. The defendants are Philip, the various Underwriters, and Deloitte & Touche.

12 At the instance of Philip and Deloitte & Touche, however, a motion was brought for an order dismissing the U.S. Class Action on the grounds that the United States Court was not the proper Court for the disposition of the claims, but that the Ontario Court was. This motion was successful and on May 4, 1999 the U.S. Class Action was dismissed. A motion to reconsider was also dismissed. Although the U.S. Class Action plaintiffs have appealed, the present status of those proceedings is that they have been dismissed.

13 Nonetheless, the U.S. claims persist, and there have been negotiations between counsel for the U.S. and Canadian Class Action plaintiffs and Philip since early 1999 with a view to arriving at a settlement of the class action claims against Philip. Because of the nature of these claims, and the potential quantum of any judgments that might be obtained, a resolution of the Class Action proceedings, according to Philip, is an essential element of any successful restructuring. On June 23, 1999, the parties to the negotiations entered into a Memorandum of Understanding which outlined a proposed settlement between Philip and the U.S. Class Action and CPA Proceedings plaintiffs.

14 Philip and the CPA Proceeding plaintiff now seek certification of the CPA Proceeding and approval of the Settlement by the Court. Philip, separately, seeks approval of this Court under the CCAA to enter into the proposed Settlement. These motions have triggered the series of matters that

are now to be disposed of. Deloitte & Touche not only opposes the Motions, but seeks separate declaratory relief on its own part touching upon the Settlement itself and as well the overall "fairness" and "reasonableness" of the proposed Canadian Plan. I shall return to the specifics of the competing Motions and the relief sought shortly. First, however, some brief reference to the controversial aspects of the Canadian and U.S. Plans, and to the terms of the Settlement, is required.

The Controversial Aspects of the Plans, and the Settlement

15 The principle terms and conditions of the U.S. and Canadian Plans, as they presently stand, were hammered out in a "Lock-Up Agreement" entered into in April, 1999 and later amended on June 21st, between Philip (as Canadian Borrower), PSI, (as U.S. borrower), and a Steering Committee representing the Lenders. There were also negotiations with certain of Philip's major unsecured creditors and with counsel for the U.S. and Canadian class action plaintiffs. The Lock-Up Agreement is variously described as the result of "heavy" negotiations and "very hard bargaining". No doubt that is indeed the case.

16 The amended Lock-Up Agreement provides in substance that the Lenders will become the holders of 91% of the equity in the newly restructured Philip, and that they will as well receive U.S. $ 300 million of senior secured debt (now reduced to $250 million through asset sales) and $100 million of secured "payment in kind" notes. Under the U.S. Plan the remaining 9% of the equity in the restructured Philip is to be made available to other stakeholders, on the following basis: 5% (plus U.S. $60 million in junior notes) is to be for the compromised unsecured creditors; 2% for the existing shareholders; 1.5% for the Canadian and U.S. class action plaintiffs; and, 0.5% for the holders of other securities claims. The formula is conditional upon cross-approvals of the U.S. and Canadian Plans.

17 From Philip's perspective the Plans filed in both the U.S. and in Canada are interdependent and form a single Plan from a "business point of view". The general concept of the overall plan is that each class of stakeholders in the Consolidated Philip with similar characteristics are to be treated similarly whether they are located in the U.S. or in Canada. With this in mind, and having regard to the need for a coordinated restructuring of claims and interests against Philip, PSI, and the Canadian and U.S. subsidiaries, the Plans provide that,

a) creditors with claims against Philip's Canadian subsidiaries but not against Philip itself are to file their claims in the CCAA proceedings in Canada, and are to be dealt with in the Canadian Plan; and
b) creditors with claims against Philip or its U.S. subsidiaries are to have their claims processed in the U.S. proceedings and are to be dealt with in the U.S. Plan.

18 The result of this is that the claims of Philip's creditors, whether Canadian or U.S. are to be dealt with under the U.S. Plan and governed by Chapter 11 of the U.S. Bankruptcy Code. This includes the claims of Deloitte & Touche and of the Underwriters, and of certain former officers

and directors, for contribution and indemnity in relation to the U.S. and Canadian class proceedings. It also includes the claims of certain creditors, such as Royal Bank of Canada, in relation to personal leases.

19 Not surprisingly, those so affected take umbrage at this treatment. They submit that it contravenes the provisions of the CCAA and their substantive rights under Canadian law, and should not be countenanced. It renders the Canadian Plan unfair and unreasonable, in their submission, and should not be sanctioned. Philip argues, on the other hand, that matters relating to whether or not the Plan is fair and reasonable are matters to be dealt with at the sanctioning hearing, when the Plan is brought before the Court for approval after is has received the earlier approval of the Company's creditors.

The Proposed Settlement

20 Under the proposed Settlement the Canadian and U.S. class action plaintiffs are to receive 1.5% of the common shares of a restructured Philip, as noted above. The shares are to be distributed pro rata amongst the Canadian and U.S. plaintiffs. There is to be, in addition, an amount of up to U.S. $575,000 for costs of counsel for the U.S. and Canadian class action plaintiffs. The Settlement is embodied in the U.S. Plan as "Allowed Class 8B Claims". It includes the right of persons caught by the class proceedings to opt out; however, any member of the class who elects to opt out of the proposed settlement is also to be dealt with in the U.S. Plan as a Class 8B claimant.

21 The proposed Settlement is conditional upon its being approved by the Courts in Canada and in the U.S. and according to Philip, upon the successful implementation of both the Canadian and the U.S. Plan. Philip has made it clear that it and its professional advisors do not believe that a restructuring of Philip can be accomplished without resolution of the class action claims in Canada and the U.S. Philip, counsel in the Canadian class action, and the Lenders all argue that in the event of liquidation, the plaintiffs will get nothing because -- even if they are successful on liability -- they will have no chance of recovering a damage award against the insolvent Philip. The Settlement is also recommended by Ernst & Young, the court appointed Monitor for Philip in the CCAA proceedings.

22 What, then, are the specific issues that the Court is asked to determine on the pending Motions?

II - THE ISSUES RAISED

23 The following Motions, as summarized, are before the Court:

1) A Motion by Philip pursuant to the CCAA for authorization and direction to enter into the proposed Settlement of the proceeding pending against it under the Class Proceeding Act;
2) A joint Motion by Philip and Mr. Menegon, the representative plaintiff in

the CPA Proceedings, for certification of the class proceeding as against the defendant Philip only, and for approval of the Settlement Agreement together with directions regarding notification of members of the proposed class;

3) A cross-Motion by Deloitte & Touche - one of Philip's co-defendants in the CPA Proceedings, supported by the other co-defendant Underwriters -- for declaratory relief in the nature of an order:

   a) declaring, pursuant to s. 5.1(3) of the CCAA and s. 97 of the Court of Justice Act that the Canadian Plan is not fair and reasonable in the circumstances, having regard to those provisions in the Canadian Plan which compromise the ability of Deloitte & Touche to claim contribution and indemnity against Philip and certain of its directors, officers and employees;
   b) precluding the compromise of the Deloitte & Touche claims and amending both the Canadian Plan and the U.S. Plan so the Deloitte & Touche's rights are to be determined under the Canadian Plan alone, and in accordance with Canadian law and without unfairly prejudicing its rights.

4) A Motion by Royal Bank of Canada for an order,

   a) declaring that the claim of Royal Bank against Philip under certain leases shall be determined with reference to Canadian law and in the Canadian proceedings;
   b) declaring that the Canadian Plan is not fair and reasonable because it seeks to compromise the Bank's claims in the U.S. Plan, thus adversely affecting the Bank's rights and circumventing Philip's obligations under Canadian law;
   c) amending the Canadian Plan so that the Bank's claim is not dealt with in the U.S. Plan; and
   d) amending sub-paragraph 14(d) of the Initial Order granted in the CCAA proceeding on June 25, 1999 -- which presently permits Philip to terminate any and all arrangements entered into by them by providing that the sub-paragraph does not apply to leases of personal property; and, finally,

5) A Motion on behalf of certain former officers and directors of Philip

seeking to have the Canadian Plan and the U.S. Plan declared not fair and reasonable in the circumstances, having regard to those provisions,

a) which attempt to compromise or otherwise limit the ability of the Moving Parties to claim contribution and indemnity from Philip without compensation whatsoever;
b) which call for releases to be provided to current directors and officers of Philip, but not to former directors and officers;
c) which deprive the Moving Parties of their rights as creditors to vote on the Canadian Plan.

III - LAW AND ANALYSIS

The Class Proceedings

24 There is little difference is substance between the joint Motion of Philip and the Canadian class action plaintiff under the Class Proceedings Act, and that of Philip alone, under the CCAA. Both ultimately seek approval and implementation of the proposed Settlement. However, the CCAA proceeding provides the context in which this approval is sought and, indeed - as I have already mentioned - Philip and others are of the view that a successful restructuring of Consolidated Philip is not possible without the implementation of the proposed Settlement, and that the converse is also true. Thus, there is a close link between the two, and in my opinion the issue of settlement approval cannot be viewed in isolation from the CCAA/restructuring environment in the context of which it was developed.

Certification

25 I have little hesitation in certifying - and do certify - the CPA Proceeding as a class proceeding pursuant to subsection 5(1) of the Class Proceedings Act, as requested. That is, the proceeding is certified as a class proceeding as against the defendant Philip only and for settlement purposes only. It is without prejudice to any arguments the other defendants to the CPA Proceedings may wish to make in opposition to any element of the plaintiff's claim, including, but not limited to, certification of a class as against them.

26 For those purposes, however, I am satisfied that the tests set out in subsection 5(1) have been met. The statement of claim discloses a cause of action based upon faulty disclosure. There is an identifiable class, as articulated in the materials, and a common issue, as therein very broadly defined.[2] A class proceeding makes sense, and is the preferable procedure for the resolution of the common issue in the circumstance, and Mr. Menegon constitutes a representative plaintiff as called for in the subsection. An Ontario Court has jurisdiction pursuant to the Class Proceedings Act to certify a Canada-wide opt out class where the action has a "real and substantial" connection to Ontario, as is the case here; see, Carom v. Bre-X Minerals Ltd., 43 O.R. (3d) 441, February 11,

1999, (Ont. Gen. Div.); Nantais et al v. Telectronics Proprietary (Canada) Ltd. et al, (1995), 25 O.R. (3d) 331 (Ont. Gen. Div.), leave to appeal refused [1995] O.J. No. 3069, at p. 347 (Div. Ct.).

Approval and Notice

27 I have concluded, however, that Notice should be given at this time to the members of the class as certified, in accordance with the provisions of section 17 of the Class Proceedings Act, but that the proposed Settlement ought not to be approved at this time and at this stage of the restructuring proceedings.

28 This conclusion is based not so much on the issue of whether notification under the Act may be given jointly for certification and approval, and not so much of the question of the merits of the proposed Settlement as between the class action plaintiffs and Philip. The former issue has not yet been settled, but need not be determined in this case. The latter is supported by the recommendations of the Monitor and seasoned U.S. representative counsel, and by the "reality check" that is there is no settlement it is unlikely that the class action plaintiffs will ever recover anything from Philip.

29 Rather, my conclusion is based upon my sense that it is premature to approve a settlement of the U.S. and Canadian class action proceedings at this stage of the restructuring process. Philip and the Lenders have made it clear that the settlement of those claims forms a central underpinning to the ability of Consolidated Philip to reorganize successfully. But the reverberations of the class actions extend to more than merely the relations between Philip and the class action plaintiffs. They affect the relations between Philip and the co-defendants in the proceedings, and between the class action plaintiffs and the co-defendants as well. The class action plaintiffs and the co-defendants are all unsecured claimants of Philip in the restructuring process - the claim of the co-defendants for contribution and indemnity against Philip and its former officers and directors arise out of the same "nucleus of operative facts"[3] as the claims of the class action plaintiffs against Philip; and one follows from the other. It has frequently been noted that the full name of the CCAA is "An Act to facilitate compromises and arrangements between companies and their creditors". In the bare-knuckled ring of commercial restructuring negotiations, this cannot be accomplished if one group of unsecured claimant is given an unwarranted advantage over another.

30 To grant approval to the proposed Settlement of the class action plaintiffs with Philip at this stage would in effect immunize both those plaintiffs and Philip from the need to have regard to the co-defendants in resolving their dispute. It may well be that a plaintiff in an action with multi-party defendants can settle unilaterally with one of those defendants without creating other repercussions in the lawsuit. It may also be, however, that such a settlement cannot be effected without taking into account some aspects of the "other party" issues - things such as the impact of the settlement on the co-defendants' claims for contribution and indemnity, including the quantum of or a cap on recovery and questions of releases, to take only some examples.

31 For instance, Philip is contractually bound under the terms of its Underwriting Agreement

with the Underwriters to indemnify and hold the Underwriters harmless against all claims based on allegations of untrue statements or alleged untrue statements in a prospectus. More to the point, Philip is not entitled without the consent of the Underwriters, under the terms of the same Agreement, to settle any action in which such claims are made against it and unless the settlement includes an unconditional release in favour of the Underwriters. Approval of the proposed Settlement at this state of the restructuring proceedings would deprive the Underwriters of the contractual right. What is significant at this point is not the attempt to compromise the claim, including the contractual right to the release, but rather the loss of the bargaining chip on the part of the Underwriters in the process as a result of the unilateral settlement as between Philip and the plaintiffs.

32 Philip, the Lenders, and counsel for the class action plaintiffs have mounted an adamant chorus that if the proposed Settlement is not approved the U.S. and Canadian class action plaintiffs will get nothing because Philip will be liquidated and, in addition, that there is simply no room for the class action plaintiffs to receive anything more than the 1.5% share distribution in the restructured Philip which is currently on the table. The Lenders point out that they are fully secured and that they need not leave available even that 1.5% interest (not to mention the 9% equity interest which they have agreed to leave available to other stakeholders generally). These pronouncements may well reflect the final reality of the situation. However, I am somewhat less inclined to accept them at face value than the parties are to make them, particularly at this stage of the proceedings. It would not be the first time in restructuring negotiations where an adamant chorus turned into a more harmonious melody before the end of the day. Only the final moments of the process will tell the tale. In the meantime, as many negotiating options as possible should be kept open as amongst claimants of equal status in the restructuring, in my view.

33 I do not say that this proposed Settlement, in its present or some other form, will not ultimately be approved. It is simply premature at this stage in the restructuring process to give it that imprimatur, in my opinion - if the imprimatur is to be given - for the reasons I have articulated. Accordingly, the question of approval of the proposed Settlement is adjourned to a date to be fixed which is more contemporaneous with the sanctioning hearing. In the meantime, Notice of certification and of the pending motion for approval is to be sent to all members of the class.

The Fairness Issues Regarding the Canadian Plan.

34 Much of the foregoing reasoning applies to the conclusions I have reached with respect to the issues raised by Deloitte & Touche and others respecting the Canadian Plan and its nexus with the proposed Settlement.

35 The claim of the plaintiffs in the CPA Proceedings as against Deloitte & Touche and the Underwriters includes a claim for the difference between the value received by the plaintiffs as a result of the settlement and their actual loss. If the Settlement and the Canadian and U.S. Plans are approved, however, these co-defendants will lose their rights to claim contribution and indemnity

form Philip in the class action. This, in itself, is not a reason for impugning the fairness and reasonable of the Plans, because the ability to compromise claims against it is essential to the ability of a debtor corporation to restructure its affairs. Nonetheless, where the proposed structure of the reorganization affects the substantive rights of claimants in a fashion which treats them differently than they would otherwise be treated under Canadian law, and where the effect of that treatment is to place the claimants in a position where their ability to engage in full and complete negotiations with the debtor company are impaired, there is cause for concern on the part of the Court. That, in my view, is the case here.

36 The effect of the Canadian Plan, as presently structured, is to deprive Deloitte & Touche, the Underwriters and others such as the former directors and officers of Philip who may have claims of contribution and indemnity as against Philip arising out of the same "nucleus of operative facts" pertaining to the class action claims, for pursuing those contribution claim in the Canadian CCAA proceeding. The same is true, but for different reasons, of the claim of Royal Bank with respect to its equipment leases. This is accomplished by carving out the claims in question from the CCAA proceedings and providing that they are to be dealt with under the U.S. Plan in U.S. Bankruptcy Court in accordance with the provisions of the U.S. Bankruptcy Code. All claims against Philip are to be dealt with in that fashion, notwithstanding that it was Philip which set in motion the CCAA proceeding in the first place and which sought and obtained the stay of proceedings preventing these very same claimants form pursuing their claims in Canada against it. At the same time, the Canadian Plan, but its very terms, is to be binding upon all holders of claims against Philip - including those which are subject to the Canadian Plan; see section 9.15 of the Canadian Plan. This is to be accomplished without even according the right to those claimants to vote on the Plan.

37 The binding nature of the Canadian Plan has the effect of requiring the responding claimants to provide releases in favour of Philip while they are at the same time not released by Philip from claims that might be subsequently asserted against them. Furthermore, as the Plan presently stands, Deloitte & Touche and the Underwriters will be against them. Furthermore, as the Plan presently stands, Deloitte & Touche and the Underwriters will be deemed to have released former directors and officers from claims for contribution and indemnity. The Class Action plaintiffs have chosen not to pursue the directors and officers, at the present time, and there is apparently upwards of $100 million in insurance that might be available to satisfy such claims. This is a matter of considerable concern for Deloitte & Touche and for the Underwriters. Philip has advised, during the course of these motions and before, that it does not intend the proposed Settlement or the Plan to preclude the ability of Deloitte & Touche and of the Underwriters to pursue the former officers and directors. For the present, however, the Plan is worded in such a way that they will be so precluded. The real point is that all of this is being visited upon the responding claimants without there being entitled to any say in the Canadian proceedings as to their willingness or lack of willingness to be so treated.

38 In my opinion it is the loss of the right to vote in the Canadian Plan which lies at the heart of the present dilemma. The mere fact that a Canadian creditor's rights are to be dealt with and affected by single or parallel insolvency proceedings in the U.S. Bankruptcy Court - or that the reverse may

be the case (U.S. creditor/Canadian Court) - is not necessarily sufficient, in itself, to undermine the fairness and reasonable of a proposed Plan; see, for example Roberts v. Picture Butte Municipal Hospital (1998), 64 Alta. L.R. (3d) 218 (Alta. Q.B.); Re Starcom Services Corp., Bank. W.D. Wash., case no M-98-60005, Nov. 20, 1998. In Canadian insolvency proceedings under the CCAA, however, it is the right to vote on the compromise or arrangement which the debtor company proposes to make with them which is the central counterpart, on the part of the creditors, to the debtors right to attempt to make that compromise or arrangement. In my view, having chosen to initiate and take advantage of the CCAA proceedings, Philip cannot now evade the implications and statutory requirements of those proceedings by seeking to carve out certain pesky - and potentially large - contingent claimants, and to require them to be dealt with under a foreign regime (where they will be treated less favourably) while at the same time purporting to bind them to the provisions of the Canadian Plan. All of this without the right to vote on the proposal.

39 While the fact that their treatment under U.S. Bankruptcy law will apparently be considerably less favourable then their treatment under Canadian law is not determinative, it is certainly a factor for consideration when taken in conjunction with the loss of voting rights in the Canadian Plan. As counsel have presented it, contribution claimants such as Deloitte & Touche, the Underwriters and the directors and officers will have the status equivalent to equity holders under the U.S. Plan. Their claims will not be considered as unsecured debt claims in terms of priority ranking. Pursuant to the "cram down" provisions of the U.S. Bankruptcy Code, the Bankruptcy Court can approve a plan of reorganization even if a class of creditors votes not to accept the plan provided no junior-ranking class receives a distribution and the plan is otherwise fair and reasonable. Moreover, the U.S. Bankruptcy Court may on motion deem such a class of stakeholders to have voted to reject the plan in order to dispense with the necessity of having such a vote amongst its members. While Philip's deponents and its counsel have not said so expressly, it is the clear inference from the materials filed that that is precisely the route which Philip proposes to follow vis à vis the contribution claimant whose claims have been left to be dealt with under the U.S. Bankruptcy Code.

40 For purposes of the CCAA the claim of an unsecured creditor includes a claim in respect of any indebtedness, obligation of liability which would be a claim provable in bankruptcy, and therefore includes a contingent claim for unliquidated damages. Thus, Deloitte & Touche, the Underwriters, the officers and directors, and Royal Bank are all entitled to assert claims in the CCAA proceedings. They are Canadian claimants, asserting claims against a Canadian company in a Canadian proceeding. In respect of the claims for contribution and indemnity those claims arise out of a "nucleus of operating facts" which the U.S. Courts - at the urging of Philip, amongst others - have already determined are more conveniently litigated in Canadian class action proceedings.

41 In respect of the Royal Bank, the claim relates to some 57 equipment leases entered into between the Bank and Philip under lease agreements governed by the laws of Ontario and with respect to equipment located (with one exception) in Ontario. However, under U.S. Bankruptcy laws, Philip would be entitled to "reject" leases, which it is not entitled to do under Ontario law, although it may of course "break" the leases if it is prepared to suffer the legal consequences. Again

the attempt by Philip is to treat the claims under a regime which is more favourable to it and less so to the claimant. That attempt may not in itself be objectionable, but to the extent that it is accomplished by depriving the creditor of its right to vote and to participate in the Canadian proceedings which were initiated for the purposes of shielding Philip against the claim, it is troubling.

42 The rights of creditors under the CCAA cannot be compromised unless,

a) the creditor has been given a right to vote, in the appropriate class, on the proposed compromise;
b) the creditor's vote is in accordance with a value ascribed to the claim by a Court approved procedure;
c) the class in which the creditor has been appropriately placed has voted by a majority in number and two-thirds in value in favour of the compromise; and,
d) the Court has sanctioned the compromise on the basis that it is fair and reasonable (with considerable deference being given by the Court in this regard to the votes of the creditors).

43 See CCAA, section 4, 6 and 12; Re Olympia & York Developments Ltd. (1993), 12 O.R. (3d) 500, at p. 510 (Ont. Gen. Div.).

44 Here, for the reasons I have outlines, what Philip proposes is inconsistent with the foregoing.

45 Philip and the Lenders argue that the issues raised in this regard by the Respondents go entirely to the fairness and reasonableness of the U.S. and Canadian Plans, and that such considerations should be reserved for determination at the sanctioning hearings. I agree that generally speaking matters relating to fairness and reasonableness are better considered in the overall context of the final sanctioning hearing. Where, as here, however, the debtor company has acted earlier to obtain approval of a step in the restructuring process - in this case, the Class Action Settlement - which gives rise to issues that are inextricably linked to the overall fairness of the proposed Plan, and its compliance with statutory requirements, the consideration of those issues may be called for. This is one of those cases, Settlement - in conjunction with the manner in which the debtor intends to treat other claimants directly affected by the settlement, have the effect of requiring those claimants to participate in the subsequent restructuring negotiations without a full deck of cards.

46 Philip and the Lenders also argue that "comity" demands that this Court defer to the U.S. Bankruptcy Court in allowing the claims of Deloitte & Touche, the Underwriters, the former directors and officers, and the Royal Bank to be dealt with in the U.S. Plan. They point out that in its Initial Order in the CCAA proceedings this Court approved an international Protocol which provides for co-operation between the U.S. and Canadian Court, to the extent possible. I do not think that either comity or the question of whether the claims will be dealt with ultimately under the

U.S. Plan, are the issues here. In addition, the effect of the Protocol as I read it - given the circumstances outlined above - is to provide some protection to claimants on either side of the border from being swept into the rigours of the other countries regimes where to do so might prevent them from asserting their substantive rights under the applicable laws of their own jurisdiction.

47 In this regard, the following provisions of the Protocol are worthy of note:

> (C) Comity and Independence of the Courts
>
> (7) The approval and implementation of this Protocol shall not divest or diminish U.S. Court's and the Canadian Court's independent jurisdiction over the subject matter of the U.S. Cases and the Canadian Case, respectively. By approving and implementing the Protocol, neither the U.S. Court, the Canadian Court, the Debtors nor any creditors or interested parties shall be deemed to have approved or engaged in any infringement on the sovereignty of the United States or Canada.
>
> 8. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct and hearing of the U.S. Cases. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct and hearing of the Canadian Cases.
>
> 9. In accordance with the principles of comity and independence established in paragraphs 7 and 8 above, nothing contained herein shall be construed to:
>
> * increase, decrease or otherwise modify the independence, sovereignty or jurisdiction of the U.S. Court, the Canadian Court or any other court or tribunal in the United States or Canada ...;
> * preclude any creditor or other interested party from asserting such party's substantive rights under the applicable laws of the United States, Canada or any other jurisdiction including, without limitation, the rights of interested parties or affected persons to appeal from the decisions taken by one or both of the Courts.
>
> (emphasis added)
>
> (J) Preservation of Rights

27. Neither the terms of this Protocol nor any actions taken under the terms of this Protocol shall prejudice or affects the powers, rights, claims and defenses of the Debtors and their estates, the Committee, the Estate Representatives, the U.S. Trustee or any of the Debtors' creditors under applicable law, including the Bankruptcy Code and the CCAA.

(emphasis added)

48 The extension of comity as between Courts in cross-border insolvency situations, and co-operation generally in such matters, are matters of great importance, to be sure, in order to facilitate the successful and orderly implementation of insolvency arrangements in such circumstances. Nothing I have said in these Reasons is intended to counter that ethic. However, comity and international co-operation do not mean that one Court must code its authority and Jurisdiction over its own process or over the application of the substantive laws of its own jurisdiction, whenever any kind of differences between the two jurisdiction may arise. Both the Protocol and the provisions of subsection 18.6(2) of the CCAA - which gives this Court authority "to make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in c co-ordination of proceedings under [the CCAA] with any foreign proceeding" - confirm this, Subsection 18.6(5) of the CCAA provides that "nothing in this section requires the Court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court" (emphasis added)

49 Here, there is yet no order of the U.S. Court, or treatment of the Claimants or Debtor to which comity may be extended, but there is - as I have outlined above - a failure to comply with the requirements of insolvency laws and procedure of Canada, as stipulated in the CCAA. I conclude, therefore, that the Canadian Plan as it presently stands is flawed because it seeks to exclude Canadian claimants from participation in its process by providing that their claims against Philip itself are to be governed by and treated in the U.S. proceedings while at the same time seeking to bind them to the provisions of the Canadian Plan, all without affording those claimants any right to vote.

50 There was much debate in argument over whether the issue of treatment of the claims in the Canadian or U.S. proceedings was a function of the "real and substantial connection" of Philip with the U.S. jurisdiction, or a function of the "real and substantial connection" of the responding claimants and their claims to the Canadian proceedings. There is no doubt that Philip has a substantial connection with the United States in terms of the residence of the majority of shareholders and the location of the majority of operating assets. This connection certainly justifies the U.S. Chapter 11 proceedings. However, Philip also has a substantial connection to Canada, with its headquarters in Ontario, its Canadian subsidiaries, and its 94 locations and 2,000 employees throughout the country. This connection, together with its array Canadian creditors, sustains the resort to the CCAA proceedings.

51 I do not think that the analysis fall to be made, in these particular circumstances, on purely foreign conveniens grounds. There is more to the situation than that.

Philip initiated the CCAA proceedings and sought and accepted the benefits flowing from that step. The responding claimants seek to assert claims in the Canadian proceeding against the Canadian company which instituted those proceedings, in relation to matters arising out of a Canadian class proceeding or (in the case of Royal Bank) out of Canadian contracts and equipment largely located in Canada. The substantive law of Canada under the CCAA, and the procedures therein laid down, entitle them to assert those claims in the Canadian proceedings and to have a vote on the "Plan" which is set forth by the debtor company to compromise them. They should not be deprived of those substantive and procedural rights without having any say in the matter. Putting it another way, I am satisfied that the unquestioned "juridical advantage" which Philip seeks to achieve through its proposed treatment of the responding claimants is outweighed by the unquestioned "juridical disadvantage" on the part of the latter, given that the juridical scales would otherwise be tipped towards Philip through the resort to a stratagem which in my view is not sanctioned under the CCAA.

52 Philip and the Lenders argue that there is great urgency to effect the restructuring process, and that requiring Philip to adhere to the procedures relating to classification, the valuation of claims, and voting - with the numerous issues that may have to be determined in that context - may well doom the process from the beginning. The Lenders are truculent, as their secured position lead them to be; they say that if the reorganization is not completed quickly they may simply abandon the process and exercise their rights to realize on their security, and the entire restructuring process will fail, with dire consequences for all concerned. Mr. McDougall, on behalf of Deloitte & Touche, characterized this as "the cry of doom".

53 I am very aware of the need for timeliness in situations as these - particularly given the sensitive nature of Consolidated Philip's service oriented business. However, I do not think that the need for a timely resolution alone is justification for depriving claimants of their substantive rights under Canadian law, and for abrogating their right to vote which lies at the very heart of the Canadian restructuring process from the creditor's perspective. It is the tool which gives them ultimate leverage in the bargaining process, and without it their practical rights - as well as their substantive and procedural ones - are greatly diminished.

III - CONCLUSION

54 An order will therefor go in terms of the foregoing.

The Class Proceedings

55 As indicated, an Order is granted certifying the CPA Proceedings as a class proceeding, pursuant to subsection 5(1) of the Class Proceedings Act, as against Philip only and for settlement purposes only. The certification is without prejudice to any arguments the other defendants in the

CPA Proceeding may wish to make in opposition to any element of the plaintiff's claim including, but not limited to, certification of a class as against them. In addition, notice of the certification and of the pending motion for approval of the proposed Settlement is to given to members of the class as certified, in accordance with the provisions of section 17 of the Act. The question of approval of the Settlement, in its present form or some other form as may be advised, is adjourned to a date to be fixed which is more contemporaneous with the sanctioning hearing.

The Fairness/Substantive Law Issues

56 Notwithstanding the observations in these Reasons about the Canadian Plan and the treatment of claims in the U.S. proceedings, I am reluctant to grant the sweeping declaratory relief sought by the Respondents. Whether the Plan is ultimately found to be fair and reasonable and in accordance with all necessary requirements remains still a matter for determination in the sanctioning hearing, after all the negotiations have been concluded and the votes counted. As much as is reasonably possible should be left to that process.

57 I am prepared to make an Order, however - and do - declaring that the Canadian Plan as it is presently constituted fails to comply with the procedural and statutory requirements of the CCAA regime in that it seeks to exclude the responding claimants from participation in its process by providing that their claims against Philip itself are to be governed by and treated in the U.S. proceedings while at the same time seeking to bind them to the provisions of the Canadian Plan, all without affording those claimants any right to vote. Anything further in this respect, it seems to me, should be left to the negotiation arena.

58 The position of the Royal Bank is slightly different. It is entitled, in addition, to an order,

a) declaring that the claim of Royal Bank against Philip under certain leases shall be determined with reference to Canadian law and in the Canadian proceedings;
b) amending the Canadian Plan so that the Bank's claim is not dealt with in the U.S. Plan; and,
c) amending sub-paragraph 14(d) of the Initial Order granted in the CCAA proceeding on June 25, 1999 - which presently permits Philip to terminate any and all arrangements entered into by them - by providing that the sub-paragraph does not apply to the Royal Bank leases of personal property.

59 There will be not order as to costs.

60 Order accordingly.

BLAIR J.

qp/t/qlala/qlalm/qlcvs

1 These various actions were eventually consolidated and transferred to the United States District Court, Southern District of New York, by order dated June 2, 1998.

2 The common issue is very broadly and vaguely defined, and while such a definition has received approval in other cases, I do not mean to be taken as having approved such a definition for any purposes other than those of this particular case.

3 To use the phrase adopted by the parties.

Case Name:

Metzler Investment GmbH v. Gildan Activewear Inc.

Between
Metzler Investment GmbH, Plaintiff, and
Gildan Activewear Inc., Glenn J. Chamandy, Glenn Chamandy Holdings Corporation and Laurence G. Sellyn, Defendants

[2011] O.J. No. 885

2011 ONSC 1146

17 C.P.C. (7th) 190

2011 CarswellOnt 1252

Court File No. 58574CP

Ontario Superior Court of Justice

L.C. Leitch J.

Heard: January 25 and February 1, 2011.
Judgment: February 28, 2011.

(40 paras.)

Counsel:

Anthony O'Brien, Dimitri Lascaris and Michael G. Robb for the Plaintiff.

Steve Tenai and Suzanne Wood, for the Defendants.

[Editor's note: A corrigendum was released by the Court March 4, 2011; the corrections have been made to the text and the corrigendum is appended to this document.]

REASONS FOR JUDGMENT

1 L.C. LEITCH J.:-- The plaintiff seeks an order that the settlement provided for in a settlement agreement dated August 2, 2010 (the "Settlement Agreement") is fair, reasonable and in the best interest of the Ontario Class and is approved pursuant to s. 29 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

2 The form of order sought by counsel contains provisions releasing the defendants from claims by the representative plaintiff and each member of the Ontario Class and incorporates and adopts the definitions set out in the Settlement Agreement.

3 The Settlement Agreement resolves this action and parallel proceedings in Québec and the United States.

4 The settlement is conditional upon approval by this court and the court in Québec and the United States.

The factors for consideration in approving negotiated settlements

5 The case law has made clear that the following are factors to be considered on settlement approvals:

- likelihood of recovery or likelihood of success

- amount and nature of discovery, evidence or investigation

- settlement terms and conditions

- recommendation and experience of counsel

- future expense and likely duration of litigation and risk

- recommendation of neutral parties, if any

- number of objectors and nature of objections

- the presence of good faith, arms length bargaining and the absence of collusion

- the degree and nature of communications by counsel and the representative plaintiffs with class members during this litigation

- information conveying to the court the dynamics of, and then positions taken by the parties during the negotiation

(see *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (Gen. Div.) (QL) at para. 13, *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) (QL) at paras. 71-72.)

Terms and Conditions of the Settlement

6 Pursuant to the Settlement Agreement, the defendants caused its insurers to pay into an escrow account 22.5 million dollars in U.S. dollars. As the Settlement Agreement states, it is not a claims made settlement and none of the settlement amount shall be returned or otherwise paid to the defendants or its insurers funding the settlement unless the Settlement Agreement is terminated in accordance with its terms.

7 The settlement amount will be distributed amongst all class members who submit valid claim forms to the administrator after payment of any administration costs and legal fees and expenses awarded by the courts.

8 The Settlement Agreement contains a plan of allocation which provides that 89% of the net settlement amount is allocated for pro-rata distribution among Authorized Canadian Claimants, while the remaining 11% of the net settlement amount is allocated for pro-rata distribution among Authorized U.S. Claimants.

9 Pursuant to the definitions in the Settlement Agreement, all Canadian residents are within the definition of an Authorized Canadian Claimant. Based on the trading volume on the New York Stock Exchange (NYSE) and the Toronto Stock Exchange (TSX) Mr. Wright, who has filed an affidavit in support of the settlement approval, has deposed that Authorized Canadian Claimants will fare substantially better than authorized U.S. Claimants under the settlement. A majority of the trading during the Class Period occurred on the NYSE but the NYSE purchasers (excluding the small member of Canadian residents) will receive only 11% of the net settlement amount.

10 As Mr. Wright has also deposed, ultimately the amount of each Class Member's compensation from the net settlement amount will depend upon: (i) the number and the price of Eligible Shares purchased by the Class Member; (ii) the time and the price at which the Class Member sold such Eligible Shares, if at all; (iii) the total number and value of claims for compensation filed with the administrator; (iv) whether the Class Member falls within the Authorized Canadian Claimant or the Authorized U.S. Claimant category.

11 The operative part of the Settlement Agreement makes sense. The allocation amongst the Class Members seems appropriate.

12 In considering the approval of the Settlement Agreement in Ontario, the submission of Mr. Wright's affidavit that the settlement is significantly weighted in favour of Canadian Class Members is important.

13 I am satisfied that the Class Members will have their claims administered in a timely matter and that the administration of the settlement can be conducted in a fair, efficient, independent and manageable manner.

14 As counsel submitted, the Settlement Agreement represents very significant recovery in a challenging, hotly contested case.

15 Furthermore, the amount provided for in the Settlement Agreement is within the range specified in the retainer agreement as a reasonable settlement in the action.

16 The foregoing factors favour approval of the settlement.

How was the settlement reached?

17 The Settlement Agreement resulted from extensive negotiations conducted over several months. The parties were assisted in their settlement negotiations by The Honourable Judge Layn R. Phillips, a former United States attorney and United States District Judge. As Mr. Wright deposed, the mediation was complex and after two days of mediation the parties had not agreed on the essential financial terms of a settlement. However, negotiations continued. Thereafter, Judge Phillips made a mediator's recommendation that the case settle for the amount provided for in the Settlement Agreement, and all parties accepted that recommendation.

18 The proposed settlement provides certainty to the class members facing hotly contested lengthy litigation fraught with uncertainties and provides a measure of recovery, which Judge Phillips, a neutral party, recommended.

19 It is clear the settlement resulted from good faith, arms length bargaining in the absence of collusion.

20 Counsel for the plaintiff had the opportunity to review mediation briefs prepared by each of the parties for the purposes of the two day mediation, as well as documentary production from the defendants for the purposes of confirmatory discovery prior to the execution of the Settlement Agreement.

21 As Mr. Wright deposed, plaintiff's counsel had more than adequate information available from which to make an appropriate recommendation concerning the resolution of this action.

22 Consideration of the above noted factors supports approval of the settlement.

Are there any objections to these settlements? Have any Class Members opted out?

23 Counsel advised that the Notice Program was very effective. There was a focused and targeted mailing that was possible because of the information provided by the defendants. As a result, there was a direct mailing to almost 25,000 people.

24 No class members have opted out of the proposed settlement. There were three pieces of correspondence received as a result of the Notice Program but no valid opt out requests were received.

25 There have been no objections to the settlement.

26 Considering the extent of direct mailing pursuant to the Notice Program it is significant that there have been no objections or opts out and the fact that there were no objections and no valid opt outs favours approval of the Settlement Agreement.

Recommendation from counsel and the representative plaintiff

27 Experienced counsel recommends the approval of the Settlement Agreement. As Mr. Wright deposed, the Settlement Agreement delivers a substantial, immediate benefit to Ontario Class Members on claims which plaintiff's counsel consider meritorious but which undoubtedly face significant risks.

28 As plaintiff's counsel submitted, they were well informed and had a good basis on which to assess the plaintiff's prospects in the litigation.

29 I am satisfied that counsel has undertaken sufficient investigation to analyze the settlement and the benefits to class members.

30 In addition, it is significant that the plaintiff instructed Class Counsel to seek the Court's approval of the Settlement Agreement. The plaintiff is a sophisticated commercial investor with a very significant direct interest in the action.

31 The recommendation of experienced counsel is entitled to considerable weight given their ability to weigh the factors bearing on the reasonableness of the settlement.

Was the plaintiff's claim likely to be challenged if the action was not settled?

32 This litigation involved numerous and substantial risks as particularized in Mr. Wright's affidavit.

33 In particular, the defendants intended to challenge the plaintiff's common-law claims on an

appeal from the motion to strike decision, when the motion for certification was heard and ultimately at trial. There remained a contentious issue that the plaintiff's negligent misrepresentation claim could not succeed because it could not establish actual reliance on the alleged misrepresentations. There is a very significant issue with respect to whether an alternate theory of liability can be advanced to avoid the need to prove individual reliance. As observed by Mr. Wright, the defendant's position on this issue was strengthened by the decision in *McKenna v. Gammon Gold Inc.*, [2010] O.J. No. 1057.

34 There also was a contentious issue with whether a representation with respect to a future event is actionable. In other words, can statements or forecasts about the future sustain a claim for misrepresentation?

35 In addition, the plaintiff faced the risks of obtaining the required leave under Part XXIII.I of the Ontario *Securities Act*. As counsel observed, there is minimal guidance from case law in relation to such leave applications with only one decision having been released which was the subject of an appeal at the time of this hearing (leave to appeal that decision was subsequently denied: 2011 ONSC 1035).

36 Furthermore, as a result of the Schulman affidavit having been struck, confidential witnesses referred to in that affidavit were required to swear affidavits in support of the plaintiff's motion for leave. Mr. Wright deposed in his affidavit at the time of settlement, none of those witnesses had agreed to swear such affidavits. Thus, the plaintiff faced the uncertainty of whether it could satisfy its evidentiary burden on the motion for leave.

37 In addition, as Mr. Wright outlined, there were risks relating to the scope of any certified Class as well as issues with respect to the quantum of damages. As Mr. Wright deposed, the defendant's mediation brief foreshadowed a number of arguments that the defendants would have advanced in mitigation of the quantum of damages.

38 Finally it is clear as Mr. Wright deposed, that continued pursuit of the Ontario action would involve the expense of arguing a contested leave and certification motion, holding oral discoveries containing documentary discovery, attendance at a trial of common issues and perhaps holding trials to make determinations regarding any individual issues and even if the plaintiff was successful at all stages of the proceeding, the Ontario action would not have resolved for many years. Therefore, the Settlement Agreement provides the additional advantage of delivering immediate benefits to Class Members without the risk and delay inherent in protracted litigation.

39 The formidable risks and barriers in the litigation and the inevitable delay before trial favour approval of the Settlement Agreement.

Conclusion

40 Considering the foregoing factors, I am satisfied that in all the circumstances the Settlement

Agreement is a fair and reasonable resolution of this action and in the best interest of the Ontario Class Members.

L.C. LEITCH J.

* * * * *

Corrigendum
Released: March 4, 2011

[1] To correct a typographical error, TSX in the last sentence of para. 9 is deleted and replaced with the word NYSE.

[2] For clarity para. 9 will now read as follows:

> Pursuant to the definitions in the Settlement Agreement, all Canadian residents are within the definition of an Authorized Canadian Claimant. Based on the trading volume on the New York Stock Exchange (NYSE) and the Toronto Stock Exchange (TSX) Mr. Wright, who has filed an affidavit in support of the settlement approval, has deposed that Authorized Canadian Claimants will fare substantially better than authorized U.S. Claimants under the settlement. A majority of the trading during the Class Period occurred on the NYSE but the NYSE purchasers (excluding the small member of Canadian residents) will receive only 11% of the net settlement amount.

L.C. LEITCH J.

cp/e/qllxr/qlvxw/qljxh/qljyw/qlgpr

Case Name:

Nunes v. Air Transat A.T. Inc.

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Josephine Nunes and Jorge Nunes, plaintiffs, and
Air Transat A.T. Inc., Airbus S.A.S., Airbus of North America Inc., Rolls-Royce PLC and Rolls-Royce Canada Limited and Airbus GIE, defendants

[2005] O.J. No. 2527

20 C.P.C. (6th) 93

140 A.C.W.S. (3d) 25

2005 CarswellOnt 2503

Court File No. 01-CV-217295 CP

Ontario Superior Court of Justice

M.C. Cullity J.

Heard: May 30, 2005.
Judgment: June 20, 2005.

(30 paras.)

Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval.

Motion by the plaintiffs, Nunes and Nunes, for approval of a settlement of the class action against Air Transat, Airbus and Rolls-Royce. The action was for damages suffered by passengers when an Air Transat flight ran out of fuel, lost power and made an emergency landing. The time for opting out had expired and 176 class members would share the settlement. The settlement provided for a $7,650,000 fund plus accrued interest to be distributed to class members after payment of counsel fees, disbursement and expenses. Class members would receive a maximum of $80,000 non-pecuniary damages for post-traumatic stress disorder or $100,000 if accompanied by a

significant personal injury. Monetary limits also included $50,000 for loss of income, $5,000 for out-of-pocket expenses and $5,000 for future care expenses. Family Law Act claims would be limited to $5,000. Class members would make claims to class counsel who would give an assessment. Class members could accept the assessment or request review by an arbitrator. The settlement agreement did not allow class members to opt out. In negotiating the settlement, class counsel had obtained questionnaires from all but a few class members to enable their claims to be reviewed with the assistance of a clinical psychologist and physician. Two class members informed the court that they objected to the settlement.

HELD: Motion allowed in part. Provisional approval was given to the settlement pending the decision on the fees of class counsel. The settlement was fair and reasonable. Class counsel's meticulous investigation concluded that almost all class members would claim to suffer post-traumatic stress disorder or other psychological harm. Given that the Warsaw Convention limited Air Transat's liability to damages for bodily injury, there was a significant risk that claims for post-traumatic stress disorder would not be successful at trial. Class counsel concluded that the case against Rolls-Royce was weak and that Airbus had tenable defences. The monetary limits on damages were carefully considered and determined principally for the purpose of achieving fairness for the class as a whole. The most problematic limit was for loss of income, but there would likely be few claims for loss of income relative to claims for psychological harm. Only one member provided documentation in favour an income loss in excess of the limit. The fairness and reasonableness of the settlement had to be judged in relation to the class as a whole. In choosing to impose monetary limits, class counsel properly considered the nature of damages likely to be claimed, the likely value of the claims, the possibility that one or a few very large claims for income losses would substantially deplete the amount available for other class members and the need to simplify the claims process to avoid delays.

Statutes, Regulations and Rules Cited:

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

Family Law Act,

Negligence Act, R.S.O. 1990, c. 1,

Warsaw Convention,

Counsel:

J.J. Camp Q.C., Glenn Grenier and Allan Dick -- for the Plaintiffs

B. Timothy Trembley -- for the Defendant, Air Transat A.T. Inc.

D. Bruce Garrow -- for the Defendants, Rolls-Royce PLC and Rolls-Royce Canada Limited

John Callaghan and Keith Geurts -- for the Defendants, Airbus of North America Inc., and Airbus GIE

REASONS FOR DECISION

1 **M.C. CULLITY J.**:-- The plaintiffs moved for the court's approval of a settlement of this action pursuant to section 29(2) of the Class Proceedings Act 1992 S.O. 1992, c. 6 ("CPA"). There was also a motion for approval of the fees and disbursements of class counsel.

2 The proceedings involve claims against the defendants for damages suffered by passengers on Air Transat Flight 236 ("Flight 236") when, in August 2001, the aircraft, an Airbus A330, ran out of fuel, lost power in each of its engines and made an emergency landing in the Azores Islands. The defendant, Air Transat A.T. Inc., ("Air Transat") was the operator of the aircraft. Airbus S.A.S. and Airbus North America Inc., (together "Airbus") and Rolls-Royce PLC and Rolls-Royce Canada Limited (together "Rolls-Royce") were sued as responsible for the manufacture of the aircraft, and that of its engines, respectively. Claims were also made on behalf of family members of the passengers.

The Settlement

3 The proceedings were certified by order of this court on July 4, 2003. The time for opting out has expired and it has now been determined that, of the 291 passengers on board Flight 236, 115 have either opted out or entered into individual settlements with Air Transat - leaving 176 class members who would share in the benefits to be provided under the terms of the proposed settlement. These benefits can be summarised as follows:

1. A fund of $7,650,000, plus accrued interest, is to be paid to an administrator in exchange for a release of all claims of class members arising from the events of Flight 236.
2. The administrator is to invest the fund in income-earning accounts and, after payment of class counsel fees and disbursements and expenses of administration, the fund is to be distributed among class members subject to monetary limits for particular kinds of damages and, otherwise, in accordance with a claims procedure contained in the settlement agreement.
3. The monetary limits on different heads of damages claimed by any member are:

(a) damages for non-pecuniary loss arising from post-traumatic stress disorder or similar psychological injury would not exceed $80,000 unless accompanied by evidence of other significant permanent personal injury - in which case the maximum amount of non-pecuniary damages would not exceed $100,000;
(b) damages for past and future loss of income would not exceed $50,000;
(c) damages for out-of-pocket expenses would not exceed $5000; and
(d) damages in respect of future-care expenses would not exceed $5000.

4. Family member claimants would be limited to their rights of recovery under the Family Law Act (Ontario) and the claims asserted by all such members that are derivative of the claims of a particular passenger would not exceed $5000.

4 The settlement provides for class members to make claims, initially, to class counsel who are to provide the claimants with what counsel consider to be a fair and reasonable assessment of the value. Members then would have the option of accepting the assessment or of requesting a review by an arbitrator to be appointed by the court. In the latter event, the arbitrator would determine the value of the claim. Distributions would be made accordingly.

5 The claims process and the powers and procedures to be followed by class counsel, the administrator, a management committee of counsel - that is to work with the administrator and to make the initial assessment of claims for loss of income - and the arbitrator are set out in some detail in the settlement agreement and in a schedule to it. Caps would be placed on the fees payable to the administrator and to members of the management committee, and on an hourly rate to be charged by the arbitrator. Class counsel would not charge fees for their services in assessing the value of claims in addition to the lump-sum amount that the court is asked to approve in connection with their services to date, and the capped amounts that may be charged by members of the management committee.

The Law

6 The role of the court, and the standards to be applied, in determining whether a settlement should be approved has been discussed in several decisions of this court 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; and Vitapharm v. F. Hoffman - La Roche Ltd, [2005] O.J. No. 1118 (S.C.J.), at paras. 110-118.

7 In Vitapharm, Cumming J. distilled the following principles from the earlier authorities:

(a) to approve a settlement, the court must find that it is fair, reasonable, and in the best interests of the class;

(b) the resolution of complex litigation through the compromise of claims is encouraged by the courts and favoured by public policy;

(c) there is a strong initial presumption of fairness when a proposed class settlement, which was negotiated at arm's-length by counsel for the class, is presented for court approval;

(d) to reject the terms of the settlement and require the litigation to continue, a court must conclude that the settlement does not fall within a zone of reasonableness;

(e) a court must be assured that the settlement secures appropriate consideration for the class in return for the surrender of litigation rights against the defendants. However, the court must balance the need to scrutinise the settlement against the recognition that there may be a number of possible outcomes within a zone or range of reasonableness. All settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs obligation.

(f) it is not the court's function to substitute its judgment for that of the parties or to attempt to renegotiate a proposed settlement. Nor is it the court's function to litigate the merits of the action or, on the other hand, to simply rubber-stamp a proposal;

(g) the burden of satisfying the court that a settlement should be approved is on the party seeking approval;

(h) in determining whether to approve a settlement, the court takes into account factors such as:

(i) the likelihood of recovery or likelihood of success;
(ii) the amount and nature of discovery, evidence or investigation;
(iii) the proposed settlement terms and conditions;
(iv) the recommendations and experience of counsel;
(v) the future expense and likely duration of litigation;
(vi) the recommendation of neutral parties, if any;
(vii) the number of objectors and nature of objections;
(viii) the presence of arm's-length bargaining and the absence of collusion;
(ix) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiations; and
(x) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

8 I believe the following statements of Winkler J. in Parsons and in Fraser are particularly apposite to the settlement under consideration in this case:

> It is well established that settlements need not achieve a standard of perfection. Indeed, in this litigation, crafting a perfect settlement would require an omniscience and wisdom to which neither this court nor the parties have ready recourse. The fact that a settlement is less than ideal for any particular class member is not a bar to approval for the class as a whole. (Parsons, at paragraph 79)

> Lengthy litigation would not be in the interests of the plaintiffs with its inherent risk and delay. The court must approve or reject the settlement in its entirety. It cannot substitute or alter it. ... The court does not, and cannot, seek perfection in every aspect, nor can it insist that every person be treated equally." (Fraser, at para. 13)

9 I note, however, that, unlike the position in the above cases, other than Fraser, class members who do not approve of the settlement have no right to opt out of the proceedings as the time in which this could be done has expired and, unlike what I think I was the position in Parsons, such a right is not conferred, or contemplated, by the settlement agreement. As notice of the terms of the settlement and of the approval hearing, and the right to object, that I considered to be reasonable and adequate was given to class members, and only two of them have informed the court that they have objections to the settlement, the potential significance of the inability to opt out at this stage might be considered to be limited to these objectors.

Discussion

10 Subject to the specific points made by, or on behalf of, the two objectors, I am satisfied that the factors set out above militate heavily in favour of the settlement. The proceedings were contentiously adversarial from the outset and the litigation risks for the plaintiffs were significant. Article 17 of the Warsaw Convention limits the liability of Air Transat to damages for bodily injury. Class counsel conducted a meticulous investigation and review of the likely claims of class members and concluded that virtually all of them will claim to have suffered post-traumatic stress disorder or other forms of mental or emotional harm. Although I found that, for the purposes of certification, the question whether such harm is to be considered to be bodily injury should be included in the common issues to be tried, counsel's research into the interpretation of Article 17 in this jurisdiction, and internationally, convinced them that there was a highly significant risk that the plaintiffs would not be successful on this issue at trial. After a lengthy examination of the evidence relating to the causes of the events on Flight 236, they concluded also that the case against Rolls-Royce was very weak and that Airbus had tenable defences that not only cast doubts on the prospects for establishing liability against it but made it inevitable that the litigation would be

protracted and expensive. I see no reason to question the competence, diligence or judgment of class counsel on the assessment of litigation risks or, indeed, in the manner in which the proceedings were conducted and the settlement negotiated at arm's-length between the parties.

11 When negotiating the terms of the settlement, class counsel had obtained completed questionnaires from all but a few class members to enable their claims to be reviewed with the assistance of a clinical psychologist in Vancouver and a physician in Portugal. This information, and medical reports that were provided by class members, were independently reviewed by each of the firms acting as co-counsel for the purpose of arriving at an estimate of the total value of the claims of class members. All the information was then provided to counsel for Air Transat to enable them to make their own assessment and, after the negotiations that ensued, the settlement amount of $7,650,000 was arrived at. In class counsel's submission, this amount, less counsels' fees, expenses and administration costs should be considered to be fair and reasonable - as well as substantial - compensation for the claims of class members. In their estimate - made on the basis of their assessment of the claims of class members that have already been completed - it should provide each class member with a recovery of at least 70 per cent of the amount likely to be assessed as the value of such member's claim. This is, of course, only an estimate and, to some extent, it is based on assumptions - about, for example, the amounts that will be claimed for loss of income and the number of claims that will be referred to the arbitrator - that might, or might not, turn out to be unduly optimistic.

12 I am satisfied that the caps proposed to be placed on the recovery of particular heads of damages have been carefully considered and determined principally for the purpose of achieving fairness for the class as a whole. It appears likely that the claims for mental and emotional harm will be made by virtually all of the class members and will be far more common than claims for significant physical injuries or loss of income. The cap of $80,000 for psychological harm ($100,000 if accompanied by significant permanent other injury) was chosen after a review of recent awards in this jurisdiction and elsewhere for post-traumatic stress disorder and similar illnesses.

13 I should note at this point that, although the terms of the proposed settlement might be construed as limiting claims for physical injuries to those that are accompanied by claims for psychological harm, I understand the intention to be that claims for physical injuries alone - if there are any - are to be compensated subject to a cap of $100,000.

14 The most problematic of the monetary limits placed on the recovery of particular types of damages is that relating to loss of income. In conducting their preliminary assessment of the value of the claims of class members, class counsel had less information about the potential loss of income than they had relating to the other heads of damages. However, to the extent that they were able to judge, there would be few claims for loss of income relative to those for psychological harm and only one passenger had provided documentation in support of an income loss in excess of the cap of $50,000. That member, I presume was Mr. Manuel Ribeiro, one of the two members of the

class who objected to the settlement. At the hearing, counsel indicated that their attention had been drawn to one other such potential claim that, on the basis of the information available to them, they considered to be of doubtful weight.

15 Through his counsel, Mr. Ribeiro successfully requested an adjournment of the original hearing date appointed for the motion for approval. At the continuation of the hearing, he was represented by Mr. Brian Brock Q.C. who, while disclaiming an intention to object to the settlement agreement in principle, requested that class counsel should be required to revisit it to address a number of issues that he raised in his written and oral submissions. In general terms, these issues relate to (a) whether class counsel gave sufficient significance to the fact that neither Airbus nor Rolls-Royce could claim the protection of Article 17 of the Warsaw Convention and the possibility that, as joint tortfeasors with Air Transat, damages that could not be recovered from it might be recoverable in full from either of them under section 1 of the Negligence Act R.S.O. 1990, c. 1 (as amended) even if only a very small degree of relative fault was apportioned to them; (b) whether the caps placed on non-pecuniary and pecuniary damages are fair and reasonable; and (c) whether the amount of legal fees requested by class counsel, and the manner in which they would be borne by class members, are fair and reasonable.

16 In an affidavit sworn for the purpose of the motion by Mr. Joe Fiorante - a partner of one of the firms acting as class counsel - he indicated that the arguments mentioned by Mr. Brock in connection with the first of the above issues had been considered by them and advanced in the negotiations for the settlement. I see no reason to reject this evidence or to conclude that the considerations to which Mr. Brock referred are sufficient to remove the terms of the settlement from the "zone of reasonableness".

17 Mr. Brock's submission that the caps were unfair was made in the context of his opinion that the value of Mr. Ribeiro's claims for non-pecuniary damages for post-traumatic stress disorder and loss of income will exceed the limits of $80,000 and $50,000 that would be imposed under the settlement.

18 Class counsel's response to the submission with respect to non-pecuniary damages was that already mentioned - namely, that, from their review of damages awarded in recent cases, other than those involving sexual assaults, the $80,000 cap was at the high end of the range and, notwithstanding the evidence that, since the events of Flight 236, Mr. Ribeiro has suffered, and will continue to suffer, psychological difficulties that will require psychiatric support and, probably, adjunct medication, they are not convinced that his claim would fall outside the likely range of damages. Based on their review of damages awards, I do not believe this conclusion is unreasonable although, as an experienced counsel in personal injury cases, Mr. Brock's opinion that a higher award could be obtained merits respect. The fairness and reasonableness of the settlement - including the cap of $80,000 for non-pecuniary damages - must, however, be judged in relation to the class as a whole and is not to be determined in respect of the claims of each member considered separately. The comments of Winkler J. that I have quoted from Parsons and Fraser are in point. On

the basis of the record before me, I believe I am justified in deferring to the opinion of class counsel that the cap of $80,000 on non-pecuniary damages would not operate unfairly in respect of Mr. Ribeiro, let alone in respect of the class as a whole.

19 Mr. Brock's criticism of the existence of the cap on the recovery for different heads of damages was not based exclusively on his opinion that his client's non-pecuniary damages would exceed $80,000. He made a similar objection with respect to the application of a $50,000 limit to Mr. Ribeiro's claim for loss of income. In his submission, such a limit would operate with obvious unfairness to Mr. Ribeiro in that his potential claim - calculated on the basis of a reduction in his income of $54,000 a year - would be approximately $670,000. Mr. Brock informed me that his client was prepared to testify that, since Flight 236, he has lost his motivation to conduct his landscaping business of 25 years, the number of his employees and his customers has diminished and the business is now confined to grass cutting. In support of his estimate of Mr. Ribeiro's loss of income, Mr. Brock provided unaudited income statements of the corporation that operates the business for 1998, 2000, 2002 and 2004. These show that, between April 2001 and April 2004, the gross income of the corporation declined by approximately $48,600. During that period, operating expenses fell by approximately $49,156. Of this amount, approximately $32,000 represented a reduction in wages paid to employees. Two employees were laid off in the period after Flight 236. No personal income tax returns, or other information, were provided that would indicate the wages, or other amounts, received by Mr. Ribeiro from the business in those years.

20 The income statements hardly support Mr. Brock's estimate that his client had suffered an income loss of approximately $54,000 a year and, on the basis of the limited information provided, class counsel concluded that they were unable to determine whether Mr. Ribeiro's total past and future income loss would exceed $50,000. I am in no better position. At the most, I can infer that Mr. Ribeiro claims to have suffered a loss of income that will exceed the cap by a significant amount. The question is whether the existence of this claim is, in itself, sufficient to justify a decision to withhold approval of the settlement. In Mr. Brock's submission it is, because it illustrates not merely that the cap is too low but, as well, the unfairness of placing any caps on heads of damages. As he stated in his brief or memorandum filed in the motion:

> If an individual plaintiff's claim falls within the cap it would appear that such person would make a full recovery. Those whose claims exceed the cap would recover only a proportionate share. No explanation is provided as to why those with serious claims should have their claims compromised in this way at the expense of those whose claims are not as serious.
>
> At a minimum one would expect that the recovery for each plaintiff would be on a pro-rata basis so that the percentage of recovery or loss of recovery would be equal.

21 Although I cannot amend the settlement, I do not think there is any doubt that I would have authority to refer this aspect of it back to the parties for their further consideration. After giving this matter careful thought, I am not disposed to do this.

22 As I have indicated, I do not intend to find that the total amount to be paid by Air Transat is less than that which would fall within a zone, or range, of reasonableness. The question that arises is how the net amount is to be distributed among class members if it is less than the total amount of their claims. The provision of caps is one method. Each of the possibilities suggested by Mr. Brock is another. In preferring the first method as being in the best interests of the class as a whole, counsel considered:

(a) the nature of the damages likely be claimed by the great majority of class members;
(b) the likely value of such claims;
(c) the possibility that the existence of one, or a few, very large claims for income losses would substantially deplete the amount available for distribution to the other class members; and
(d) the need to simplify the claims process to avoid delays and to reduce expenses.

23 In my judgment each of these considerations was relevant, and properly considered by class counsel. The last of them underlines the necessity to consider the provisions of the settlement as a whole and not to place the focus on particular aspects of it in isolation. The objective of simplifying the claims process is relected in the caps placed on certain types of administrative expenses, the involvement of class counsel without further remuneration and the attempt to devise a process that members will find satisfactory without having recourse to arbitration. Each of these factors presupposes the existence of - and is designed to assist in effecting - an expeditious and economic method of allocating and distributing the net settlement funds among class members.

24 In my judgment, I would not be justified in finding that the existence, or the amounts, of the caps is so evidently unfair and unreasonable that approval of the settlement should be withheld. Nor do I believe that anything of value is likely to be gained by referring the matter back for further consideration by the parties. I am satisfied that the questions have been carefully considered by them. The qualifications and experience of class counsel were reviewed at some length in the carriage motion early in the proceedings. Nothing has occurred since then to dilute my confidence in the competence and diligence with which they would perform their responsibilities under the CPA. Their ability to identify each of the members of the class has enabled them to conduct an unusually thorough investigation and preliminary assessment of the claims of virtually all of them. Their decision that the imposition of the caps would be in the interests of the class as a whole is one which is entitled to be given considerable weight. I do not believe there is sufficient reason for impeding, or delaying, the implementation of the settlement by asking them to reconsider that decision.

25 The third of Mr. Brock's objections concerns the amount of the fees of class counsel and the manner in which they would be borne by class members. The appropriate amount of the fees will be considered in an endorsement that will follow the release of these reasons after Mr. Brock has had an opportunity to review the time dockets of class counsel. The extent to which approval is given to the payment of class counsel's fees before the final distribution - and any consequential changes to the terms of the claims process - will also be considered in the endorsement to follow.

26 The proposal that the fees, as then approved, should come off the top - rather than to be apportioned among class members in accordance with the value of the amounts ultimately distributed to each of them - is, I believe, appropriate in the circumstances of this case where a gross settlement amount would be paid up front by Air Transat and the further services of class counsel - other than those of the management committee - are to be provided for no further charge. Counsel have acted for the class as a whole and have negotiated a settlement on that basis. I see nothing unfair, or unreasonable, in awarding approved fees out of the settlement proceeds without regard to the proportions in which the proceeds will be shared by class members.

27 The other objection I received was made by Mr. Giancarlo Cristiano in an attachment to an email message to class counsel. In the message Mr. Cristiano thanked counsel for their diligence in dealing with the file and, subject to certain questions, concerns and objections to the terms of the settlement, he expressed his pleasure that it had been reached. In the attached letter he objected that the settlement contained no finding of liability for negligence on the part of Air Transat and no award of punitive damages. He also complained of the level of fees payable to class counsel and the administrator.

28 The first two of these objections misapprehend both the nature of the settlement as a compromise between the parties and the powers of the court. The settlement contains no admission of liability, negligence, on the part of Air Transat because it has not agreed to make any such admission. This, of course, is very common in a settlement of litigation and I have no jurisdiction to insert such a provision in the settlement. All I could do would be to refuse approval of the settlement unless it contained an admission of liability. Mr. Cristiano did not ask me to do this and I would not consider such a decision to be in the best interests of class members. Similarly, and contrary to Mr. Cristiano's impression, I have no power to amend the settlement so as to insert a claim for punitive damages.

29 I will consider Mr. Cristiano's objection with respect to legal fees and expenses of administration in the endorsement that is to follow.

Disposition

30 Accordingly, pending the decision on the fees of class counsel, I will give provisional approval to the settlement as fair, reasonable and in the best interests of class members. This approval is subject to the terms of the endorsement that is to follow, any necessary adjustments to the times within which claims are to be made, any other acts to be performed and any other

amendments counsel may consider to be required as a result of the delay in the release of these reasons. These changes, counsel's submissions with respect to the fees of independent counsel, a few drafting issues and the terms of any formal order can be considered following the release of the endorsement.

M.C. CULLITY J.

cp/e/qlalc/qlkjg/qlrme/qlmjb

Ontario New Home Warranty Program et al. v. Chevron Chemical Company et al.* [Indexed as: Ontario New Home Warranty Program v. Chevron Chemical Co.]

46 O.R. (3d) 130

[1999] O.J. No. 2245

Court File No. 22487/96

Ontario Superior Court of Justice

Winkler J.

June 17, 1999
*This judgment was recently brought to the attention of the editors.

Civil procedure -- Class actions -- Approval of settlement -- Proposed settlement containing "bar order" -- Bar order precluding claims for contribution and indemnity between settling defendants and non-settling defendants -- Court having jurisdiction to approve settlement with bar order -- Settlement fair and reasonable and in interests of class members -- Settlement approved subject to terms that addressed procedural objections of non-settling defendants -- Negligence Act, R.S.O. 1990, c. N.1, ss. 1, 3, 5 -- Class Proceedings Act, 1992, S.O. 1992, c. 6, ss. 5, 12, 13.

The Ontario New Home Warranty Program ("ONHWP") and two individuals commenced a proposed class proceeding under the Class Proceedings Act, 1992 to advance a product liability claim on behalf of a class of some 11,000 Ontario homeowners who had installed mid-efficiency furnaces with allegedly defective plastic venting pipes. As a consequence of a safety order issued by the Ministry of Consumer and Commercial Relations, the owners of the furnaces had been required to replace the defective piping. ONHWP's claim was a subrogated claim in place of homeowners whom it paid to replace the defective piping.

In early 1996, and thereafter, there were settlement discussions in the action and settlements were reached between the plaintiffs and some of the defendants, the "settling defendants". The plaintiff intended to discontinue the action against certain defendants but to continue the litigation against

seven defendants, the "non-settling defendants". The plaintiffs moved for certification against the settling defendants and for approval of the settlement in accordance with s. 29(2) of the Act. The proposed settlement provided for compensation of $800 per unit, and the plaintiffs and the settling defendants agreed that the proportionate liability of the settling defendants was to be fixed at 65 per cent of $800 plus amounts for party and party costs, disbursements, interest, and claims administration. The settlement provided for a simple claims approval process. The settlement also contained a provision described as a "bar order" that would prevent non-settling defendants from making claims for contribution or indemnity. Under the bar order, the plaintiffs agreed to make only several claims against the non-settling defendants such that the plaintiffs shall be limited to the degree of liability proven against the non-settling defendants at trial, but in no event shall such liability be greater than 35 per cent of the total damages proven at trial as against each non-settling defendant.

The bar order precluded claims over in respect of the subject-matter of the class action by or against non-settling defendants or settling defendants.

The settling defendants supported the plaintiffs' motion as long as the judgment approved the entire settlement agreement. The non-settling defendants opposed only the bar order provision of the settlements. The non-settling defendants submitted that the bar order would prejudice them substantively by derogating from their rights under the Negligence Act and procedurally by depriving them of their ability to bear only their fair share of any liability to the plaintiffs. Specifically, they asserted that they would be precluded from conducting effective discovery and denied evidence necessary to establish the respective degrees of fault as between themselves and the settling defendants.

Held, the motion should be granted subject to terms.

The proceeding against the settling defendants met the requirements for certification as set out by s. 5 of the Class Proceedings Act. Subject to the legitimate concerns of the non-settling defendants, the settlement agreement taken as a whole was fair and reasonable and in the interests of the class members, and it brought a significant degree of resolution to a protracted proceeding. The concerns of the non-settling defendants could be addressed without rejecting the settlement.

Section 13 of the Class Proceedings Act, 1992, which provides that a court may stay any proceeding related to the class proceeding, provides a mechanism through which the objectives of a "bar order" could be achieved. This broad discretion was supported by s. 12 of the Act, which permits the court to make such orders as are necessary to ensure the fair and expeditious determination of the class proceeding. The court, however, did not have any jurisdiction under the Act to derogate from the substantive rights of the parties, but in the immediate case, there was no derogation of substantive rights nor substantive prejudice. When the bar order was considered in total, it was apparent that did not affect any claim of the non-settling defendants that could be successfully asserted against the settling defendants under the Negligence Act or otherwise. Under the settlement agreement, there

would be no claim against the non-settling defendants for contribution and indemnity and since they would be required to pay damages in accordance with their own negligence and liability to the plaintiff, if any, they would have no claim for contribution and indemnity against the settling defendants or against third parties. Because of s. 3 of the Negligence Act, under which the court shall apportion liability, the non-settling defendants could not successfully assert a claim in damages against any party based upon their own negligence, no matter how the claim was characterized.

As to the non-settling defendants' objections based on procedural prejudice, these objections could be addressed without rejecting the settlement agreement because the court had the necessary power under the Act to adapt procedures to ensure that the interests of all parties can be adequately protected in situations where those interests conflict. The procedural concerns could be adequately addressed through the terms of approval for the settlement. Accordingly, judgment should be granted approving the settlement but subject to terms upon which the non-settling defendants could obtain documentary discovery, oral discovery, requests to admit and an undertaking to produce a representative to testify at trial.

Cases referred to

British Columbia Ferry Corp. v. T & N plc (1995), 16 B.C.L.R. (3d) 115, [1996] 4 W.W.R. 161, 27 C.C.L.T. (2d) 287 (C.A.); Canada v. Curragh, [1994] O.J. No. 1452 (Gen. Div.); Carom v. Bre-X Minerals Ltd. (1999), 43 O.R. (3d) 441, 30 C.P.C. (4th) 133, [1999] O.J. No. 281 (Gen. Div.); Chace v. Crane Canada Inc. (1997), 44 B.C.L.R. (3d) 264, 14 C.P.C. (4th) 197 (C.A.); Dabbs v. Sun Life Assurance Co. (No. 1), [1998] O.J. No. 1598 (Gen. Div.); Dabbs v. Sun Life Assurance Co. (No. 2) (1998), 40 O.R. (3d) 429, 22 C.P.C. (4th) 381, [1998] I.L.R. 1-3575 (Gen. Div.); Sparling v. Southam Inc. (1988), 66 O.R. (2d) 225, 41 B.L.R. 22 (H.C.J.)

Statutes referred to

Class Proceedings Act, 1992, S.O. 1992, c. 6, ss. 5, 12, 13, 29(2)
Negligence Act, R.S.O. 1990, c. N.1, ss. 1, 5

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

Authorities referred to

Cheifetz, Apportionment of Fault in Tort (Aurora: Canada Law Book, 1981), p. 18
Newberg on Class Actions, 3rd ed. (Shepard's/McGraw Hill, 1992), ss. 11.45-46
Report of the Attorney General's Advisory Committee on Class Action Reform, p. 37

MOTION for certification and for approval of a settlement under the Class Proceedings Act, 1992, S.O. 1992, c. 6.

C. Scott Ritchie, Q.C., and Michael Eizenga, for plaintiffs.
Allan A. Farrer, for Chevron Chemical Company.
Robert B. Bell and Peter D. Ruby, for Hart & Cooley Inc.
Lawrence E. Thacker, for Selkirk Metalbestos.
Markus Koehnen and Kathryn Manning, for Underwriters' Laboratories of Canada.
Paul J. Martin, for Underwriters Laboratories Inc.
Marilyn Field-Marsham, Randy A. Pepper and Stephen Lamont, for Armstrong Air Conditioning Inc., Evcon Supply Inc., Inter-City Products Corporation (Canada), Inter-City Products Corporation (U.S.), RHEEM Manufacturing, York International Ltd. and Lennox Industries.
John E. Callaghan, for Consolidated Industries, Welbilt Industries and Nordyne Inc.
F. Paul Morrison and Frank J. McLaughlin, for General Electric Company.
J.A. Prestage, for Carrier Canada.
C. Stephen White and Ellen J. Bessner, for Goodman Manufacturing and Quietflex Manufacturing Company, L.P.
James G. Norton, for Wabco Trane Standard Inc.
John C. Cotter, for American Water Heater Group.
Dominic T. Clarke, for The Canadian Gas Association, Canadian Gas Research Institute, International Approval Services Canada Inc.
Jean C.H. Iu, for Her Majesty the Queen in Right of Ontario.
Cynthia R. Sefton and Murdoch R. Martin, for Consumers Gas Utilities Ltd.
Glenn F. Leslie, for Union Gas Ltd. and Centra Gas Ontario Inc.
No one appearing for CMIL Industries Inc., Superior Propane, Slant/Fin Ltd./Ltée and Weil-McLean division of Marley Canadian Inc.

WINKLER J.: --

The Nature of the Motion

[1] This is a motion to approve the settlement of this action between the plaintiffs and Chevron Chemical Company, Hart & Cooley, Inc., Eljer Manufacturing Inc. c.o.b. as Selkirk Metalbestos, General Electric Company, Her Majesty the Queen in Right of Ontario, Goodman Manufacturing Co. Ltd., CMIL Industries Inc. c.o.b. as DMO Industries, Nordyne Inc., Wabco Standard Trane Inc., Carrier Canada Limited, Slant/Fin Ltd/ Ltée, Weil-McLean division of Marley Canadian Inc. and Underwriter's Laboratories Inc. (the "settling defendants").

[2] The plaintiffs also seek class certification pursuant to s. 5 of the Class Proceedings Act, 1992, S.O. 1992, c. 6 with respect to the settling defendants.

[3] The plaintiffs seek to discontinue the action against certain other defendants, namely Consumers Gas Utilities Inc., Union Gas Limited, Centra Gas Ontario Inc., Superior Propane Inc., the Canadian Gas Association, the Canadian Gas Research Institute and International Approval Services Canada Inc. This motion was adjourned at the hearing pending the disposition of the motions for certification and settlement approval.

[4] The plaintiffs propose to bring a subsequent motion for certification for litigation purposes with respect to the non-settling defendants which consists of a group of furnace manufacturers represented by one law firm and Underwriters' Laboratories of Canada ("ULC").

The Nature of the Claim

[5] This is a product liability claim concerning residential mid-efficiency gas or propane furnaces, boilers and hot water heaters with high temperature plastic vent ("HTPV") exhaust systems. The claim alleges negligent design, manufacture, negligent misrepresentation, breaches of warranty and misrepresentation, negligent approval, breach of fiduciary duty, and failure to warn.

[6] The action is a proposed class proceeding brought by the Ontario New Home Warranty Program ("ONHWP") and two individuals, as representative plaintiffs. The plaintiff class consists of some 11,000 Ontario homeowners who installed mid-efficiency furnaces with the allegedly defective plastic venting pipes.

[7] ONHWP makes a subrogated claim in place of many new homeowners whom it paid to repair or replace appliances and HTPV piping. The two individual representative plaintiffs were homeowners with heating systems using HTPV. The settling defendants include Chevron, Hart and GEC, three companies against which allegations have been made relating to HTPV. The non-settling defendants are primarily furnace manufacturers, namely, Armstrong Air Conditioning Inc., Evcon Supply Inc., Evcon Industry Inc., Inter-city Products Corporation (U.S.), Lennox Industries (Canada) Ltd., RHEEM Manufacturing Company and York International Ltd. In addition, the defendant Underwriters Laboratory is included in the non-settling group.

Background

[8] Prior to the 1980s, gas- or propane-heating appliances used chimneys or vertical metal vents to carry exhaust gases out of homes and other buildings. In the early 1980s, mid- and high-efficiency appliances were introduced into the marketplace. These appliances could be vented horizontally through the side walls of buildings. The exhaust gas of a mid-efficiency furnace is vented at a high temperature. With the horizontal vent pipes, there was a possibility that the exhaust gas would cool during the venting process, and that the by-products in the gas would form acidic condensates in the horizontal vent pipes. These acidic condensates were known to be corrosive to

metal vent pipes.

[9] In response to this problem of corrosion, high temperature plastic venting ("HTPV") was developed. As a result of the low cost and the corrosion resistance of HTPV, heating systems combining HTPV and mid-efficiency appliances came into wide-spread use.

[10] The plaintiffs allege that mid-efficiency gas or propane appliances, vented with HTPV, result in a defective product (the "heating system"). As a result of residual stresses incurred during manufacture, thermal expansion and contraction of the pipe, and a build-up of acidic condensate during in-service use, HTPV pipes in the heating system were prone to cracking or separating at the joints. This had the potential to release poisonous carbon monoxide gas into the building. Neither the appliances nor the venting pipes were designed with any type of safety device which would prevent defective operation.

[11] Prior to being marketed, these heating systems were submitted to the relevant regulatory bodies for product approval. The National Standards System, a Federation of independent organizations working towards the development of voluntary standardization in Canada is coordinated by the Standards Council of Canada ("SCC"). The SCC delegates the function of setting standards and approving testing procedures to various standards organizations which appoint key people from the relevant industry to develop standards in relation to particular products.

[12] Once a standard has been agreed upon by SCC delegated members, a final draft of the standard is published. This standard must be accepted by the Ministry of Consumer and Commercial Relations ("MCCR") in the Province of Ontario before a product can be marketed. After the standard is accepted by the MCCR, manufacturers submit their product to testing and certification agencies to test the product against the standard accepted by the MCCR, in order to certify that the product meets the relevant standard.

[13] In addition to the requirement for the certification of heating systems, each appliance manufacturer must approve and specify one or more vent products to be installed in combination with its appliances. No vent product other than those which are approved and specified by the appliance manufacturer is permitted to be installed in combination with the appliance.

[14] All of the HTPV products which are the subject of this proceeding went through the process set out above. However, in response to a series of complaints concerning defective heating systems, the MCCR compiled inspection reports and found a high failure rate in the HTPV. As a result, in March 1994 the MCCR issued a consumer alert warning about the possibility that vent pipes found in the heating systems might crack or separate at the joints allowing poisonous gases to escape into homes.

[15] On September 12, 1995, the Ontario Government, through the Ministry of Consumer and Commercial Relations, issued a Director's safety order in respect of heating systems with HTPV. The Director's safety order stated that certain brands of plastic heating vents had been found to be

defective and required all homeowners whose furnaces incorporated those vents to replace them by August 31, 1996. Pursuant to the order, natural gas utilities and propane distributors were prohibited from supplying gas after August 31, 1996 to any building in which the vents had not been replaced. The Director's safety order states in relevant part:

Director's Safety Order

Heating Systems with High-Temperature Plastic Vents

> Mounting engineering and technical evidence in Ontario and elsewhere confirms that heating systems using high-temperature plastic vents are defective, that permanent failure of the vents will take place and that the risk of failure increases with length of service. Specific heating systems using plastic vents bearing the name Plexvent, Sel-vent and Ultravent are affected. Over the past two years, four bulletins and a number of consumer advisories have been issued in Ontario as this evidence has been accumulating.
>
> To eliminate the risk associated with these systems, owners are required to correct them with a fully approved heating system prior to August 31, 1996. The options for correction consist of: (a) an existing appliance with an approved alternate vent, if available, or (b) a replacement heating system consisting of vent and appliance. Temporary repairs made using improved plastic materials are not acceptable corrections after August 31, 1996.
>
> After August 31, 1996, natural gas utilities and propane distributors will no longer be permitted to supply gas to these defective systems in Ontario.

[16] In consequence, all owners of such furnaces were required to replace the vents by the Director's deadline.

[17] In response to the Director's safety order relating to the defective heating systems, the ONHWP was required to establish a program to identify, administer and repair those heating systems covered by the ONHWP warranty program.

[18] Where there was an approved alternative vent product available, the predominant corrective measure involved the replacement of the HTPV with B-Vent and a side-wall power venter, although owners were given a choice of receiving a credit towards the installation of a high efficiency heating system as an alternative. In situations where there was no approved alternative venting product, ONHWP replaced the defective heating system with a high-efficiency heating system.

[19] Not all of the homeowners with defective heating systems had the benefit of ONHWP coverage. Nevertheless, these homeowners were also required to comply with the Director's safety order. In order to comply with the Director's safety order, repairs similar to those described above were effected by the non-covered homeowners at their own cost.

Settlement Discussions

[20] In early 1996, and continuing thereafter, settlement discussions have taken place in this action. To facilitate this process and to bring it to a conclusion, a mediation was conducted in July 1998 before a prominent American mediator, Mr. Kenneth Feinberg, who is experienced in resolving complex litigation proceedings. All defendants were invited to participate in this process but the non-settling defendants, other than Underwriters Laboratory, chose not to attend or make submissions.

[21] The mediation before Mr. Feinberg resulted in a settlement with the defendants GEC, Hart and Chevron. Subsequent to the execution of the settlement agreement by these defendants, the plaintiffs have settled their claims with the following additional defendants:

-- Eljer Manufacturing Inc., c.o.b. as Selkirk Metalbestos;

-- Her Majesty the Queen in Right of Ontario, represented by the Ministry of Consumer and Commercial Relations;

-- Nordyne Inc.;

-- Weil McLean division of Marley Canadian Inc.;

-- Wabco Standard Trane Inc.;

-- Slant/Fin Ltd./LtÚe;

-- American Water Heater;

-- Underwriter's Laboratories Inc.

[22] In addition to these settlements, the plaintiffs have reached an agreement with the defendant DMO Industries, within the context of the receivership affecting that corporation, for a $50,000 payment.

[23] The plaintiffs have also reached agreements with the defendants Goodman and Carrier, who have each conducted voluntary self-administered repair programs.

[24] The plaintiffs propose to discontinue the action against the following defendants:

(a) Canadian Gas Association;
(b) Canadian Gas Research Institute;
(c) International Approval Services Canada Inc.
(d) Consumers Gas Utilities Ltd.;
(e) Union Gas Ltd.;
(f) Centra Gas Ontario Inc.;
(g) Superior Propane Inc.; and
(h) Superior Propane Inc./Superieur Propane Inc.

[25] The plaintiffs intend to continue with the litigation against the following defendants:

(a) Underwriter's Laboratories of Canada
(b) Armstrong Air Conditioning
(c) Evcon Supply Inc./Evcon Industry Inc.
(d) Lennox Industries
(e) RHEEM Manufacturing
(f) Inter-City Corp.(Canada)/Inter-City Corp. (U.S.)
(g) York International Ltd.

The Settlement

[26] The plaintiffs now seek certification against the settling defendants, concurrently therewith approval of the settlement in accordance with s. 29(2) of the Class Proceedings Act, and judgment in accordance with the provisions of the settlement agreement achieved through the mediation process. The settlement provides compensation both to ONHWP and to those individual claimants who were not covered by ONHWP and were thus forced to replace the defective heating systems at their own cost.

[27] The compensatory amounts provided through the settlement are based upon ONHWP's costs to repair the defective systems. ONHWP's total repair costs averaged $1,160 per unit, plus internal administrative costs of $170 per unit. The mediated settlement figure is $800 per unit, exclusive of administration costs. This settlement figure takes into consideration litigation risk, the delays associated with this complex multi-party litigation, and the settling defendants' assertion that the replacement costs were unreasonably high.

[28] From the mediated amount of $800 per unit, the settling defendants and the plaintiffs agreed that the settling defendants proportionate liability was to be fixed at 65 per cent. Consequently, ONHWP's claim as against the settling defendants was settled on the basis of a lump sum payment for all such claims on the 65 per cent proportionate share of the $800, plus amounts for party and party costs, disbursements, interest, and claims administration. The total ONHWP settlement figure amounts to $5,230,000.

[29] The non-ONHWP claims were also settled on this basis, that is, 65 per cent of the mediated $800 repair cost figure.

[30] In addition, the settling defendants will be responsible for payment of the costs of administering the claims approval process for non-ONHWP claims. The proposed claims administrator is Business Response Inc., a company located in St. Louis, Missouri ("BRI"). BRI is also the claims administrator in a similar action in the United States and is experienced in administering this type of settlement.

[31] Non-ONHWP claimants will be able to take advantage of a simple claims approval process in which they will be compensated upon producing a proof of repair. This process will reduce legal and administrative costs and will allow claims to be processed quickly without the need for individual claimants to engage a lawyer. The period for claims submission will be five months from the mailing of the notice of certification and settlement approval.

[32] A non-ONHWP class member may be excluded from the agreement by completing an opt-out form which may be obtained from the claims administrator. The opt-out deadline will be 60 days from the mailing of the notice of certification and settlement approval.

[33] By virtue of this settlement, class members will be eligible to receive payments within a few months of the notice of certification and settlement approval. Absent this agreement, in the face of complex multiparty proceedings, it could be a matter of years before any benefits are received by the class.

[34] The settling defendants support the plaintiff's motion for approval of the settlement, as long as the judgment approves the entire settlement agreement, especially those provisions which would prevent the non-settling defendants from making any further claims for contribution and indemnity against the settling defendants in respect of any damages award to the plaintiffs at trial.

[35] These clauses are the only aspects of the settlement agreement that are subject to opposition by the non-settling defendants in this proceeding. Under the contested provisions, the court would be issuing an order preventing the non-settling defendants from making any further claims against the settling defendants in relation to any damages suffered by the plaintiffs.

[36] The contentious provisions are contained in cl. 13 of the settlement agreement. They state, in pertinent part:

> . . . all claims for contribution, indemnity, subrogation or other claims over shall be barred in accordance with the following terms:
>
> . . . . .
>
> d) The plaintiffs shall not make joint and several claims against the Non-Settling

Defendants or Joining Defendants but shall restrict their claims to several claims against the Non-Settling Defendants such that the plaintiffs shall be limited to the degree of liability proven against the Non-Settling Defendants at trial, but in no event shall such liability of the Non-Settling Defendants be greater than 35% of the total damages proven at trial as against each Non-Settling Defendant.

e) All claims for contribution, indemnity, subrogation or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, GST and costs, for or in respect of the subject matter of the Class Actions by or against any Non-Settling Defendants or any other person or party are barred by or against the Settling Defendants and Joining Defendants. CLARITY NOTE: The bar order deals only with claims over and is not intended to bar bona fide independent and direct claims and causes of action between settling and non-settling defendants for damages other than those claimed by the Representative Plaintiffs and the Plaintiff Class.

f) Except as otherwise provided herein, nothing in this Judgment shall prejudice or in any way interfere with the rights of the Settlement Class Members to pursue all of their other rights and remedies against persons and/or entities other than Settling Defendants and Joining Defendants.

g) Nothing in this Judgment affects any rights that the Non-Settling Defendants may have to move for leave for discovery and production of documents respecting the Settling Defendants and Joining Defendants pursuant to the Rules of Civil Procedure and, in particular, Rules 31.10 and 30.10.

[37] The plaintiffs and settling defendants contend that the settlement, taken as a whole, is fair and reasonable. They assert that the contested provisions contain adequate safeguards for the non-settling defendants. They point to the fact that the remaining claims of the plaintiffs have been converted from "joint and several" to several claims and that under this "several" approach, the liability of the non-settling defendants will be capped at 35 per cent of the total damages proven at trial. Indeed, the plaintiffs and the settling defendants state that the non-settling defendants can only benefit from this provision because it limits their maximum exposure to liability in damages to the plaintiffs regardless of the ultimate apportionment of the liability as determined by the trial judge.

[38] The plaintiffs and settling defendants characterize the prohibitive provisions as a "bar order". In support of their submissions urging the court to accept these provisions, they rely on "substantial U.S. Authority". The plaintiffs assert in their factum that "bar orders are a common mechanism used by the courts in the United States to assist in the management of complex litigation, and to encourage settlement and provide certainty to litigants while enabling them to reduce litigation costs."

[39] I am unable to accept these American authorities as being dispositive of the issue here. In many instances, the American cases turn on specific statutes providing for the issuance of "bar orders". Furthermore, even where such orders have been granted on a common law basis in the United States, the influence of the statutory regime cannot be ignored.

[40] I do, however, find that the underlying principles on which "bar orders" are granted in the American cases have some application to these proceedings. Moreover, the Class Proceedings Act provides a specific mechanism through which these objectives can be achieved in class proceedings in Ontario. Under s. 13 a court may "stay any proceeding related to the class proceeding before it, on such terms as it considers appropriate". This broad discretion is buttressed by s. 12 which permits the court, on a motion by a party or class member, to make such orders as are necessary to ensure the fair and expeditious determination of the class proceeding.

[41] By including ss. 12 and 13 in the Act, the legislature has given the court a flexible tool for adapting procedures on a case specific basis. As stated in the Report of the Attorney General's Advisory Committee on Class Action Reform at p. 37:

> [These sections describe] the general power of the Court to control its own process and to develop procedures as needed from case to case.

(Emphasis added)

[42] In view of the fact that it is apparent that a court has the statutory discretion to issue the order asked for, on appropriate terms, I turn to the objections raised by the non-settling defendants. These defendants oppose the order sought on the grounds that the prohibitive provisions would prejudice them, substantively and procedurally, in presenting any defence that they might have. The non-settling defendants do not object to any other terms of the settlement.

[43] The plaintiffs and the settling defendants take the position that the settlement agreement must either be approved in toto or rejected by the court. Sharpe J., relying on Court of Appeal authority, enunciated this approach in Dabbs v. Sun Life Assurance Co. (No. 1), [1998] O.J. No. 1598 (Gen. Div.). He stated at para. 6:

> It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3.

[44] In respect of the contention of substantive prejudice, the non-settling defendants assert that they have certain rights under ss. 1 and 5 of the Negligence Act, R.S.O. 1990, c. N.1 to pursue claims against the settling defendants for contribution and indemnity. Thus, they state, this court has no jurisdiction to prohibit the Negligence Act claims because to do so would derogate from a substantive right. Derogation of substantive rights, it is argued, is beyond the power bestowed on the court by the provisions of the purely procedural Class Proceedings Act. In addition, they contend that they have independent claims founded in negligence and negligent misrepresentation against the settling defendants and that part of the damages claimed, based upon these causes of action, will include amounts they may be required to pay to the plaintiffs as a result of the trial.

[45] Moreover, the non-settling defendants claim that the prohibiting provisions contained in the

settlement agreement are fundamentally unfair at a procedural level because the provisions deprive them of the ability to effectively ensure that they bear only their fair share of any liability to the plaintiffs. Specifically, they assert that they will be precluded from conducting effective discovery and denied evidence at trial necessary to establish the respective degrees of fault as between themselves and the settling defendants. This is especially prejudicial, they contend, in a context where the main issue at trial will be the nature of alleged defects in products manufactured by the settling defendants, rather than by the non-settling defendants.

[46] As a practical necessity, I will deal with the contested provisions of the settlement agreement prior to determining the other issues on this motion. If the provisions must be rejected on the basis of the objections raised by the non-settling defendants, then the other issues will be rendered moot.

Analysis

[47] The non-settling defendants contend that this court lacks jurisdiction to approve the settlement and issue a concomitant order containing the prohibitive provisions because of the substantive prejudice that will enure to them. The prejudice arises in part, they assert, because the contested provisions represent an abrogation of their rights under the ss. 1 and 5 of the Negligence Act.

[48] These sections provide:

> 1. Where damages have been caused or contributed to by the fault or neglect of two or more persons, the court shall determine the degree in which each of such persons is at fault or negligent, and, where two or more persons are found at fault or negligent, they are jointly and severally liable to the person suffering loss or damage for such fault or negligence, but as between themselves, in the absence of any contract express or implied, each is liable to make contribution and indemnify each other in the degree in which they are respectively found to be at fault or negligent.
>
> . . . . .
>
> 5. Wherever it appears that a person not already a party to an action is or may be wholly or partly responsible for the damages claimed, such person may be added as a party defendant to the action upon such terms as are considered just or may be made a third party to the action in the manner prescribed by the rules of court for adding third parties.

[49] I bear in mind the words of Farley J. in Canada v. Curragh, [1994] O.J. No. 1452 (Gen. Div.), in another context, as a starting point in the analysis of the jurisdictional objection raised by the non-settling defendants. He stated at para. 1:

> . . . jurisdiction cannot be conferred by agreement. Jurisdiction will only be assumed

> (i.e. undertaken) by this Court when the Court determines that it truly has jurisdiction based upon the legal principles applicable. It will not be taken by this Court merely because it will convenience the parties.

[50] Moreover, this court has noted on multiple occasions that there is no jurisdiction conferred by the Class Proceedings Act to supplement or derogate from the substantive rights of the parties. It is a procedural statute and, as such, neither its inherent objects nor its explicit provisions can be given effect in a manner which affects the substantive rights of either plaintiffs or defendants.

[51] While I have full regard to the preceding caveats, in my view, the non-settling defendants assertion that the Negligence Act affords them substantive rights which will be abrogated by the proposed settlement agreement is untenable. When the prohibitive provisions contained in the agreement are considered in total, it is apparent that they affect no claim of the non-settling defendants that could be successfully asserted against the settling defendants under the Negligence Act or otherwise.

[52] In essence, a claim for contribution and indemnity as between joint tortfeasors is a derivative claim. As stated by David Cheifetz in Apportionment of Fault in Tort (Aurora: Canada Law Book, 1981) at p. 18:

> The basis of the claim for contribution and indemnity is a breach of duty owed by the tortfeasor subject to the claim of the injured person not to the tortfeasor claiming contribution.

[53] Entitlement to the claim only flows from a finding of joint liability between tortfeasors, and a requirement to pay damages, to the plaintiff. In those cases, the trial judge apportions liability as between the defendants, but the plaintiff may obtain satisfaction of the entire judgment from either of them. In the absence of a contractual obligation for indemnification, each of the defendants, on the other hand, has a right to claim contribution and indemnity from the other in accordance with the apportionment of liability found at trial. However, neither defendant may recover from the other any amount attributable to its own negligence. The responsibility for the negligence of each defendant must therefore be borne by that defendant.

[54] Here, the settling defendants have abandoned any claim for contribution and indemnity as against the non-settling defendants. In addition, the plaintiffs have chosen to seek damages only in the amount for which the non-settling defendants are "severally" liable.

[55] In the result, the rights provided to the non-settling defendants under s. 1 of the Negligence Act form part and parcel of the settlement agreement. There will be no claim for contribution and indemnity as against them by the settling defendants. On the other hand, since they will only be required to pay damages in accordance with their own negligece and liability to the plaintiff, if any, they will have no claim for contribution and indemnity against the settling defendants in respect of any such payment.

[56] The right provided under s. 5 of the Negligence Act is of a different nature in that it allows the non-settling defendants to join third parties who are not already party to the action. It is apparent, however, that the intent of this section is to permit a defendant to have the opportunity of limiting its liability to the plaintiff to that for which it is actually responsible. As such, there can be no concern that the rights under s. 5 will be abrogated in this case. The protections it affords have likewise been incorporated into the settlement agreement. The settling defendants have been party to the proceedings and are now attempting to settle their liability and extricate themselves. In so doing, they have accepted a proportion of the liability but, more so, by virtue of their agreement with the plaintiffs, there are clauses which prevent the plaintiffs from obtaining any damages from the non-settling defendants in excess of the non-settling defendants' actual liability to the plaintiffs.

[57] The non-settling defendants have not delivered a statement of defence to the plaintiffs' claim, nor a statement of claim against the settling defendants in these proceedings. In argument on this motion, counsel for the non-settling defendants gave an undertaking that it is their intention to commence an action against the settling defendants alleging causes of action in negligence and negligent misrepresentation as against them.

[58] The non-settling defendants assert that the settling defendants owed them a duty of care which was negligently breached. This negligence, it is stated, is the direct cause of any damages that the non-settling defendants may be required to pay to the plaintiffs. In consequence, the non-settling defendants contend that this negligence gives rise to an independent tort claim, separate and apart from a claim for contribution and indemnity against the settling defendants. It is the position of the plaintiffs and the settling defendants that such a claim would be nothing more than a claim for contribution and indemnity by another name and, therefore, would be prohibited by the clauses in the settlement agreement.

[59] I do not necessarily accept this characterization of the potential claim of the non-settling defendants. In my view, however, the thrust of the submissions of the plaintiffs and the settling defendants with respect to the effect of the provisions of the settlement agreement is correct. The non-settling defendants cannot successfully assert a claim in damages against any party based upon their own negligence, no matter how such a claim is characterized, because of s. 3 of the Negligence Act. It provides:

> 3. In any action for damages that is founded upon the fault or negligence of the defendant if fault or negligence is found on the part of the plaintiff that contributed to the damages, the court shall apportion the damages in proportion to the degree of fault or negligence found against the parties respectively.

In the result, in any claim against the settling defendants, any damages of the non-settling defendants attributable to their own negligence cannot be recovered.

[60] On the other hand, damages which have been incurred by the non-settling defendants independent of any liability to the plaintiffs in a concurrent tort can be pursued and are not

foreclosed by the contested provisions of the settlement agreement. The clarity note appended to cl. 13(e) of the agreement speaks to this.

[61] For these reasons, I do not find that there is any substantive prejudice caused to the non-settling defendants by the contested provisions, nor is there any deprivation of any protections conferred upon them by the Negligence Act.

[62] I turn next to the non-settling defendants' contention that the contested provisions will prejudice them on a procedural level. In support of this contention, the non-settling defendants rely on a decision of the British Columbia Court of Appeal in British Columbia Ferry Corp. v. T & N plc, [1996] 4 W.W.R. 161, 16 B.C.L.R. (3d) 115 (C.A.). Although they rely on this case in support of their assertion of procedural prejudice, I observe that the decision supports the above reasons in so far as the allegation of substantive prejudice is concerned.

[63] In the B.C. Ferry case, the plaintiffs had sued a group of asbestos manufacturers. The manufacturers sought to add the installers of the asbestos to the action by way of third party proceedings. The plaintiffs entered into agreements with several of the third parties, in which the plaintiffs agreed that they would not seek to recover from the manufacturers any portion of the damages which a court attributed to the fault of the third parties.

[64] The manufacturers sought contribution and indemnity from the third parties, and in addition, damages for the out of pocket expenses incurred in defending the plaintiffs' claim as well as a declaration as to the degree of fault, if any attributable to each third party. The third parties, in a series of proceedings, moved successfully for dismissal of all of the claims against them.

[65] On appeal the court upheld the dismissal of the claim in contribution and indemnity, on the basis that the agreement between the plaintiffs and the third parties saved the defendants "harmless from any damages caused or contributed to by the fault of the concurrent tortfeasor", thus eliminating any "basis upon which the right to contribution or indemnity . . . could be exercised." In addition, the dismissal of the claim in damages for out of pocket expenses for defending the plaintiffs' claim was upheld. The court found that the trial judge had correctly determined that there was no duty of care existing between the defendants and the third parties such that the claim could be asserted.

[66] However, the appeal in respect of the claim for declaratory relief was allowed because of considerations of fairness to the defendants. Wood J.A. stated at pp. 175-76:

> It would, in my view, be manifestly wrong if a private accord between plaintiff and third party could work to deprive a defendant of the ability to establish an element of proof essential to a just resolution of the action on which all parties had joined issue. But that is precisely what will occur here if the defendants are denied the declaratory relief they seek. . . . In those circumstances, I am of the view that the third party claims for declaratory relief should be allowed to proceed.

[67] In respect of submissions that declaratory relief could not issue because there was no lis between the parties, Wood J.A. stated at p. 175:

> While I am of the view that the general rule against sanctioning actions brought for purely procedural relief will always be an important consideration governing the exercise of the court's discretion to grant declaratory relief, I do not accept the proposition that it must be regarded as a controlling consideration in all cases. There will be instances, albeit rarely, where the declaratory relief should be granted notwithstanding the fact that it is needed only for such purpose.
>
> . . . . One has only to consider the importance to the process of proof of such procedures as the right of discovery, the notice to admit and the ability to call parties as adverse witnesses, to realize that there will be circumstances in which the need to resort to such procedures will meet the expanded definition given to the term "relief" by Lord Justice Bankes in the Guaranty Trust Company of New York case.

[68] The agreement at issue in the B.C. Ferry case was much the same in effect as the provisions of the agreement between the plaintiffs and the settling defendants at issue here. However, the Court of Appeal was able to address the issue of procedural prejudice, without negating the agreement, in such a manner so that the fairness to the defendants was not compromised. Although the decision is not binding on this court, it provides an enlightened guide in the current context.

[69] The procedural objection raised by the non-settling defendants brings to bear the requirement of balancing the interests of the plaintiff class, on the one hand and the defendants, on the other, in a complex class proceeding. The objects of the Class Proceedings Act must be met without prejudice to either the plaintiff class or the defendants.

[70] However, the settlement of complex litigation is encouraged by the courts and favoured by public policy. Indeed, according to Callaghan A.C.J.H.C. in Sparling v. Southam Inc. (1988), 66 O.R. (2d) 225 at pp. 230, 41 B.L.R. 22 (H.C.J.):

> . . . the courts consistently favour the settlement of lawsuits in general. To put it another way, there is an overriding public interest in favour of settlement. This policy promotes the interests of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial court system.

[71] In consideration of the interests which must be balanced, it is my view that the procedural objections raised by the non-settling defendants can be addressed without a wholesale rejection of the proposed settlement agreement.

[72] This court has pointed out in Carom v. Bre-X Minerals Ltd. (1999), 43 O.R. (3d) 441, [1999] O.J. No. 281 (Gen. Div.), in another context, that [at p. 451], "the CPA is a procedural statute

replete with provisions guaranteeing order and fairness".

[73] The Class Proceedings Act is meant to provide a mechanism for the redress of mass wrongs which are linked by an element of commonality. This is such a case. The court must remain flexible and exercise its inherent jurisdiction to meet the needs of the parties and to achieve the purpose of the statute.

[74] The settlement before this court meets the underlying objective of the Act. There is no objection to its terms, save for the prohibitive provisions. However, if these provisions are not approved, the entire settlement will fail. This will seriously prejudice the plaintiff class in terms of delay and costs of litigation and further, expose the plaintiffs to the risks of litigation. Conversely, to ignore the procedural concerns advanced by the non-settling defendants would unfairly prejudice those parties.

[75] The Class Proceedings Act is sui generis legislation which envisions the balancing of interests between the parties. Through legislative foresight, the court has been given the necessary power to adapt procedures to ensure that the interests of all parties can be adequately protected in situations where those interests conflict. Here, the benefits of the settlement to the plaintiffs favour the approval of the settlement as presented, including the contentious prohibitive provisions. As I have stated above, these provisions do not occasion any substantive prejudice to the defendants. The procedural concerns may be adequately addressed through the terms on which the settlement is approved.

[76] Accordingly, I am prepared to grant judgment on the basis of the settlement agreement, subject to terms I set out below. The prohibitive provisions will be entered as a "stay of proceedings", as against the settling defendants under s. 13 of the Act, subject to compliance by the settling defendants with the following terms as they relate to the conduct of the remaining portions of the action.

[77] These terms, generally described, are that the non-settling defendants may, on motion to this court, obtain:

1. documentary discovery and an affidavit of documents in accordance with the Rules of Civil Procedure from each of the settling defendants;
2. oral discovery of a representative of each of the settling defendants, the transcript of which may be read in at trial;
3. leave to serve a request to admit on each settling defendant in respect of factual matters;
4. an undertaking to produce a representative to testify at trial, with such witness to be subject to cross-examination by counsel for the non-settling defendants.

[78] In addition, the fact of the settlement, but not the terms thereof, shall be disclosed to the trial judge at the commencement of trial.

[79] Furthermore, pursuant to its case management powers under the Act, this court shall maintain an ongoing supervisory role in this action. In the event that any settling defendant fails to comply with an order of this court made pursuant to the above terms, the court may, in addressing any such failure, lift the stay of proceedings in respect of that defendant.

Certification

[80] The next consideration is whether the proceeding against the settling defendants meets the requirements for certification as a class proceeding. The elements of the test for certification are set out in s. 5 of the Class Proceedings Act.

> 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.

(i) Cause of action

[81] The statement of claim discloses a cause of action. The plaintiffs claim damages against the settling defendants arising from, inter alia, their negligent design, manufacture, and failure to establish appropriate and safe standards relating to the heating systems, as well as breaches of statutory duties, warranties and representations, and negligent misrepresentations. The plaintiffs also claim that these defendants failed to warn the public of the potential safety hazard presented by the defective product; to report these defects to the Ministry of Consumer and Commercial Relations; and to recall the defective and dangerous product.

(ii) Identifiable class

[82] The plaintiffs propose that upon certification, the class be defined as

> ONHWP and all persons or entities in the Province of Ontario, Canada who have incurred or will incur remediation expenses as a result of owning a natural gas or propane fired appliance installed with high-temperature plastic venting under the trade names PLEXVENT, ULTRAVENT or SELVENT (manufactured or sold by Chevron, Hart&Cooley and Eljer Manufacturing respectively).

This class definition meets the second element of the test for certification.

(iii) Common issue

[83] The plaintiffs propose that the common issue for the class be defined as:

> What claims does the Settlement Class have arising from the Ministry of Consumer and Commercial Relations Director's Safety Order dated September 12, 1995.

The common issue proposed satisfies the third criterion of the certification requirements.

(iv) Preferable procedure

[84] A class proceeding is the preferable procedure for the resolution of the common issue as outlined above. The aggregate claims of the class are substantial but individually, these claims cannot be litigated economically. On a practical basis, should certification be denied, the result would be to deny access to the courts for many of the claims not covered by ONHWP. In addition to being expensive to litigate on an individual basis, the effect of multiple claims of this nature coming forward would place a heavy burden on judicial resources. In this case, a class proceeding is the preferable procedure for providing members of the class with access to an effective remedy.

(v) Representative plaintiff

[85] Kathy Adetuyi and Andrew Duke are individuals who purchased heating systems with HTPV installed in conjunction with mid-efficiency appliances. Kathy Adetuyi's home was not enrolled in the ONHWP program and she bore the entire cost of complying with the Director's safety order. Andrew Duke's home was covered by ONHWP. As such, a portion of his cost to correct the defective heating system was borne by ONHWP.

[86] Kathy Adetuyi, Andrew Duke and ONHWP are all prepared to act as representative plaintiffs for the class. Collectively, their actions indicate that they have fairly represented the class and there is no evidence that they will not continue to do so. These proposed representative plaintiffs do not have interests which conflict with the interests of other class members and the settlement agreement provides a plan for the resolution of this proceeding. The proposed representative plaintiffs are acceptable to the court, thus meeting the final requirement for certification.

[87] Accordingly, all of the requirements of the Act regarding certification are met.

Settlement Approval

[88] Finally, I turn to the settlement. For a settlement to be approved it must be fair, reasonable and in the best interests of the class, and, as stated in Dabbs, will generally take into account factors such as:

1. likelihood of recovery or likelihood of success;
2. amount and nature of discovery, evidence or investigation;
3. settlement terms and conditions;
4. recommendation and experience of counsel;
5. future expense and likely duration of litigation;
6. recommendation of neutral parties, if any;
7. number of objectors and nature of objections; and
8. the presence of arms-length bargaining and the absence of collusion.

[89] The exercise of settlement approval does not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness. The range of reasonableness has been described by Sharpe J. in Dabbs v. Sun Life Assurance Co. (No. 2) (1998), 40 O.R. (3d) 429, 22 C.P.C. (4th) 381 (Gen. Div.) as follows at p. 440:

> . . . all settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interest of those affected by it when compared to the alternative of the risks and costs of litigation.

[90] Furthermore, the recommendation of class counsel is a factor to be considered, though the potential for conflict must also be noted. Sharpe J. stated at p. 440:

> The recommendation of class counsel is clearly not dispositive as it is obvious that class counsel have a significant financial interest in having the settlement approved. Still, the recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line.

[91] In Ontario, the courts have also recognized that the practical value of an expedited recovery is a significant factor for consideration. In Dabbs, Sharpe J. determined that in addition to the legal and factual risks, a practical concern favouring settlement includes the potential that the case would take several years to reach trial and exhaust all appeals.

[92] Evidence sufficient to decide the merits of the issue is not required because compromise is necessary to achieve any settlement. However, the court must possess adequate information to elevate its decision above mere conjecture. This is imperative in order that the court might be satisfied that the settlement delivers adequate relief for the class in exchange for the surrender of litigation rights against the defendants: see Newberg on Class Actions, 3rd ed. (Shepard's/McGraw-Hill, 1992), ss. 11.45-46.

[93] In the case at bar, the settlement proposed provides compensation to class members through a settlement mechanism that allows partial recovery for the damages of the class. I am satisfied that significant research and investigation was conducted in this matter prior to issuance of the statement of claim. Settlement negotiations between the settling parties have been ongoing since early 1996. These negotiations have been adversarial and protracted. The plaintiffs have been guided in their settlement negotiations by an understanding of the risks associated with the litigation, the potential future expense and the recommendation and experience of their counsel. Further, the terms of the settlement were arrived at as a result of intensive mediation conducted by an experienced arbitrator with specific knowledge of the factual background. The settlement benefits to the plaintiff class are well within the range of reasonableness.

[94] In conclusion, I find that the settlement is fair and reasonable and in the best interests of the class as a whole.

Disposition

[95] This action represents the quintessential class proceeding. It involves a single purpose product which is alleged to be defective. This core element of commonality is such that a determination of liability to the representative plaintiffs would be determinative of liability to the entire class. As stated in Chace v. Crane Canada Inc. (1997), 14 C.P.C. (4th) 197 at p. 202, 44 B.C.L.R. (3d) 264 (C.A.):

> This court recently observed that in a product liability case a determination that the product in question is defective or dangerous as alleged will advance the claims to an appreciable extent. . . . I agree with the chambers judge that is the situation here. The respondents are alleging an inherent defect. . . . This seems exactly the type of question for which a class action is ideally suited and remarkably similar to that concerning faulty heart pacemaker leads that was certified by the Ontario Court (General Division) in Nantais v. Telectronics Proprietary (Canada) Ltd. (1995) 25 O.R. (3d) 331 (Ont. Gen. Div.).

(Citations omitted)

[96] This product liability claim involves thousands of relatively small, nearly identical claims. In the absence of certification as a class proceeding, they would not present viable individual lawsuits because of the costs of litigation. Cost barriers to litigation impact on both access to justice and

behavioural modification, two of the goals of the Act. Taken together with the nature of the claim and the element of commonality, the case cries out for certification. The motion for certification against the settling defendants is granted.

[97] The settlement agreement taken as a whole is fair and reasonable and in the interests of the class members. It brings a significant degree of resolution to a protracted proceeding. Although the non-settling defendants have raised some legitimate concerns about the prohibitive provisions, in light of the procedural protections available through the Class Proceedings Act, the Rules of Civil Procedure, R.R.O. 1990, Reg. 194 and the terms attached to the stay granted in these reasons, these procedural concerns can be addressed without rejecting the settlement. Accordingly, the settlement is approved in its entirety, subject to the terms set out above.

[98] The motion raises a novel point of law and the result is divided. There shall be no order as to costs. I may be spoken to in respect of any other matters arising out of these reasons.

Order accordingly.

Case Name:

Osmun v. Cadbury Adams Canada Inc.

Between
David Osmun and Metro (Windsor) Enterprises Inc.,
Plaintiffs, and
Cadbury Adams Canada Inc., The Hershey Company, Hershey Canada Inc., Nestlé Canada, Inc., Mars, Incorporated, Mars Canada Inc. and Itwal Limited, Defendants
PROCEEDING UNDER the Class Proceedings Act 1992

[2009] O.J. No. 5566

85 C.P.C. (6th) 148

2009 CarswellOnt 8132

Court File No. 08-CV-347263PD2

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: December 18, 2009.
Judgment: December 30, 2009.

(52 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Common interests and issues -- Definition of class -- Representative plaintiff -- Motion by the plaintiffs for an for an order certifying the action as a class proceeding for the purpose of settlement as against the settling defendants allowed -- Motion was made on consent of settling defendants -- Class action alleged price fixing of chocolate confectionary products -- Representative plaintiffs were an individual purchaser of the products and a corporation in the vending machine business -- Settlements reached in three provinces pending court approval -- Cause of action was established -- Class was identifiable -- Representative plaintiffs were appropriate -- Class proceeding was preferable procedure -- Opt-out procedure ordered.

Motion by the plaintiffs for an order certifying the action as a class proceeding for the purpose of settlement as against the settling defendants. The motion was made on consent of the settling defendants. The plaintiffs commenced the class action alleging that the defendants conspired to, and did, fix maintain or stabilize prices of chocolate confectionary products in Canada. Class proceedings in Ontario, Quebec and British Columbia were settled as against Cadbury Adams and ITWAL, subject to court approval. One representative plaintiff, Osmun, resided in Windsor and was a purchaser of chocolate confectionary products. The second representative plaintiff, Metro, was an Ontario corporation engaged in the catering and vending machine business. The settlement agreement provided that Cadbury would pay $5,700,000 for the benefit of three settlement classes in Canada. ITWAL would assign all claims it had against Cadbury to the settlement classes.

HELD: Motion allowed. It was clear on the face of the pleading that a cause of action was established under the Competition Act. The proposed class was identifiable. The claims raised common issues that were suitable for certification. A class proceeding was the preferable procedure. The proposed representative plaintiffs were a direct purchaser and an indirect purchaser. They were settlement class members and would adequately represent the interests of the class. An opt-out procedure was ordered.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 5, s. 5(1), s. 9, s. 17

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 21

Competition Act, R.S.C. 1985, c. C-34, s. 36, s. 45

Counsel:

Charles M. Wright and Jay Strosberg, for the plaintiff.

Christopher P. Naudie and Jean-Marc LeClerc, for the defendant Cadbury Adams Canada Inc.

Don Houston, for the defendant ITWAL Limited.

Scott Maidment and Jonathan Hood, for the defendants The Hershey Company and Hershey Canada Inc.

Sandra Forbes, for the defendants Mars Incorporated and Mars Canada Inc.

Rob Kwinter, for the defendant Nestlé Canada Inc.

REASONS FOR DECISION: CERTIFICATION AS AGAINST CADBURY ADAMS CANADA INC. AND ITWAL LIMITED AND NOTICE OF SETTLEMENT APPROVAL HEARING

G.R. STRATHY J.:--

I. BACKGROUND

Introduction

1 The plaintiffs bring a motion pursuant to the *Class Proceedings Act, 1992*, S.O. 1992, c. 6., s. 5 (the "*C.P.A.*"), for an order certifying this action as a class proceeding for the purpose of settlement as against the defendants Cadbury Adams Canada Inc. ("Cadbury") and ITWAL Limited ("ITWAL") (the "Settling Defendants") and for an order approving the notice of certification, the notice of the settlement approval hearing, and the manner of service of both notices. The motion for certification is made on consent of the Settling Defendants and is not opposed by the other defendants (the "Non-Settling Defendants"). The plaintiff proposes to continue the action against the Non-Settling Defendants and will bring a motion for certification in relation to those defendants at a future date.

2 For the reasons that follow, I will grant the order sought. An order will issue defining the proposed class for settlement purposes as against Cadbury and ITWAL, appointing David Osmun ("Osmun") and Metro (Windsor) Enterprises Inc. ("Metro") as the representative plaintiffs for the Ontario Settlement Class (as defined below). I will also approve a notice program that will give members of the class notice of this decision, an opportunity to opt out of the class action, and an opportunity to support or oppose the proposed settlements.

Procedural History

3 The plaintiffs commenced this class action alleging that the Defendants conspired to fix, and that they did fix, maintain or stabilize prices of chocolate confectionary products in Canada, and that ITWAL engaged in price maintenance. With the exception of ITWAL, the Defendants are manufacturers of chocolate confectionary products. ITWAL operates a retail and foodservice wholesale distribution network, and was a major purchaser and distributor of chocolate confectionary products during the relevant period.

4 Companion proceedings have been commenced across Canada regarding alleged price-fixing in the chocolate confectionary industry. This action, together with the British Columbia action titled *Jacob Stuart Main v. Cadbury Schweppes plc, Cadbury Adams Canada Inc., Mars, Incorporated, Mars Canada Inc. formerly known as Effem Inc., The Hershey Company, Hershey Canada Inc., Nestlé S.A., Nestlé Canada Inc. and ITWAL Limited* (Vancouver Registry) (Court File No. S078807) and the Quebec action titled *Gaetan Roy v. Cadbury Adams Canada Inc., Hershey Canada Inc., Mars Canada Inc., Nestlé Canada Inc.* (File No. 200-06-000094-071), will be referred

to as the "Main Proceedings".

5 The Plaintiffs in the Main Proceedings have entered into separate settlements with Cadbury, dated October 14, 2009 (the "Cadbury Settlement Agreement") and ITWAL, dated October 6, 2009 (the "ITWAL Settlement Agreement") (collectively, the "Settlement Agreements"). The Settlement Agreements are subject to court approval in Ontario, British Columbia and Quebec. As well, Cadbury retains the right to terminate the Cadbury Settlement Agreement if there is insufficient support for the settlement by members of the class - that is, if a pre-defined "opt out threshold" is exceeded. If the settlement is not approved, or is terminated by one of the Settling Defendants, the action will proceed as a contested proceeding and the Settling Defendants will be entitled to contest certification.

6 The procedure of bringing a motion for certification and notice approval in advance of a motion for settlement approval has been adopted in other cases and is an efficient and appropriate manner of proceeding: see *Donnelly v. United Technologies Corp.*, [2008] O.J. No. 271, 163 A.C.W.S. (3d) 700 (S.C.J.); *Kelman v. Goodyear Tire and Rubber Co.*, [2005] O.J. No. 175, 5 C.P.C. (6th) 161 (S.C.J.); *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065, 59 C.P.C. (6th) 166 (S.C.J.).

7 Other proceedings have also been commenced in Canada regarding alleged price-fixing in the chocolate confectionary industry (collectively the "Additional Proceedings"). The plaintiffs in the Additional Proceedings have agreed to resolve their claims as part of the Settlement Agreements. Pursuant to the terms of the Settlement Agreements, the plaintiffs in the Additional Proceedings have agreed that, upon the Settlement Agreements becoming effective, the Additional Proceedings will be dismissed without costs and with prejudice against the Settling Defendants and other Releasees.

8 As well, a proposed class proceeding in Ontario, *Ebert v. Hershey Canada Inc., Mars Inc., Nestlé Canada Inc., Cadbury Beverages Canada Inc.*, (Court File No. 08-CV-349126CP) will be discontinued on consent. At the hearing of this matter I indicated that I would make an order approving the discontinuance.

Representative Plaintiffs

9 The plaintiff Osmun is a resident of Windsor, Ontario. During the relevant period, he purchased chocolate confectionary products in Ontario indirectly from each of the manufacturer Defendants.

10 The plaintiff Metro is an Ontario corporation located in Windsor and is engaged in the catering and vending machine business. Metro purchased chocolate confectionary products in Ontario directly from Mars Canada Inc. and indirectly from the other Defendants during the relevant period.

Settlement Agreements

11 Under the terms of the proposed settlements, following court approval in all proceedings Cadbury will pay $5,700,000 for the benefit of the three settlement classes in Canada. These funds will be held in an interest-bearing account. Due to the costs of administering the claims of class members, it is proposed that these funds will be distributed at a later date, after additional settlements or judgments are obtained, if that proves to be the case.

12 ITWAL is making no financial contribution to the settlement, other than the payment of $25,000 towards the costs of the notice program. It was, however, a major purchaser of chocolate confectionary products during the relevant period and it will assign to the settlement classes all claims that it has against the defendants in relation to the claims made in the Main Proceedings. As well, both ITWAL and Cadbury have agreed to cooperate with the Plaintiffs in the prosecution of the claims against the Non-Settling Defendants.

13 The terms of the proposed settlements will be attached to the Certification order. They will be described in more detail in the materials that will be filed in support of the Settlement Approval motion.

Notice Program

14 The Plaintiffs in the Main Proceedings and the Settling Defendants have agreed on the form and content of a short-form and long-form notice of Certification and Settlement Approval Hearing (the "Notice of Hearing"). The Notice of Hearing will, broadly speaking, give class members:

* notice of the Main Proceedings;
* notice of certification for the purpose of settlement;
* notice of the terms of the settlement and of the settlement approval hearing;
* information about their opt-out rights and the procedure for opting out; and
* information about class counsel and how they may obtain further information or have their questions answered.

15 The Plaintiffs in the Main Proceedings and the Settling Defendants have also agreed on a plan for disseminating the Notice of Hearing, which will be:

(a) published in newspapers across the country;
(b) published in industry magazines;
(c) sent to trade organizations for voluntary distribution to their members;
(d) posted on the websites of class counsel in the Main Proceedings and counsel in the Additional Proceedings; and
(e) sent by direct mail to the Canadian customers of the Settling Defendants. It is anticipated that the group of customers will be the largest single claimants and they will receive direct mailed notice of the proposed settlement.

16 ITWAL is responsible for the costs of the notice program up to $25,000. The remaining costs

of the notice program will be paid from the Cadbury settlement funds.

II. THE TEST FOR CERTIFICATION

17 The test for certification is set out in s. 5 of the *C.P.A.*:

> (a) the pleadings or the notice of action disclose a cause of action;
> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff;
> (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 a plan which sets out a workable method for the advancement of the proceeding on behalf of the class, including notification of class members; and
> (iii) does not, on the common issues, have an interest in conflict with the interests of other class members.

18 Because the *C.P.A.* is both mandatory and remedial in nature, it should be given a large and liberal interpretation to widen access to our courts in appropriate circumstances. In *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, 2009 BCCA 503, [2009] B.C.J. No. 2239 the British Columbia Court of Appeal noted at para. 64 that class proceeding legislation should be "construed generously" in order to achieve its objectives.

19 A certification motion is not an assessment of the merits of the action. The court is not required to determine whether the plaintiffs' claims are likely to succeed. The issue is simply whether the action "can be appropriately prosecuted as a class action": *Cloud. v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401, [2004] O.J. No. 4924 (C.A.), at para 38, leave to appeal to S.C.C. refused May 12, 2005, [2005] S.C.C.A. No. 50. Other than the requirement that the pleadings disclose a cause of action, the class representative is required to show "some basis in fact for each of the certification requirements set out in s. 5 of the Act": *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158, [2001] S.C.J. No. 67, at para. 25.

20 The consent of the defendants to certification does not reduce the responsibility of the court to be satisfied that the requirements of section 5(1) of the *C.P.A.* have been met and that the case is indeed appropriate for certification: *Vezina v. Loblaw Companies Ltd.*, [2005] O.J. No. 1974, 17 C.P.C. (6th) 307, (S.C.J.). Certification affects the rights of the entire class, who will be bound by the judgment or by a court-approved settlement. It is important, therefore, that the court determine that the proceeding is appropriate for prosecution as a class action.

21 The plaintiff submits that although the certification requirements are the same in a settlement context as in a litigation context, it is generally accepted that they need not be as rigorously applied in a settlement context: *National Trust Co. v. Smallhorn*, [2007] O.J. No. 3825, 52 C.P.C. (6th) 123 (S.C.J.) at para. 8. I accept this as a general proposition. See also: *Bellaire v. Daya*, [2007] O.J. No. 4819, 49 C.P.C. (6th) 110 (S.C.J.) at para. 16; *Bona Foods Ltd. v. Ajinomoto U.S.A., Inc.*, [2004] O.J. No. 908, 2 C.P.C. (6th) 15 (S.C.J.); *Nutech Brands Inc. v. Air Canada*, above, at para. 9. In *Gariepy v. Shell Oil Co.*, [2002] O.J. No. 4022, 26 C.P.C. (5th) 358 (S.C.J.), Nordheimer J. noted at para. 27 that where certification is for the purpose of settlement, the court has less reason to be concerned about the manageability of the proceeding.

22 I will now apply the s. 5 test to the circumstances of this case.

(a) *Cause of Action*

23 The test for establishing a cause of action is the same as the test under rule 21 of the Ontario *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194: assuming the facts stated in the statement of claim can be proved, whether it is, "plain, obvious and beyond a reasonable doubt that the Plaintiff cannot succeed": *Peter v Medtronic Inc.* (2007), 50 C.P.C. (6th) 133, [2007] O.J. No. 4828 (S.C.J.) at paras. 29-30, aff'd. (2008), 55 C.P.C. (6th) 242, [2008] O.J. No. 1916 (Div. Ct.); *Hollick v. Toronto (City)*, above, per McLachlin C.J. at para.25; *Cloud v. Canada (Attorney General)*, above, per Goudge J.A. at para. 41.

24 No evidence is admissible and the material facts pleaded must be accepted as true, unless patently ridiculous or incapable of proof: *Peter v Medtronic Inc*., above; *Tiboni v. Merck Frosst Canada Ltd*. (2008), 295 D.L.R. (4th) 32, [2008] O.J. No. 2996 (S.C.J.) at para. 56.

25 The plaintiffs assert a cause of action under s. 36 of the *Competition Act*, R.S.C. 1985, c. C-34, and rely on section 45, which is contained in Part VI of that statute. Those provisions are as follows:

> 36. (1) Any person who has suffered loss or damage as a result of
> (a) conduct that is contrary to any provision of Part VI, or
> (b) the failure of any person to comply with an order of the Tribunal or another court under this Act,
>
> may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.

...

45. (1) Every one who conspires, combines, agrees or arranges with another person
(a) to limit unduly the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any product,
(b) to prevent, limit or lessen, unduly, the manufacture or production of a product or to enhance unreasonably the price thereof,
(c) to prevent or lessen, unduly, competition in the production, manufacture, purchase, barter, sale, storage, rental, transportation or supply of a product, or in the price of insurance on persons or property, or
(d) to otherwise restrain or injure competition unduly,

is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years or to a fine not exceeding ten million dollars or to both.

26 It is clear on the face of the pleading that a cause of action is established. The Plaintiffs allege that:

(a) the Defendants contravened Part VI of the *Competition Act*, giving rise to a right of damages under section 36 of the *Competition Act*;
(b) the Defendants are liable for the tort of conspiracy; and
(c) the Defendant, ITWAL, engaged in price maintenance in contravention of the *Competition Act*.

27 The Plaintiffs have satisfied the Rule 21 test. Class actions based on breach of the *Competition Act* have been certified in other proceedings: *Irving Paper Ltd. v. Atofina Chemicals Inc.*, [2009] O.J. No. 4021 (S.C.J.); *Nutech Brands Inc. v. Air Canada*, above; *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, above; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2000] O.J. No. 4594, 4 C.P.C. (5th) 169 (S.C.J.).

(b) *Identifiable Class*

28 The proposed Ontario Settlement Class includes all levels of purchasers and is defined as follows:

All persons in Canada who, during the Settlement Class Period, purchased Chocolate Products* in Canada, except the Excluded Persons and Persons who are included in the Quebec Settlement Class and the BC Settlement Class.

* Chocolate Products are defined as any and all chocolate confectionary

products of the Defendants sold in Canada.

29 The proposed class definition is set out in objective terms, such that membership in the class is readily ascertainable. Inclusion in the class does not depend on the merits of the claim or the outcome of the litigation: *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534, [2000] S.C.J. No. 63 at para. 38.

30 The proposed class includes everyone from an individual who purchased a chocolate bar at a corner store to intermediate buyers to large retailers such as Wal-Mart. Classes of indirect and direct purchasers have been approved in other cases: see *Irving Paper Ltd. v. Atofina Chemicals Inc*., above; *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, above. I accept the submission of plaintiff's counsel that the approach of including all levels of purchasers in the class is in keeping with the *Competition Act* - section 36 provides that "*any person* who has suffered loss or damage" can bring an action to recover for their losses, including it would seem, indirect purchasers: *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, above, at para. 44.

31 I am satisfied that the proposed class definition meets the test set out in *Bywater v. Toronto Transit Commission*, [1998] O.J. No. 4913, 27 C.P.C. (4th) 172, (Gen. Div.), per Winkler J., as he then was, at para. 10:

> (a) it identifies persons who have a potential claim for relief against the defendants;
> (b) it defines the parameters of the lawsuit so as to identify those persons who are bound by the result; and
> (c) it describes the persons is entitled to notice of certification.

(c) *Common Issues*

32 The Plaintiffs proposes the following common issue:

> Did the Settling Defendants conspire to raise, maintain, fix or stabilize the prices of, or allocate markets and customers for, Chocolate Products in Canada during the Settlement Class Period? If so, what damages did Settlement Class Members suffer?

33 The existence of common issues is the essential element of a class proceeding. The purpose of the *C.P.A.* is to provide a means for the resolution of those common issues in a single forum: *Bywater v. Toronto Transit Commission*, above, at para 12.

34 As stated in *Western Canadian Shopping Centres Inc.*, above, at para 39, the fundamental issue is whether the determination of the common issues will avoid duplicative fact-finding or legal analysis. In order to avoid this duplication, the court must ensure that the common issues are necessary to the resolution of each class member's claim. However, the common issues need not be

determinative of each class member's claim and each class member need not share the same interest in the resolution of the common issues. The common issues criterion is not a high bar: the plaintiff must merely establish some basis in fact to believe that these issues are common: *Hollick v. Toronto (City)*, above, at paras. 18-25.

35 The determination of the existence of a conspiracy is central to the claim of each member. As Cumming J. stated in *Vitapharm Canada Ltd. v. F Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758, [2005] O.J. No. 1118, at para. 34:

> Price-fixing cases by their nature, deal with common legal and factual questions about the existence, scope and effect of an alleged conspiracy. Putative class members have a common interest in any proof of a concerted action, conspiracy, and of agreement with the aim and result of restricting trade.

36 In *Irving Paper Ltd. v. Atofina Chemicals Inc.*, above, Justice Rady observed at paras. 113-4 that a determination of the proposed common issues relating to the existence and scope of the conspiracy can be made without reference to the individual class members and would significantly advance the litigation.

37 The claims of the class members raise common issues that are suitable for certification.

(d) *Preferable Procedure*

38 I conclude that a class proceeding is the preferable procedure in this case, because it provides a fair, efficient and manageable method of determining the common issue and advances the proceeding in accordance with the goals of judicial economy, access to justice and behaviour modification. In the absence of this proceeding, it is unlikely that the majority of claims would be advanced. *Vitapharm Canada Ltd. v. F Hoffmann-La Roche Ltd*. (2005), 74 O.R. (3d) 758, [2005] O.J. No. 1118, at para. 41; see also *Irving Paper Ltd. v. Atofina Chemicals Inc*., above.

39 Certification of the Ontario Settlement Class will give consumers and smaller retailers access to justice that would otherwise be prohibitively expensive. It also serves important behaviour modification goals by holding anti-competitive conspirators accountable for their actions and by requiring them to disgorge the fruits of their unlawful conduct.

(e) *Representative Plaintiffs*

40 I am satisfied that the proposed representative plaintiffs (a direct purchaser and an indirect purchaser) are Ontario settlement class members within the definition, that they have no conflict and that they would fairly and adequately represent the interests of the proposed settlement class.

41 In conspiracy claims, every class member has a common interest in proving the existence of the conspiracy and maximizing the aggregate damages: *Vitapharm Canada Ltd. v. F Hoffmann-La*

Roche Ltd. (2005), 74 O.R. (3d) 758, [2005] O.J. No. 1118, at para. 44.

42 The Settlement Agreements set out a workable method of resolving the proceeding. The Settlement Agreements contemplate the Plaintiffs bringing a motion for an order certifying the Ontario Settlement Class for settlement purposes, fixing the date of the approval hearing, and approving the Notice of Hearing. The Settlement Agreements also contemplate the Plaintiffs bringing a motion for an order approving the Settlement Agreements.

III. PROCEDURAL MATTERS Opting Out

43 Putative settlement class members will be provided a single opportunity to opt out of the Main Proceedings. They cannot opt out of the settlements yet remain a part of the class in the claim against the other defendants. In this case, while ITWAL makes no financial contribution to the settlement, other than a contribution of $25,000 to the cost of notice, it (along with Cadbury) has agreed to co-operate with the plaintiffs in their claims against the other defendants. It would not be fair to give a class member the right to opt-out of the settlement, sue ITWAL, yet take advantage of ITWAL's co-operation in the action against the other defendants.

44 This approach is in keeping with section 9 of the *C.P.A.* which allows class members to "opt out of a *proceeding* in the manner and within the time specified in the certification order": *Nutech Brands Inc. v. Air Canada*, above, at para. 18; *Currie v. McDonald's Restaurants of Canada Ltd.* (2005), 74 O.R. (3d) 321, [2005] O.J. No. 506 (C.A.) at paras. 25 and 28; *Guercio v. Stone Paradise Inc*., (December 2006), London 46460CP/45604CP (Ont. S.C.J.) [unreported] at paras. 5 and 9; *Class Proceedings Act, 1992*, S.O. 1992, c. 6 at s. 9.

45 There is no prejudice caused to putative class members by requiring them to decide whether to opt out at the time certification is granted for settlement purposes. The decision to opt out does not impact a putative class members' substantive rights; it simply requires putative class members to choose a venue in which to pursue their substantive rights. Moreover, in the context of a settlement approval, putative class members are provided not only with the prescribed information required under section 17 of the *C.P.A.*, but also with information about the settlement. This enhances their ability "to evaluate whether their interests are better served by opting out or choosing to participate now and in the future." *Nutech Brands Inc. v. Air Canada*, above, at paras. 18-19; *Guercio v. Stone Paradise Inc.*, above at para. 6.

46 The opt out period will commence upon the first publication of the Notice of Hearing. This approach is commonly used where certification precedes settlement approval and is consistent with the opt out provisions of the *C.P.A.*, which contemplate the opt out period being established in the certification order: *C.P.A.* s. 9; *Nutech Brands Inc. v. Air Canada*, above; *National Trust Co. v. Smallhorn*, above, at para. 18.

Notice Approval

47 The Plaintiffs in the Main Proceedings and the Settling Defendants have proposed short form and long form notices of certification and of the settlement approval hearing. I have suggested certain modifications that have now been incorporated into the notices and I will approve the notices.

48 The short-form notice is designed to:

* enable persons to identify themselves as settlement class members;
* inform them that the proceeding has been certified;
* alert settlement class members that their legal rights may be affected by the Settlement Agreements;
* advise settlement class members of the dates of the settlement approval hearings and their rights to participate in the settlement approval hearings; and
* advise settlement class members on how to obtain more information about the Main Proceedings, the Settlement Agreements, and the options available to them.

49 The long-form Notice of Hearing is more comprehensive and is intended to provide settlement class members with more detailed information and instructions regarding the Main Proceedings, the Settlement Agreements, and settlement class members' options with respect to the Main Proceedings and the Settlement Agreements. The long-form Notice of Hearing contains the following information:

* a description of the Main Proceedings;
* a summary of the pertinent terms of the Settlement Agreements, including the definition of the settlement classes;
* a description of settlement class members' options with respect to objecting to the Settlement Agreements and opting out of the Main Proceedings, and the consequences of each, including a statement that settlement class members who do not opt out of the Main Proceedings will be bound by the Settlement Agreements and any subsequent settlement or judgment achieved in the Main Proceedings;
* the time and place of the settlement approval hearings and a statement that settlement class members are entitled to appear and make submissions at the settlement approval hearings;
* instructions as to the method and time within which settlement class members may opt out of the Main Proceedings;
* a statement that a further notice will be published that will notify settlement class members of the process for filing a claim under the Settlement Agreements;
* a summary of the arrangement between the representative plaintiffs and their counsel respecting fees and disbursements; and

* directions as to how to obtain more complete information regarding the Main Proceedings, the Settlement Agreements, and the options available to settlement class members.

The Proposed Plan of Dissemination

50 The Plaintiffs in the Main Proceedings and the Settling Defendants have agreed on a plan for disseminating nation-wide notice of certification of this proceeding and notice of the hearing of the settlement approval motion. A short-form notice will be published in newspapers and industry publications across the country and sent to industry organizations for voluntary distribution to their membership. The long-form notice will be posted online on the websites of class counsel in the Main Proceedings and counsel in the Additional Proceedings, and sent by direct mail to the Canadian customers of the Settling Defendants. ITWAL has agreed to pay for the costs of the notice program up to $25,000. The remaining costs of the notice program will be paid from the Cadbury settlement funds. I am satisfied that the proposed notice plan will provide reasonable and effective notice to the members of the class.

IV. CONCLUSION AND ORDER

51 For the foregoing reasons, an order will issue:

(a) certifying this action as a class proceeding, as against the Settling Defendants only, for settlement purposes only, and conditional on:

(i) certification of the other actions in the Main Proceedings being certified as against the Settling Defendants only for the purposes of settlement;
(ii) the terms set out in paragraph 9.2 of the ITWAL Settlement Agreement and 10.2 of the Cadbury Settlement Agreement;

(b) defining the Ontario Settlement Class as set forth above;
(c) appointing David Osmun and Metro (Windsor) Enterprises Inc. as representative plaintiffs for the Ontario Settlement Class;
(d) stating that the class asserts claims for damages and other relief as a result of the alleged conspiracy and other unlawful conduct of the defendants in breach of the *Competition Act;*
(e) declaring the common issue as set forth above;
(f) providing that any person who wishes to opt out of this action must do so by sending a written election to opt-out to the Opt Out Administrator within sixty (60) days of the first publication of the Notice of Certification and Approval Hearings;

(g) further providing that any person who has validly opted-out of this action is not bound by the Settlement Agreements and shall no longer participate in or have the opportunity in the future to participate in the continuing action against the Non-Settling Defendants, including in any future settlements or judgments;

(h) appointing Howie & Partners Chartered Accountants LLP as the Opt Out Administrator;

(i) approving the short-form and long-form notices of certification and settlement approval hearings and the plan of dissemination; and

(j) providing for such further and incidental matters as may be required to give effect to these reasons.

52 If there are any additional or incidental matters that require discussion in the course of settling the order, or finalizing the notices, arrangements can be made for a case conference.

G.R. STRATHY J.

cp/e/qlafr/qljxr/qlhcs/qlhcs/qlsxs/qlaxw/qljyw

Case Name:

Osmun v. Cadbury Adams Canada Inc.

Between
David Osmun and Metro (Windsor) Enterprises Inc.,
Plaintiffs, and
Cadbury Adams Canada Inc., The Hershey Company, Hershey Canada Inc., Nestlé Canada, Inc., Mars, Incorporated, Mars Canada Inc. and ITWAL Limited, Defendants
PROCEEDINGS UNDER the Class Proceedings Act, 1992.

[2010] O.J. No. 1877

2010 ONSC 2643

Court File No. 08-CV-347263PD2

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: April 21, 2010
Judgment: May 5, 2010.

(70 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Motion by plaintiffs for approval of partial settlement allowed, subject to resolution of issues -- Plaintiffs in class alleged defendants conspired and fixed chocolate confectionary prices -- Proposed settlement had one chocolate manufacturer pay $5,700,000 and co-operate with plaintiffs; distributer assigned its claims to plaintiffs and co-operated -- Settlement fair and reasonable -- Settlement included Pierringer order barring non-settling defendants from seeking contribution from settling defendants -- While order not symmetrical, not prejudicial as it exposed non-settling defendants to liability for all damages only if no right of contribution found -- However, wording unclear, so counsel to resolve precise form of order.

Motion by the plaintiffs for approval of a partial settlement with two defendants. The action had been certified for the purposes of settlement and notice had been delivered to the class members and

no one had objected to the settlement or opted out. The plaintiffs alleged that the defendants, three chocolate manufacturers and a major distributor, had conspired to, and did, fix chocolate confectionary prices in Canada. Companion proceedings had been commenced across Canada. The plaintiffs had entered into separate settlements with one manufacturer and the distributor. The plaintiffs in additional proceedings had agreed to resolve their claims through the settlement and have their actions dismissed without costs. The chocolate manufacturer had agreed to pay $5,700,000 plus interest, co-operate with plaintiffs in their claims against the non-settling defendants and pay costs of notice in excess of $25,000. The distributor had agreed to assign any claims it had against non-settling defendants to the plaintiffs, to co-operate and to pay notice costs up to $25,000. In return, the settling defendants were to receive full releases. The proposed settlement also contained a Pierringer order preventing the non-settling defendants from seeking contribution from the settling defendants. The non-settling defendants objected to the proposed settlement on the basis of the Pierringer order, which they argued was not symmetrical.

HELD: Motion allowed, subject to resolution of issues. The settlement provided a direct financial benefit to the plaintiffs and a non-pecuniary benefit in the defendants' co-operation. The settlement was rational, given that the manufacturer was a major player, representing 50 per cent of profits and the distributor was essentially a co-operative with no substantial assets. The settlement was fair, reasonable and in the class members' best interests. The lack of symmetry complained of by the non-settling defendants was only problematic if it was prejudicial. The bar order provided that, if it was found that there was a right of contribution from the settling defendants, the plaintiffs would be limited to only damages that the non-settling defendants were proportionately liable for. However, if no right of contribution was found, the non-settling defendants could be exposed liability for all the damages. This was not prejudicial, since the non-settling defendants would have no right of indemnification in light of such a finding, regardless. The order did not immediately make the non-settling defendants liable; it simply left the determination of liability for another day. The order was not oppressive, as the non-settling defendants were also major players in the chocolate confection industry, and the settling defendants had receiving a substantial financial penalty in settling. However, the wording of the bar order was confusing and contained unclear phrases, such as "allocable to the conduct of". It would likely be more appropriate to use a standard bar order. Counsel was directed to resolve the precise form of the order and the settlement would be approved subject to this resolution.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, S.O. 1992, c. 6, s. 8.1(1)(b), s. 12

Negligence Act, R.S.O. 1990, c. N.1, s. 1

Counsel:

Harvey T. Strosberg Q.C. and *Charles M. Wright*, for the plaintiffs.

Scott Maidment and *Adrienne Boudreau*, for the defendants The Hershey Company and Hershey Canada Inc.

Christopher P. Naudie and *Jean-Marc LeClerc*, for the defendant Cadbury Adams Canada Inc.

Catherine Beagan Flood and *Iris Antonios*, for the defendant Nestle Canada Inc.

Don Houston and *Randy Hughes*, for the defendant ITWAL Limited.

Sandra Forbes and *Davit D. Akman*, for the defendants Mars Incorporated and Mars Canada Inc.

REASONS FOR DECISION - SETTLEMENT APPROVAL

1 **G.R. STRATHY J.**:-- This is a motion by the plaintiffs for approval of a partial settlement with two of the defendants, Cadbury Adams Canada Inc. ("Cadbury") and ITWAL Limited ("ITWAL"). For the reasons that follow, I approve the settlement.

2 On December 30, 2009, I certified this action against Cadbury and ITWAL, on consent, for the purposes of settlement: *Osmun v. Cadbury Adams Canada Inc.*, [2009] O.J. No. 5566.

3 Notice of the certification and of this approval hearing has been given to the class. The deadline for written objections to the settlement agreement was April 11, 2010. There have been no objections delivered. The deadline to submit written requests to opt out of the action was April 13, 2010. No class members have opted out. The settlement is opposed by the defendants The Hershey Company and Hershey Canada Inc. (together, "Hershey"), primarily on the basis of the terms of the bar order. Other concerns, detailed below, have been expressed by counsel for Mars Incorporated and Mars Canada Inc. (together, "Mars").

Background

4 The plaintiffs allege that the defendants conspired to fix, and did fix, maintain or stabilize prices of chocolate confectionary products in Canada, and that ITWAL engaged in price maintenance. The defendants, other than ITWAL, are manufacturers of chocolate confectionary products. ITWAL operates a retail and wholesale foodservice distribution network, and was a major purchaser and distributor of chocolate confectionary products during the relevant period.

5 Companion proceedings have been commenced across Canada. This action, together with the British Columbia action titled *Jacob Stuart Main v. Cadbury Schweppes plc, Cadbury Adams Canada Inc., Mars, Incorporated, Mars Canada Inc. formerly known as Effem Inc., The Hershey Company, Hershey Canada Inc., Nestlé S.A., Nestlé Canada Inc. and ITWAL Limited* (Vancouver

Registry) (Court File No. S078807) and the Quebec action titled *Gaetan Roy v. Cadbury Adams Canada Inc., Hershey Canada Inc., Mars Canada Inc., Nestlé Canada Inc.* (File No. 200-06-000094-071), will be referred to as the "Main Proceedings."

The Settlement Agreements

6 The plaintiffs in the Main Proceedings have entered into separate settlements with Cadbury, dated October 14, 2009 and with ITWAL, dated October 6, 2009 (the "Settlement Agreements"). Cadbury and ITWAL will be referred to as the "Settling Defendants" or "SDs." The Settlement Agreements are subject to court approval in Ontario, British Columbia and Quebec. Cadbury retained the right to terminate its settlement agreement if a pre-defined "opt out threshold" was exceeded. If the settlement is not approved, or is terminated by one of the SDs, the action will proceed as a contested proceeding and the SDs will be entitled to contest certification. If the Settlement Agreements are approved, the Main Proceedings will continue against the remaining defendants (referred to as the "Non-Settling Defendants" or "NSDs").

7 Other proceedings have been commenced in Canada regarding alleged price-fixing in the chocolate confectionary industry (the "Additional Proceedings"). The plaintiffs in the Additional Proceedings have agreed to resolve their claims as part of the Settlement Agreements. The plaintiffs in the Additional Proceedings have agreed that, upon the Settlement Agreements becoming effective, the Additional Proceedings will be dismissed without costs and with prejudice against the SDs and other Releasees.

8 The Settlement Agreements are detailed and complex. Among other things, under the Cadbury settlement agreement:

a. Cadbury agreed to pay CDN $5,700,000 to the class. On November 5, 2009, Cadbury paid $5,795,695.60, being the settlement amount, plus pre-deposit interest at a rate of 2.5% per annum from February 5, 2009. Class counsel deposited these monies in an interest-bearing trust account. As of April 12, 2010, after payment of the costs of distributing the notice, the balance in the trust account was $5,655,431.33.

b. Cadbury is required to cooperate with the plaintiffs to aid them in pursuing their claims against the non-settling defendants. Cadbury is required to:

i. provide an evidentiary proffer;

ii. produce relevant documents, including transactional data and price announcements; and

iii. make available current and (if reasonably necessary) former directors, officers or employees of Cadbury for interviews with counsel in the Main Proceedings and/or experts retained by them, to provide testimony at trial, and/or affidavit evidence.

c. Cadbury will pay for the cost of the notice program in excess of $250,000. Counsel estimate that Cadbury will be required to pay at least $16,000 towards the cost of notice.
d. Cadbury has the right to terminate the Cadbury Settlement Agreement should opt outs exceed a certain threshold. As noted, there have been no opt outs.

9 The ITWAL settlement agreement provides:

a. ITWAL will assign to or for the benefit of the settlement class any claim it has against the NSDs in relation to the purchase, sale, pricing, discounting, marketing, or distribution of chocolate products (as defined). On the basis of this assignment, the plaintiffs will claim damages against the NSDs based on the sale of all chocolate products in Canada including those sold to and through ITWAL.
b. ITWAL will cooperate with the plaintiffs in pursuing the claims against the NSDs; and,

i. ITWAL will produce copies of relevant "Take Action Now" notices, transactional data, and other relevant documents that are reasonably necessary for the prosecution of the Main Proceedings;
ii. Glenn Stevens, the President and Chief Executive Officer of ITWAL will make himself available for an interview with counsel in the Main Proceedings and/or experts retained by them; and
iii. If reasonably necessary, ITWAL will make current directors, officers or employees of ITWAL available for testimony at trial and/or to provide affidavit evidence.

c. ITWAL will pay the costs of notice up to $25,000.

10 Upon the Settlement Agreements becoming effective, the Main Proceedings will be dismissed against Cadbury and ITWAL, without costs and with prejudice. Cadbury and ITWAL will receive full and final releases from the settlement class. If approved, these releases will form part of the final settlement approval orders.

The bar order - *Pierringer* orders

11 The Settlement Agreements also contain a "bar order," an ingredient that is common in partial settlements of tort actions in both class actions and ordinary actions. A settling defendant in such an

action would not want to settle with the plaintiff, while leaving itself exposed to claims for contribution and indemnity from its co-defendants. A defendant opposing the partial settlement could effectively act as a spoiler of the settlement by maintaining a claim for contribution and indemnity from the settling defendant. In order to promote the settlement of complex multi-party litigation, a device was necessary to permit the plaintiff to settle with one or more defendants who want to settle, while maintaining the action against one or more defendants who do not want to settle. The device that has been crafted, and approved by the courts, is referred to as a "*Pierringer* agreement."[1] Under such an agreement, the settling defendants agree to pay the plaintiff to pay a sum that is a compromise of their proportionate share of the plaintiff's claim. The court grants an order barring the non-settling defendants from seeking contribution and indemnity from the settling defendants. In return for this, the plaintiff is permitted to continue the action against the non-settling defendants, but only for the proportion of the damage for which they are directly responsible.

12 The authority to make an order giving effect to a *Pierringer* agreement, referred to as a "bar order," arises from s. 12 of the *C.P.A.*, which provides that "[T]he court, on the motion of a party or class member, may make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate." As well, s. 13 provides that "[T]he court, on its own initiative or on the motion of a party or class member, may stay any proceeding related to the class proceeding before it, on such terms as it considers appropriate": see *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130, [1999] O.J. No. 2245 (S.C.J.) at paras. 40, 41, 75, 76. It is well-settled that the bar order cannot interfere with the substantive rights of the non-settling defendants: *Amoco Canada Petroleum Co. v. Propak Systems Ltd.*, above.

13 *Pierringer* agreements have been frequently approved by Canadian courts in class proceedings and individual actions: *Manitoba (Securities Commission) v. Crocus Investment Fund*, 2006 MBQB 276, 28 B.L.R. (4th) 228 (Q.B.) at paras. 29-30; *Amoco Canada Petroleum Co. v. Propak Systems Ltd.*, 2001 ABCA 110, 200 D.L.R. (4th) 667 at 673-675; *M.(J.) v. B.(W.)* (2004), 71 O.R. (3d) 171, [2004] O.J. No. 2312 (C.A.) at para. 31; *Hudson Bay Mining and Smelting Co.* v. *Fluor Daniel Wright* (1997), 12 C.P.C. (4th) 94, 120 Man. R. (2d) 214 (Q.B.) at para. 26.

14 There are a number of cases, including price-fixing cases, in which bar orders have been approved by this court: *Gariepy v. Shell Oil Co.* (2002), 26 C.P.C. (5th) 358, [2002] O.J. No. 4022 (S.C.J.); *Furlan v. Shell Oil Co.*, 2002 BCSC 1577, 25 C.P.C. (5th) 363; *Toronto Transit Commission v. Morganite Canada Co. (c.o.b. National Electrical Carbon Canada)* (2007), 47 C.P.C. (6th) 179, [2007] O.J. No. 448 (S.C.J.) at paras. 26, 36; *Randall Klein Inc. v. Nan Ya Plastics Corp. et al* (14 June 2005), London 41309CP, (Ont. S.C.J.)

15 In the partial settlement of a typical class action involving the negligence of several defendants, the following form of bar order has been used, to limit the plaintiff's claim against the non-settling defendants to their several liability:

The Plaintiffs shall not make joint and several claims against the Non-Settling Defendants but shall restrict their claims to several claims against each of the Non-Settling Defendants such that the Plaintiffs shall be entitled to receive only those damages proven to have been caused by each of the Non-Settling Defendants.

See: *Gariepy v. Shell Oil Co.*, above, at para. 19; *Ontario New Home Warranty Program v. Chevron Chemical Co.*, above, at para. 36.

16 In this case, the proposed form of bar order in Ontario and British Columbia, as set out in the Cadbury settlement agreement, is in the following terms:

(1) The Main Plaintiffs in the Ontario Proceeding and the BC Proceeding shall seek a bar order from the Ontario and BC Courts providing for the following:

(a) all claims for contribution, indemnity or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims (including, without limitation, the ITWAL Claims held and released by the Settlement Class as Released Claims), which were or could have been brought in the Main Proceedings or otherwise, by any Non-Settling Defendant or any other Person or party, against a Releasee, or by a Releasee against a Non-Settling Defendant, are barred, prohibited and enjoined in accordance with the terms of this section (unless such claim is made in respect of a claim by an Opt Out);

(b) a Non-Settling Defendant may, upon motion on at least ten (l0) days notice to counsel for the Settling Defendants, and not to be brought unless and until the action against the Non-Settling Defendants has been certified and all appeals or times to appeal have been exhausted, seek an order from one or more of the Ontario and BC Courts for the following:

(A) documentary discovery and an affidavit of documents in accordance with the relevant rules of civil procedure from Cadbury Adams Canada;

(B) oral discovery of a representative of Cadbury Adams Canada, the transcript of which may be read in at trial;

(C) leave to serve a request to admit on Cadbury Adams Canada in respect of factual matters; and/or

(D) the production of a representative of Cadbury Adams Canada to testify at trial, with such witness to be subject to cross-examination by counsel for the Non-Settling Defendants.

Cadbury Adams Canada retains all rights to oppose such motion(s).

(c) To the extent that that an order is granted pursuant to section 8.1(1)(b) and discovery is provided to a Non-Settling Defendant, a copy of all discovery provided, whether oral or documentary in nature, shall timely be provided by Cadbury Adams Canada to the Main Plaintiffs and Class Counsel; and

(d) a Non-Settling Defendant may effect service of the motion(s) referred to in section 8.1(1)(b) on Cadbury Adams Canada by service on counsel of record for Cadbury Adams Canada in the Main Proceedings.

(2) If the Courts ultimately determine there is a right of contribution and indemnity between co-conspirators, the Main Plaintiffs in the Ontario Proceeding and the BC Proceeding and the Settlement Class Members in the Ontario Proceeding and the BC Proceeding shall restrict their joint and several claims against the Non-Settling Defendants such that the Main Plaintiffs in the Ontario Proceeding and the BC Proceeding and the Settlement Class Members in the Ontario Proceeding and the BC Proceeding shall be entitled to claim and recover from the Non-Settling Defendants on a joint and several basis, only those damages, if any, arising from and allocable to the conduct of and/or sales by the Non-Settling Defendants. [emphasis added]

17 The terms of the proposed ITWAL bar order are substantially the same.

18 The reason for the underlined language, which is contentious, is that the law in Canada is uncertain about whether there is a right to contribution and indemnity between intentional tortfeasors, particularly where their conduct is alleged to be a criminal conspiracy: see *Blackwater v. Plint*, 2005 SCC 58, [2005] 3 S.C.R. 3 at para. 67.

19 For this reason, the plaintiffs in this case, like plaintiffs in other price-fixing cases, want to preserve their right to pursue the NSDs based on their joint liability for the plaintiffs damages, should it be determined that there is no right to contribution and indemnity between criminal co-conspirators. This is why para. 2 of the proposed bar order provides that "If the Courts ultimately determine there is a right of contribution and indemnity between co-conspirators ..." the plaintiffs will only be able to claim damages "arising from and allocable to the conduct of and/or sales" of the NSDs.

20 I will return to the subject of the proposed bar order later in these reasons.

The Position of the Defendants

Hershey's Position

21 Hershey objects to the settlement because it says that the terms of the bar order permit the plaintiffs to sue the NSDs for the profits wrongfully earned by the SDs while at the same time

depriving the NSDs of their substantive right to seek apportionment, contribution and indemnity from those parties. It says that, unlike the typical "symmetrical" bar order in a *Pierringer* settlement, which releases the SDs but limits the plaintiff's claim against the NSDs to their own proportionate share of liability, the proposed settlement in this case is "asymmetrical". Hershey says that the settlement should not be approved because it deprives the NSDs of their substantive rights, allows Cadbury to retain unlawful profits while transferring liability for them to the NSDs, and it is generally unfair to them because it treats them differently from the SDs. I will discuss this objection in more detail below.

Mars' Position

22 Mars raises several issues with respect to the settlement. I will identify them here and will also set out the disposition of these issues, which is largely the result of agreement between counsel.

(1) The ITWAL Assignment

23 Mars raises questions about the validity of the assignment of ITWAL's claims to the plaintiffs. These questions include whether the assignment is champertous and whether there is any right to assign a claim that is associated with the assignor's own illegal behaviour: *Frederickson v. Insurance Corporation of British Columbia* (1985), 64 B.C.L.R. 301, 1986 CarswellBC 131, at paras. 26 and 36-37 (C.A.), aff'd [1988] 1 S.C.R. 1089, 1988 CarswellBC 697; *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452, [1983] S.C.J. No. 33 at pp. 473, 475-479. Plaintiffs' counsel acknowledges that there may be some defences to the assignment and to ITWAL's underlying claims. The parties agree that these issues do not have to be resolved at this time. The NSDs are at liberty to raise these and other issues relating to the ITWAL assignment at any time in the future. I leave it to counsel to agree on and propose the terms of the order to give effect to this acknowledgment.

(2) The fate of the Additional Proceedings and other actions

24 Ms. Forbes on behalf of Mars expressed the concern that the proposed settlement approval orders contemplate that the Additional Proceedings will be dismissed against the SDs but will continue against the NSDs, without the benefit of a bar order, causing potential unfairness to the NSDs. She also notes that the Settlement Agreements provide that any person who falls within the settlement class, and has commenced another action, but has not opted out of the Main Proceedings, is deemed to have agreed to the dismissal of that other action as against the SDs. Mars submits that by not opting out, the class members are required to pursue any claims they have against the NSDs in the Main Proceedings and not through other actions and there should be an order to this effect.

25 I was advised that counsel are continuing to discuss the resolution of these issues. I will therefore defer consideration pending counsel either proposing a solution or reaching an impasse.

(3) Cadbury Holdings Limited

26 Cadbury Holdings Limited ("Cadbury Holdings") is not a defendant in this action or in the Quebec action, but it is a defendant in the British Columbia action. For this reason, it is a signatory to the Cadbury settlement agreement. Mars submits that both Cadbury and Cadbury Holdings should be identified as an SD in the settlement approval order and the NSDs should have the right to bring a motion for discovery of both Cadbury entities. Counsel for Cadbury acknowledges that such an order is appropriate. I agree.

(4) The Bar Order

27 Ms. Forbes made other submissions with respect to the bar order, the details of which I will discuss below.

The Plaintiffs' Response

28 Mr. Strosberg on behalf of the plaintiffs points to the enormous value of obtaining the cooperation of a "whistleblower" in conspiracy class actions. Leniency is part of the Competition Bureau's official policy (see Canadian Competition Bureau's Immunity Program under the *Competition Act* found online at http://competitionbureau.gc.ca/eic/site/cb-bc.nsf /eng/ 02480. html). There is nothing wrong in the civil context, he submits, with giving the party who breaks the "icejam" a better deal on settlement than the other defendants who want to defend the case to the hilt. This is particularly the case when the "icebreaker" cooperates with the plaintiff as Cadbury and ITWAL have promised to do here. I accept this general proposition.

29 Mr. Strosberg also submits that the simple answer to Hershey's objections concerning the bar order is that its claim for contribution and indemnity is statute barred because it has not been asserted and the limitation period has expired. I do not accept this submission. First, in order to come to this determination it would be necessary to make factual inquiries and there is no record before me that would permit me to do so. Second, there are limitation periods in other jurisdictions that appear to be unexpired.

30 The balance of Mr. Strosberg's submissions have to do with the approval of the settlement and the bar order.

The Test for settlement approval

31 The plaintiffs refer to *Nunes v. Air Transat A.T. Inc.,* [2005] O.J. No. 2527, 20 C.P.C. (6th) 93 (S.C.J.) at para. 7, in which Cullity J. set out a useful summary of the principles to be applied on a motion for settlement approval:

(a) to approve a settlement, the court must find that it is fair, reasonable, and in the best interests of the class;
(b) the resolution of complex litigation through the compromise of claims is encouraged by the courts and favoured by public policy;

(c) there is a strong initial presumption of fairness when a proposed settlement, which was negotiated at arm's-length by counsel for the class, is presented for court approval;
(d) to reject the terms of a settlement and require the litigation to continue, a court must conclude that the settlement does not fall within a zone of reasonableness;
(e) a court must be assured that the settlement secures appropriate consideration for the class in return for the surrender of litigation rights against the defendants. However, the court must balance the need to scrutinize the settlement against the recognition that there may be a number of possible outcomes within a zone or range of reasonableness. All settlements are the product of compromise and a process of give and take. Settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when considered in light of the risks and obligations associated with continued litigation;
(f) it is not the court's function to substitute its judgment for that of the parties or to attempt to renegotiate a proposed settlement. Nor is it the court's function to litigate the merits of the action or simply rubber-stamp a proposed settlement; and
(g) the burden of satisfying the court that a settlement should be approved is on the party seeking approval.

32 In addition, the plaintiffs refer to the often-cited decisions of Sharpe J., as he then was, in *Dabbs* v. *Sun Life, Assurance Company of Canada*, [1998] O.J. No. 1598 (Gen. Div.) at para. 13; and (1998), 40 O.R. (3d) 429, [1998] O.J. No. 2811 (Gen. Div.) at pp. 439-444; aff'd (1998), 41 O.R. (3d) 97, 165 D.L.R. (4th) 482 (C.A.); leave to appeal to denied [1998] S.C.C.A. No. 372. In the first of the above judgments, Sharpe J. set out a list of factors that are useful in assessing the reasonableness of a proposed settlement. The factors are as follows:

(a) the presence of arm's-length bargaining and the absence of collusion;
(b) the proposed settlement terms and conditions;
(c) the number of objectors and nature of objections;
(d) the amount and nature of discovery, evidence or investigation;
(e) the likelihood of recovery or likelihood of success;
(f) the recommendations and experience of counsel;
(g) the future expense and likely duration of litigation;
(h) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiations;
(i) the recommendation of neutral parties, if any; and
(j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

33 It is worth noting, as Sharpe J. himself did, that these factors must not be applied in a mechanical way. They are no more than a guide to the process. It is not necessary for all factors to be present, nor is it necessary that the factors be given equal weight. Some factors may be given greater significance, while others might be disregarded, depending on the circumstances of the case.

34 The court cannot modify the terms of a proposed settlement. The court can only approve or reject the settlement. In deciding whether to reject a settlement, the court should consider whether doing so could de-rail the settlement negotiations. There is no obligation on parties to resume discussions and it may be that the parties have reached their limits in negotiations and will backtrack from their positions or abandon the effort. This result would be contrary to the widely-held view that the resolution of complex litigation through settlement is encouraged by the courts and favoured by public policy: *Semple* v. *Canada (Attorney General)*, 2006 MBQB 285, 40 C.P.C. (6th) 314 at para. 26; *Ontario New Home Warranty Program v. Chevron Chemical Co.*, at paras. 69, 70.

35 I will examine below what I regard as the most important factors supporting approval of the settlement in this case.

The settlement terms and conditions are favourable to the class

36 I have set out above the key terms of the settlement. In this case, the court is dealing with a partial settlement that resolves the plaintiffs' claims against two of the defendants but leaves three remaining defendants in the action. There are direct financial benefits from the settlement, in that there will be a significant monetary recovery for the class. In addition, securing the cooperation of Cadbury and ITWAL is an important and immeasurable non-pecuniary benefit. This would be significant in any case, but in a conspiracy action, where the allegation is that the defendants share a dark secret, obtaining the cooperation of two of the alleged conspirators to assist the plaintiff in pursuing the alleged co-conspirators is of inestimable value. Cooperation of non-settling defendants has been considered to be an important factor in other cases: *Crosslink Technology, Inc. v. BASF Canada et al*, (November 30, 2007), London, 50305CP (Ont. S.C.J.) at p. 8, paras. 22, 23 (unreported); *Nutech Brands Inc. et al. v. Air Canada et al.*, [2009] O.J. No. 709 (19 February 2009), London, 50389CP (S.C.J.) at paras. 29-30, 36-37.

37 Tactically, the settlement is beneficial to the Class, because it reduces the size of the opposition, simplifies the litigation, and drives a potential wedge between the alleged conspirators.

38 There is a rational and justifiable basis for the *quantum* of the plaintiffs' settlement with Cadbury. It represents approximately 50% of the profits flowing to Cadbury as a result of an average 5.2% increase in its prices on October 31, 2005 and continuing until September, 2007. It represents a reasonable compromise of the plaintiffs' financial claim to reflect litigation risks, other factors contributing to the price increase and the benefit of Cadbury's cooperation in the ongoing action.

39 ITWAL is a corporation, but it is essentially a cooperative. Its members hold shares in the corporation and any profits are paid out annually. Counsel agree that ITWAL does not have significant assets. It is unlikely that a large judgment against it could be satisfied.

40 The assignment of ITWAL's claims represents a significant potential value to the settlement class. It is an integral part of the ITWAL settlement agreement. Moreover, the Cadbury settlement agreement is subject to express conditions that require the completion of this assignment under the ITWAL settlement agreement prior to the effective date of the Cadbury settlement. Since ITWAL was a major purchaser of chocolate products during the relevant period, Cadbury required a release of ITWAL's claims as a part of the settlement.

41 While ITWAL's financial contribution to the settlement is very modest, the benefit of its cooperation is important.

The settlement is the result of a real negotiating process

42 I am satisfied that the settlement in this case was the process of a real and extensive bargaining process between parties represented by experienced counsel and that the settlement achieved is a real one.

The partial settlement reduces risk of loss and increases prospects of success

43 Litigation is all about risks. Every party wants to reduce its downside and increase its upside. This partial settlement gives the plaintiffs the best of both worlds. It compromises a difficult, and by no means certain, claim against the SDs in exchange for real money and increased prospects of success against the NSDs. It may well act as an incentive to some of the NSDs to settle the claim, either individually or as a group.

There has been no objection to the settlement

44 It is significant that there has not been a single objection or opt-out. No class member opposes the settlement. There has been extensive advertising of the settlement and members of the class include large and sophisticated corporations.

The settlement comes with the recommendations of experienced class counsel

45 When class counsel presents a negotiated settlement to the court for approval, it is almost invariable that it will bear counsel's seal of approval. One might ask, therefore, why the recommendation of class counsel should be a factor. The answer is threefold. First, counsel has a duty to the class as a whole and not just to the representative plaintiffs. Counsel has to keep this responsibility in mind in recommending a settlement. Second, having been appointed by the court, counsel owes a duty to the court, including a duty to identify any limitations of the settlement. That duty has been fulfilled in this case. Third, counsel is uniquely situated to assess the risks and

benefits of the litigation and the advantages of any settlement. In the case of a partial settlement, counsel is best situated to make the kind of judgment call involved in assessing the benefits obtained in exchange for releasing a party from the litigation. Class counsel in this case have extensive experience in class proceedings, including considerable experience in price-fixing cases. Their recommendation carries considerable weight.

46 I am entirely satisfied that from the perspective of the settlement class, the settlement is fair, reasonable and in their best interests. The remaining question, however, is whether the proposed bar order is fair to the NSDs. It will not be fair if it affects their substantive rights.

Is the bar order unfair to the NSDs?

47 There is precedent for a bar order of the kind proposed here in a price-fixing conspiracy case. A similar order was granted by Rady J. in *Irving Paper Limited et al v. Autofina Chemicals Inc. et al*, (September 24, 2008), London, 47026 (S.C.J.). The order was the result of a partial settlement. It appears that in that case the NSDs took no position with respect to the form of order.

48 Rady J. also made a similar form of order in *Crosslink Technology, Inc*. v. *BASF Canada,* (November 30, 2007), File 50305CP (S.C.J.). In that case, the NSDs opposed the proposed order, arguing that it was unfair that the plaintiff did not agree absolutely to limit its claims against the NSDs to their proportionate liability, and instead put the onus on the NSDs to obtain a court ruling that there was a right to contribution and indemnity. The NSDs also objected to the use of the term "allocable to the sales or conduct" of the NSDs, which is similar to the language used in the proposed bar order in this case. They contended that this language was an attempt to transfer to the NSDs responsibility for profits made from sales by the SDs, because the conduct of the NSDs in the alleged conspiracy contributed to those profits. The plaintiffs argued that there may well be no right of contribution between criminal co-conspirators engaged in anti-competitive behaviour. They said that in view of the uncertain state of Canadian law on the subject, the bar order should not compromise the plaintiff's claims against the NSDs any more than was necessary to fairly protect them. The proposed bar order left open the possibility that a court could ultimately determine that a right to contribution and indemnity existed, in which case the plaintiffs' claim would be limited to the NSDs' proportionate share. On the other hand, if there was no such right, the plaintiffs would be free to pursue the NSDs for the full extent of the damages caused by the conspiracy.

49 Rady J. concluded, at paras. 47 - 50, that the proposed bar order was appropriate:

> I begin by observing that the litigants agree that it is not settled in Canada whether a right to contribution and indemnity exists between co-conspirators in a price fixing case. It is not necessary for the court to make that determination at this junction.
>
> It seems to me that the proposed wording ... is appropriate in the circumstances

> of this case for several reasons. First, this is a case involving allegations of what may be criminal or quasi-criminal conduct as well as allegations of tortuous behaviour, including conspiracy and intentional interference with economic relations. The law respecting the rights of co-defendants to claim contribution and indemnity in a case such as this is not clear. As a result, it strikes me as inappropriate to craft a bar order based on an assumption that the right exists. The Non Settling Defendants are not prejudiced because their potential rights are not being limited or abrogated. They are simply held in abeyance pending further determination of the court.
>
> With respect to the inclusion of the reference to the conduct of the Non Settling Defendants, it seems to me that the frailty of that argument is that it presumes that the basis of allocating liability is based on share of sales. However, there are other methods for allocating liability, one based on profits, for example. The basis for allocating liability is an open question, and as with the entitlement to contribution and indemnity, remains to be determined by the court.
>
> As a result, I cannot give effect to the objections of the Non Settling Defendants. I am unable to conclude that their ability to fully and fairly defend their position is impaired by the proposed order.

50 I was also referred to an order made by Leitch R.S.J. in a partial settlement in *Nutech Brands Inc. v. Air Canada et al.* (Court File No. 50389CP) February 18, 2009. The order defined "Proportionate Liability" as follows:

> 'Proportionate Liability' means that proportion of any judgment that, had they not settled, a court or other arbiter would have apportioned to the Settling Defendants and Released Parties, whether pursuant to the *pro rata,* proportionate fault, *pro tanto,* or another method.

51 The order then provided, in paragraph 13:

> (a) Subject to paragraph (b) of this paragraph [which deals with claims in other jurisdictions and is not relevant] all claims for contribution and indemnity or other claims over, whether asserted or unasserted or asserted in a representative capacity, inclusive of interest, taxes and costs, relating to the Released Claims, which were or could have been brought in the Action by any Non-Settling Defendant or any other Person or Party against a Released Party, or by a Released Party against a Non-Settling defendant or any other Person or Party, are barred, prohibited and enjoined in accordance with the terms of this paragraph (unless such claim is made in respect of a claim by an Opt Out);

52 Paragraphs 14 and 15 of the order then provided:

> 14. THIS COURT ORDERS that if, in the absence of paragraph 13 hereof, the Non-Settling Defendants would have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Released Parties:
>
> (a) the Plaintiffs and the Settlement Class Members shall not claim or be entitled to recover from the Non-Settling Defendants that portion of any damages, costs or interest awarded in respect of any claim(s) on which judgment is entered that corresponds to the Proportionate Liability of the Released Parties proven at trial or otherwise;
>
> (b) for greater certainty, the Plaintiffs and the Settlement Class Members shall limit their claims against the Non-Settling Defendants to, and shall be entitled to recover from the Non-Settling Defendants, only those claims for damages, costs and interest attributable to the Non-Settling Defendants' several liability to the Plaintiffs and the Settlement Class Members, if any;
>
> (c) this Court shall have full authority to determine the Proportionate Liability at the trial or other disposition of this Action, whether or not the Released Parties remain in this action or appear at the trial or other disposition, and the Proportionate Liability shall be determined as if the Released Parties are parties to this Action for that purpose and any such finding by this Court in respect of the Proportionate Liability shall only apply in this Action and shall not be binding upon the Released Parties in any other proceedings.
>
> 15. THIS COURT ORDERS that if, in the absence of paragraph 13 hereof, the Non-Settling Defendants would not have the right to make claims for contribution and indemnity or other claims over, whether in equity or in law, by statute or otherwise, from or against the Released Parties, then nothing in this Order is intended to or shall limit, restrict or affect any arguments which the Non-Settling Defendants may make regarding the reduction of any judgment against them in the Action.

53 I have reproduced the terms of this order in detail because it appears to have been the product of negotiation between sophisticated parties, represented by very experienced counsel in class proceedings, some of whom are involved in this action. There is much to commend these terms and I shall return to them later in these reasons.

54 I have set out above the substance of Hershey's opposition to the bar order in this case. Hershey says that the order is unfair because there is no symmetry between what each party gives up. The NSDs lose the right to claim contribution and indemnity from the SDs, but in return the plaintiffs do not give up the right to claim from the NSDs the profits wrongfully earned by the SDs. Mr. Maidment submits that, under a proper *Pierringer* order, when the SDs are released from the action they take their liability with them and it cannot be transferred to the shoulders of the NSDs.

55 Mr. Maidment submits that, even if this form of order is permitted by the *C.P.A.*, it should not be granted because it does not promote behaviour modification. He argues that it permits the SDs to keep the fruits of their unlawful activity by entering into a speedy settlement with the plaintiffs and passing the burden of their conduct onto the shoulders of their competitors. He submits that, faced with the potential of massive joint and several liability, with no right of recourse against the SDs, there is enormous and unfair pressure on the NSDs to settle. A bit player, who has small market share, made small profits and whose participation in the acts in question was borderline, will be under enormous pressure to settle in the face of a potentially devastating award of 100% of the damages.

56 Mr. Maidment's submission is that the *C.P.A.* does not permit the form of bar order proposed in this case because it interferes with the substantive rights of the NSDs. He relies on *Lau v. Bayview Landmark Inc.* (2006), 34 C.P.C. (6th) 138, [2006] O.J. No. 600 (S.C.J.). That proposed class action arose from a failed real estate investment scheme. It was alleged that a real estate firm (the settling defendants) was jointly and severally liable with a law firm (the non-settling defendants) for breach of trust, breach of fiduciary duty and negligence for releasing investment funds to some of the co-defendants. The terms of the proposed settlement did not contain a bar order, barring claims against the non-settling defendants for their joint and several liability. The plaintiffs, who were propounding the settlement, took the position that a bar order was not required because the non-settling defendants had not made cross-claims against the settling defendants and, in the absence of such claims, there was no reason to limit the claims of the plaintiffs to the several liability of the non-settling defendants.

57 C.L. Campbell J. refused to approve the settlement in the form sought by the plaintiffs - i.e., without a bar order. He noted that the defendants might be liable as concurrent tortfeasors rather than joint tortfeasors, but in any event he concluded that the failure to include a bar order would prejudice the non-settling defendants' rights. With the settling defendants out of the action, the non-settling defendants would be deprived of the right to shift responsibility for the plaintiffs' loss to the settling defendants and to distinguish their conduct from the conduct of the settling defendants. They would be deprived of the ability to assert crossclaims in the future, which they might have deferred doing for tactical reasons. He concluded that the absence of a bar order would cause unfairness at paras. 18-21:

> I have concluded that the non-settling Defendants cannot procedurally or substantively be put back in the position that they would have been if there were no settlement, for the purposes of fully advancing their defence without any opportunities to amend pleadings and cross-claim, neither of which are before me or permitted in the agreement between the settling parties.
>
> I accept the general premise of settlement of actions in part where settlement in whole may not be possible. Partial settlement can well result in shortened, less

> expensive trials and may well be the precursor to a full settlement. In this situation, the settlement sought by the Plaintiffs would deprive the non-settling Defendants of substantive rights.
>
> The Court of Appeal for Ontario has recognized the principle of encouraging settlement in *M. (J.) v. B. (W.),* [2004] O.J. No. 2312. But in approving what has come to be known as a "Pierringer" agreement, the Court adopted the proposition that such partial settlements must achieve "the goal of the proportionate share agreement [being] to limit the liability of the non-settling party to its several liability." ..
>
> The Court of Appeal in *M. (J.)* confirmed that while apportionment of liability may be made at trial even thought there is an absent defendant through settlement, that process must not create an unfairness. In my view, the settlement here as proposed without a bar order would create an unfairness.

58 I respectfully agree with the conclusion of Campbell J. on the issues before him. I do not, however, consider that this case is authority for the proposition that it was lack of "symmetry" that made the settlement objectionable - it was the fact that the settlement prejudiced the NSDs' substantive rights. It left them jointly liable for all the plaintiffs' damages without the corresponding right of contribution from the SDs. In this case, if it is ultimately found that there is a right of contribution from the SDs, the plaintiffs' damages will be confined to the NSDs' proportionate share. If it is found that, because of the nature of their conduct, there is no right of contribution, the NSDs may be exposed to the plaintiffs' entire damages. In the latter instance, there is no prejudice to their substantive rights because it will have been determined that the NSDs have no right to contribution and indemnity and the plaintiffs have the right to sue whomsoever they choose.

59 Mr. Maidment submits that the decision of Rady J. in *Crosslink Technology, Inc.* v. *BASF Canada*, above, is wrong because the uncertainty in the state of the law should not be a reason for depriving the NSDs of their substantive rights. He refers to *Hunt. v. Carey*, [1990] 2 S.C.R. 959, [1990] S.C.J. No. 93 at para. 33 in support of the proposition that a party should not be "driven from the judgment seat" because of the uncertain state of the law or the novelty of the issue before the court. He says that the language of s. 1 of the *Negligence Act*, R.S.O. 1990, c. N.1, permitting apportionment, contribution and indemnity between defendants "in the degree in which they are respectively found to be at fault or negligent" means that there is a right to contribution in the case of intentional faults: *Bell Canada v. COPE (Sarnia)* (1980), 31 O.R. (2d) 571, [1980] O.J. No. 3882 (C.A.), affg. (1980), 11 C.C.L.T. 170, [1980] O.J. No. 69 (H.C.J.); *Bains* v. *Hofs* (1992), 76 B.C.L.R. (2d) 98, [1992] B.C.J. No. 2709, at para. 26 (S.C.); *Brown v. Cole* (1995), 43 C.P.C. (3d) 111, 14 B.C.L.R. (3d) 53 at para. 20 (C.A.); see also, *Rabideau v. Maddocks* (1992), 12 O.R. (3d) 83, [1992] O.J. No. 2850 (Gen. Div.).

60 It of some interest that the United States Supreme Court has held that there is no right to contribution between co-conspirators under U.S. antitrust legislation: *Texas Industries v. Radcliff Materials,* 451 U.S. 630, 646 (1981). I also note a decision of Senior Master Rodgers in *Standard International Corporation et. al. v. Morgan et al.*, [1967] 1 O.R. 328, [1967] O.J. No. 932 (H.C.J.) at para. 12, in which it was held, relying on *Hollebone v. Barnard,* [1954] O.R. 236, [1954] 2 D.L.R. 278, that the words "fault or negligence" in the *Negligence Act* were synonymous and simply mean "negligence" and that there is no right of contribution between co-conspirators.

61 The decision in *Hollebone v. Barnard,* was not followed by Linden J. in *Bell Canada v. Cope (Sarnia),* a decision that was affirmed by the Court of Appeal. That case was one of both trespass and negligence. The Court of Appeal adopted the conclusion of Linden J. that:

> Fault and negligence, as these words are used in the statute, are not the same thing. Fault certainly includes negligence, but it is much broader than that. Fault incorporates all intentional wrongdoing, as well as other types of substandard conduct. In this case, both intentional and negligent wrongdoing were satisfactorily proved.

62 In *Blackwater v. Plint,* above, the Supreme Court of Canada expressly left the issue open for another day, at para. 67:

> It remains an open question whether the term "fault" in the *Negligence Act* includes vicarious liability. Fault has been held not to include intentional torts and torts other than negligence: e.g., *Chernesky v. Armadale Publishers Ltd.*, [1974] 6 W.W.R. 162 (Sask C.A.); *Funnell v. C.P.R.*, [1964] 2 O.R. 325 (H.C.). Other cases hold the contrary: *Bell Canada v. Cope (Sarnia) Ltd.* (1980), 11 C.C.L.T. 170 (Ont. H.C.); *Gerling Global General Insurance Co. v. Siskind, Cromarty, Ivey & Dowler* (2004), 12 C.C.L.I. (4th) 278 (Ont. Sup. Ct. J.). However, it is not necessary to resolve this dispute. If vicarious liability amounts to "fault" under the *Negligence Act*, the trial judge's conclusion that Canada was 75% at fault would amount to a finding that fault could be apportioned, with the result that s. 1(2) would not apply to impose an equal allocation. On the other hand, if vicarious liability is not "fault" under the Act, then the Act does not apply. In this case, liability may be assigned at common law, with the same result.

63 Mr. Maidment has pointed to some interesting commentaries on the social and economic desirability of the fair apportionment of responsibility for conspiracies in restraint of trade and allowing contribution between co-conspirators: Robert P. Taylor, *"Contribution: Searching for Fairness in a Procedural Thicket*" (1980) 49 Antitrust L. J. 1029 at 1031; Council of the Section of Antitrust Law, *"Report of the Section on Proposed Amendment of the Clayton Act to Permit Contribution in Damage Actions"* (1980) 49 Antitrust L. J. 291 at 293. As fascinating as these

issues are, the parties agree that I cannot and need not resolve them at this time.

64 Mr. Maidment submits, however, that the effect of postponing the determination of this issue is to make his clients "immediately and presumptively liable" for the overcharges of ITWAL and Cadbury. As he puts it in his factum:

> As a practical matter, the complete release of the SDs means that the SDs' liability is *immediately* and presumptively transferred to the NSDs. Moreover, the NSDs' substantive right to apportionment and contribution is *immediately* and presumptively abrogated and replaced by a vague proviso that has been specially formulated by the plaintiffs and has never been the subject of any proper judicial interpretation or application in any trial.

65 In my view, this overstates the effect of the proposed order. The order does not transfer liability, presumptively or otherwise. It simply leaves that determination for another day. While it may leave the NSDs in some uncertainty concerning their rights of indemnity, that uncertainty existed from the commencement of this litigation in view of the unsettled state of the law.

66 Finally, as I have noted, Mr. Maidment submits that if there is jurisdiction to make the order, it should not be granted because it does not promote behaviour modification and it is unfair to his clients because it puts them under extreme pressure to settle the case. On the former point, he says that permitting this type of settlement will give an incentive to the most culpable conspirator to settle the case and to shift its share of the responsibility to the less culpable. The court's approval of the settlement would create an environment in which the parties whose behaviour is most in need of modification are rewarded for their wrongdoing. On the latter point, he says that the settlement is not fair and reasonable when viewed from the perspective of the NSDs because it will place pressure on innocent defendants to settle the case to avoid a crushing liability - see Robert P. Taylor, *"Contribution: Searching for Fairness in a Procedural Thicket"*, above at 1033; Joseph Angland, *"Joint and Several Liability, Contribution, and Claim Reduction*" (2008) New Directions in Antitrust Law and Policy at 2372, 2380-2382.

67 Whatever the force that Mr. Maidment's submissions might have in another case, on the facts of this case they are not persuasive. First, I am satisfied that the settlement with Cadbury results in a substantial financial penalty that is rationally related to the benefits Cadbury received from the price increases at issue. That, coupled with the promise of cooperation and the publicity attached to the settlement, accomplishes the behaviour modification goals of class proceedings. This is not a case in which the defendant has paid a pittance for the release it has obtained. Second, the NSDs are very substantial manufacturers of chocolate products, nationally and internationally, with large shares in a market they obviously dominate. They are not "bit players" who are likely to be intimidated into an oppressive settlement.

68 I do have a concern with respect to the language of the proposed bar order that provides that if the courts determine that there is a right of contribution and indemnity the plaintiffs will be entitled

to recover from the NSDs "on a joint and several basis, only those damages, if any, arising from and allocable to the conduct of and/or sales by the Non-Settling Defendants." My concern arises for two reasons. First, I am not sure what "allocable to the conduct" means. Does it mean the same as "the degree in which they are respectively found to be at fault" as used in s. 1 of the *Negligence Act* and, if so, why not simply say so? Second, by referring to "allocable to the ... sales" of the NSDs, it appears to confuse measure of damages with degree of responsibility for damages. I think the problem arises, in part, because there is no clear agreement on the measure of the individual liability of a co-conspirator. It might be more appropriate, for example, to simply use the language of the standard bar order, such as "the damage proven to have been caused by the NSDs."

69 I mentioned earlier the terms of the bar order in *Nutech Brands Inc. v. Air Canada,* proposed by Ms. Forbes. It seems to me that an order in that form would remove some of the concerns I have expressed about the bar order currently proposed. As the issue was not fully canvassed on the hearing, I would suggest that counsel discuss the precise form of the order and attempt to resolve the question. I have set aside dates for a continuation of the hearing, and will hear further submissions on the issue at that time, if necessary. The parties may make written submissions prior to the hearing, if they wish to do so.

Conclusion

70 Subject to the resolution of the issues identified in these reasons, I am prepared to approve the Cadbury settlement and the ITWAL settlement. A case conference should be arranged, as soon as possible, to discuss the procedure for the resolution of any outstanding issues and to settle the terms of the order.

G.R. STRATHY J.

cp/e/qllxr/qljxr/qlcas

1 After *Pierringer v. Hoger,* 124 N.W. 2d 106 (Wis. S.C. 1963).

Indexed as:

Parsons v. Canadian Red Cross Society

PROCEEDING UNDER the Class Proceedings Act, 1992
Between
Dianna Louise Parsons, Michael Herbert Cruickshanks, David Tull, Martin Henry Griffen, Anna Kardish, Elsie Kotyk, Executrix of the Estate of Harry Kotyk, deceased and Elsie Kotyk, personally, plaintiffs, and
The Canadian Red Cross Society, Her Majesty the Queen in Right of Ontario and the Attorney General of Canada, defendants
And between
James Kreppner, Barry Isaac, Norman Landry, as Executor of the Estate of the late Serge Landry, Peter Felsing, Donald Milligan, Allan Gruhlke, Jim Love and Pauline Fournier, as Executrix of the Estate of the late Pierre Fournier, plaintiffs, and
The Canadian Red Cross Society, the Attorney General of Canada and Her Majesty the Queen in Right of Ontario, defendants

[**1999] O.J. No. 3572**

103 O.T.C. 161

40 C.P.C. (4th) 151

91 A.C.W.S. (3d) 351

1999 CarswellOnt 2932

Court File Nos. 98-CV-141369 and 98-CV-146405

Ontario Superior Court of Justice

Winkler J.

Heard: August 19-21, 1999.
Judgment: September 22, 1999.

(133 paras.)

Practice -- Class proceedings -- Settlements -- Court approval.

Motion by various parties for approval of a settlement in two companion class proceedings commenced under the Class Proceedings Act. One plaintiff class was persons who were infected with hepatitis C from blood transfusions between January 1, 1986 and July 1, 1990. The other plaintiff class was persons infected with hepatitis C from the taking of blood or blood products during the same time period. In both proceedings, there was also a family class consisting of family members of persons in the other main classes. The defendants in the two actions were the Canadian Red Cross Society, the Queen in Right of Ontario, and the Attorney General of Canada. The plaintiff classes were national in scope. As such, the other provincial and territorial governments except Quebec and British Columbia also moved to be included in the two actions as defendants, but only if the settlement was approved. The claims in these actions were founded on the decision by the CRCS and its government's overseers not to conduct testing of blood donations to the Canadian blood supply after a test for the hepatitis C virus became available and had been put into widespread use in the U.S. On this motion, the parties presented a comprehensive settlement package to the court. It consisted of a settlement agreement, a funding agreement, and plans for distribution of the settlement funds in the two actions. However, there were over 80 written objections to the settlement proposal from individuals afflicted with hepatitis C. The objections related to a number of issues, specifically, the adequacy of the total value of the settlement amount, the extent of compensation provided through the settlement, the sufficiency of the settlement fund to provide the proposed compensation, the reversion of any surplus, and the costs of administering the plans.

HELD: Motion dismissed. The settlement proposal was within the range of reasonableness having regard to the risks inherent in carrying the matter through to trial. The level of benefits ascribed within the settlement were acceptable having regard for the accessibility of the plan to successive claims in the event of a worsening of a class member's condition. This progressive approach outweighed any deficiencies which might have existed in the levels of benefits. However, there were two areas which required modification in order for the settlement to receive court approval. The first area related to access to the fund by opt-out claimants, specifically, the benefits provided from the fund for an opt-out claimant could not exceed those available to a similarly injured class member who remained in the class. The second area related to the surplus provisions of the settlement proposal.

Statutes, Regulations and Rules Cited:

Class Proceedings Act 1992, S.O. 1992, c. 6, ss. 5(2), 8(3), 29(2).

Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Counsel:

Harvey Strosberg, Q.C., Heather Rumble Peterson and Patricia Speight, for the plaintiffs.
Wendy Matheson and Jane Bailey, for the Canadian Red Cross Society.
Michèle Smith and R.F. Horak, for Her Majesty the Queen in Right of Ontario.
Ivan G. Whitehall, Q.C., Catherine Moore and J.C. Spencer, for the Attorney General of Canada.
Wilson McTavish, Q.C., Linda Waxman and Marian Jacko, for the Office of the Children's Lawyer.
Laurie Redden, for the Office of the Public Guardian and Trustee.
Beth Symes, for the Thalassemia Foundation of Canada, Friend of the Court.
William P. Dermody, for the Intervenors, Hubert Fullarton and Tracey Goegan.
L. Craig Brown, for the Hepatitis C Society of Canada, Friend of the Court.
Pierre R. Lavigne, for Dominique Honhon, Friend of the Court.
Bruce Lemer, for Anita Endean, Friend of the Court.
Elizabeth M. Stewart, for the Provinces and Territories other than British Columbia and Quebec.
Bonnie A. Tough and David Robins, for the plaintiffs.
Janice E. Blackburn and James P. Thomson, for the Canadian Hemophilia Society, Friend of the Court.

WINKLER J.:--

Nature of the Motion

1 This is a motion for approval of a settlement in two companion class proceedings commenced under the Class Proceedings Act 1992, S.O. 1992, c. 6, the "Transfused Action" and the "Hemophiliac Action", brought on behalf of persons infected by Hepatitis-C from the Canadian blood supply. The Transfused Action was certified as a class proceeding by order of this court on June 25, 1998, as later amended on May 11, 1999. On the latter date, an order was also issued certifying the Hemophiliac Action. There are concurrent class proceedings in respect of the same issues before the courts in Quebec and British Columbia. The Ontario proceedings apply to all persons in Canada who are within the class definition with the exception of any person who is included in the proceedings in Quebec and British Columbia. The motion before this court concerns a Pan-Canadian agreement intended to effect a national settlement, thus bringing to an end this aspect to the blood tragedy. Settlement approval motions similar to the instant proceeding have been contemporaneously heard by courts in Quebec and British Columbia with a view to bringing finality to the court proceedings across the country.

The Parties

2 The plaintiff class in the Transfused Action are persons who were infected with Hepatitis C

from blood transfusions between January 1, 1986 to July 1, 1990. The plaintiff class in the Hemophiliac Action are persons infected with Hepatitis C from the taking of blood or blood products during the same time period.

3 The defendants in the Ontario actions are the Canadian Red Cross Society ("CRCS"), Her Majesty the Queen in Right of Ontario, and the Attorney General of Canada. The Ontario classes are national in scope. Therefore, the other Provincial and Territorial Governments of Canada, with the exception of Quebec and British Columbia, have moved to be included in the Ontario actions as defendants but only if the settlement is approved.

4 The court has granted intervenor status to a number of individuals, organizations and public bodies, namely, Hubert Fullarton and Tracy Goegan, the Canadian Hemophilia Society, the Thalassemia Foundation of Canada, the Hepatitis C Society of Canada, the Office of the Children's Lawyer and the Office of the Public Guardian and Trustee of Ontario.

5 Pursuant to an order of this court, Pricewaterhouse Coopers received and presented to the court over 80 written objections to the settlement from individuals afflicted with Hepatitis-C. In addition, 11 of the objectors appeared at the hearing of the motion to proffer evidence as to their reasons for objecting to the settlement.

6 The approval of the settlement before the court is supported by class counsel and the Ontario and Federal Crown defendants. In addition to these parties, the Provincial and Territorial governments who seek to be included if the settlement is approved, and the intervenors, the Canadian Hemophilia Society, the Office of the Children's Lawyer and the Office of the Public Guardian and Trustee made submissions in support of approval of the settlement. The Canadian Red Cross Society ("CRCS") appeared, but did not participate, all actions against it having been stayed by order of Mr. Justice Blair dated July 28, 1999, pursuant to a proceeding under the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36. The other intervenors and individual objectors voiced concerns about the settlement and variously requested that the court either reject the settlement or vary some of its terms in the interest of fairness.

Background

7 Both actions were commenced as a result of the contamination of the Canadian blood supply with infectious viruses during the 1980s. The background facts are set out in the pleadings and the numerous affidavits forming the record on this motion. The following is a brief summary.

8 The national blood supply system in Canada was developed during World War II by the CRCS. Following WWII, the CRCS was asked to carry on with the operation of this national system, and did so as part of its voluntary activities without significant financial support from any government. As a result of its experience and stewardship of system, the CRCS had a virtual monopoly on the collection and distribution of blood and blood products in Canada.

9 Over time the demand for blood grew and Canada turned to a universal health care system. Because of these developments, the CRCS requested financial assistance from the provincial and territorial governments. The governments, in turn, demanded greater oversight over expenditures. This led to the formation of the Canadian Blood Committee which was composed of representatives of the federal, provincial and territorial governments. The CBC became operational in the summer of 1982. Other than this overseer committee, there was no direct governmental regulation of the blood supply in Canada.

10 The 1970s and 80s were characterized medically by a number of viral infection related problems stemming from contaminated blood supplies. These included hepatitis and AIDS. The defined classes in these two class actions, however, are circumscribed by the time period beginning January 1, 1986 and ending July 1, 1990. During the class periods, the CRCS was the sole supplier and distributor of whole blood and blood products in Canada. The viral infection at the center of these proceedings is now known as Hepatitis C.

11 Hepatitis is an inflammation of the liver that can be caused by various infectious agents, including contaminated blood and blood products. The inflammation consists of certain types of cells that infiltrate the tissue and produce by-products called cytokines or, alternatively, produce antibodies which damage liver cells and ultimately cause them to die.

12 One method of transmission of hepatitis is through blood transfusions. Indeed, it was common to contract hepatitis through blood transfusions. However, due to the limited knowledge of the effects of contracting hepatitis, the risk was considered acceptable in view of the alternative of no transfusion which would be, in many cases, death.

13 As knowledge of the disease evolved, it was discovered that there were different strains of hepatitis. The strains identified as Hepatitis A ("HAV") and Hepatitis B ("HBV") were known to the medical community for some time. HAV is spread through the oral-fecal route and is rarely fatal. HBV is blood-borne and may also be sexually transmitted. It can produce violent illness for a prolonged period in its acute phase and may result in death. However, most people infected with HBV eliminate the virus from their system, although they continue to produce antibodies for the rest of their lives.

14 During the late 1960s, an antigen associated with HBV was identified. This discovery led to the development of a test to identify donated blood contaminated with HBV. In 1972, the CRCS implemented this test to screen blood donations. It soon became apparent that post-transfusion hepatitis continued to occur, although much less frequently. In 1974, the existence of a third form of viral hepatitis, later referred to as Non-A Non-B Hepatitis ("NANBH") was postulated.

15 This third viral form of hepatitis became identified as Hepatitis C ("HCV") in 1988. Its particular features are as follows:

(a) transmission through the blood supply if HCV infected donors are unaware of

their infected condition and if there is no, or no effective, donor screening;

(b) an incubation period of 15 to 150 days;

(c) a long latency period during which a person infected may transmit the virus to others through blood and blood products, or sexually, or from mother to fetus; and

(d) no known cure.

16 The claims in these actions are founded on the decision by the CRCS, and its overseers the CBC, not to conduct testing of blood donations to the Canadian blood supply after a "surrogate" test for HCV became available and had been put into widespread use in the United States.

17 In a surrogate test a donor blood sample is tested for the presence of substances which are associated with the disease. The surrogate test is an indirect method of identifying in a blood sample the likelihood of an infection that cannot be identified directly because no specific test exists. During the class period, there were two surrogate tests capable of being used to identify the blood donors suspected of being infected with HCV, namely, a test to measure the ALT enzyme in a donor's blood and a test to detect the anti-HBc, a marker of HBV, in the blood.

18 The ALT enzyme test was useful because it highlights inflammation of the liver. There is an increased level of ALT enzymes in the blood when a liver is inflamed. The test is not specific for any one liver disease but rather indicates inflammation from any cause. Elevated ALT enzymes are a marker of liver dysfunction which is often associated with HCV.

19 The anti-HBc test detects exposure to HBV and is relevant to the detection of HCV because of the assumption that a person exposed to HBV is more likely than normal to have been exposed to HCV, since both viruses are blood-borne and because the populations with higher rates of seroprevalence were believed to be similar.

20 The surrogate tests were subjected to various studies in the United States. Among other aspects, the studies analyzed the efficacy of each test in preventing NANBH post-transfusion infection and the extent to which the rejection of blood donations would be increased. The early results of the studies did not persuade the agencies responsible for blood banks in the U.S. to implement surrogate testing as a matter of course. However, certain individuals, including Dr. Harvey Alter, a leading U.S. expert on HCV, began a campaign to have the U.S. blood agencies change their policies. In consequence, in April 1986 the largest U.S. blood agency decided that both surrogate tests should be implemented, and further, that the use of the tests would become a requirement of the agency's standard accreditation program in the future. This effectively made surrogate testing the national standard in the U.S. and by August 1, 1986, all or virtually all volunteer blood banks in the U.S. screened blood donors by using the ALT and anti-HBc tests.

21 This course was not followed in Canada. Although there was some debate amongst the doctors involved with the CRCS, surrogate testing was not adopted. Rather, in 1984 a meeting was held at the CRCS during which a multi-centre study was proposed. The purpose of the study was to

determine the incidence of NANBH in Canada. The CRCS blood centres proposed to take part in the study were those in Toronto, Montreal, Ottawa, Edmonton and Vancouver.

22 Prior to the 1984 meeting however, Dr. Victor Feinman of Mount Sinai Hospital had already begun a study to determine the incidence of NANBH in those who had received blood transfusions. This study had a significant limitation in that it did not measure the effectiveness of surrogate testing. Although the limitation was known to the CRCS, the medical directors agreed at their meeting on March 29-30, 1984 to review Dr. Feinman's research to determine whether the proposed CRCS multi-centre study was still required. Ultimately, the CRCS did not conduct the multi-centre study.

23 The CRCS was aware of the American decision to implement surrogate testing in 1986 but opted instead to await a full assessment of the results of the Dr. Feinman study and the impact of testing for the Human-Immunodeficiency Virus ("HIV") and "self-designation" as possible surrogates to screen for NANBH.

24 This decision was criticized by Dr. Alter. In an article published in the Medical Post in February 1988, Dr. Alter was quoted as stating that:

> "while the use of surrogate markers is far from ideal, the lack of any specific test to identify [NANBH], coupled with the serious chronic consequences of the disease, makes the need for these surrogate tests essential."

25 The CRCS never implemented surrogate testing. In late 1988, HCV was isolated. The Chiron Corporation developed a test for anti-HCV for use by blood banks. In March 1990, the CRCS blood centres began implementing the anti-HCV test, and by June 30, 1990, all centres had implemented the test. Hence the class definitions stipulated in the two certification orders before this court, covers the period between January 1, 1986 and July 1, 1990, which corresponds to the interval between the widespread use of surrogate testing in the U.S. and the universal adoption of the Chiron HCV test in Canada. The classes are described fully below.

The Claims

26 It is alleged by the plaintiffs in both actions that had the defendants taken steps to implement the surrogate testing, the incidence of HCV infection from contaminated blood would have been reduced by as much as 75% during the class period. Consequently, they bring the actions on behalf of classes described as the Ontario Transfused Class and the Ontario Hemophiliac Class. The plaintiffs assert claims based in negligence, breach of fiduciary duty and strict liability in tort as against all of the defendants.

The Classes

27 The Ontario Transfused Class is described as:

(a) all persons who received blood collected by the CRCS contaminated with HCV during the Class Period and who are or were infected for the first time with HCV and who are:

(i) presently or formerly resident in Ontario and receive blood in Ontario and who are or were infected with post-transfusion HCV;
(ii) resident in Ontario and received blood in any other Province or Territory of Canada other than Quebec and who are or were infected with post-transfusion HCV;
(iii) resident elsewhere in Canada and received blood in Canada, other than in the Provinces of British Columbia and Quebec, and who are or were infected with post-transfusion HCV;
(iv) resident outside Canada and received blood in any Province or Territory of Canada, other than in the Province of Quebec, and who are or were infected with post-transfusion HCV; and
(v) resident anywhere and received blood in Canada and who are or were infected with post-transfusion HCV and who are not included as class members in the British Columbia Transfused Class Action or the Quebec Transfused Class Action;

(b) the Spouse of a person referred to in subparagraph (a) who is or was infected with HCV by such person; and

(c) the child of a person referred to in subparagraph (a) or (b) who is or was infected with HCV by such person.

28 The Ontario Hemophiliac Class is described as:

(a) all persons who have or, had a congenital clotting factor defect or deficiency, including a defect or deficiency in Factors V, VII, VIII, IX, XI, XII, XIII or von Willebrand factor, and who received or took Blood (as defined in Section 1.01 of the Hemophiliac HCV Plan) during the Class Period and who are:

(i) presently or formerly a resident in Ontario and received or took Blood in Ontario and who are or were infected with HCV;
(ii) resident in Ontario and received or took Blood in any other Province or Territory of Canada other than Quebec and who are or were infected with HCV;
(iii) resident elsewhere in Canada and received or took Blood in Canada other than in the Provinces of British Columbia and Quebec and who are or were infected with HCV;

(iv) resident outside Canada and received or took Blood in any Province or Territory in Canada, other than in the Province of Quebec, and who are or were infected with HCV; and

(v) resident anywhere and received or took Blood in Canada and who are not included as class members in the British Columbia Hemophiliac Class Action or the Quebec Hemophiliac Class Action;

(b) the Spouse of a person referred to in subparagraph (a) who is or was infected with HCV by such person; and

(c) the child of a person referred to subparagraph (a) or (b) who is or was infected with HCV by such person.

29 In addition in each of the actions, there is a "Family" class described, in the Ontario Transfused Class, as follows:

(a) the Spouse, child, grandchild, parent, grandparent or sibling of an Ontario Transfused Class Member;
(b) the spouse of a child, grandchild, parent or grandparent of an Ontario Transfused Class Member;
(c) a former Spouse of an Ontario Transfused Class Member;
(d) a child or other lineal descendant of a grandchild of an Ontario Transfused Class Member;
(e) a person of the opposite sex to an Ontario Transfused Class Member who cohabitated for a period of at least one year with that Class Member immediately before his or her death;
(f) a person of the opposite sex to an Ontario Transfused Class Member who was cohabitating with that Class Member at the date of his or her death and to whom that Class Member was providing support or was under a legal obligation to provide support on the date of his or her death; and
(g) any other person to whom an Ontario Transfused Class Member was providing support for a period of at least three years immediately prior to his or her death.

There is a similarly described Family Class in the Hemophiliac Action.

The Proposed Settlement

30 The parties have presented a comprehensive package to the court. Not only does it pertain to these actions, but it is also intended to be a Pan-Canadian agreement to settle the simultaneous class proceedings before the courts in Quebec and British Columbia. The settlement will not become final and binding until it is approved by courts in all three provinces. It consists of a Settlement Agreement, a Funding Agreement and Plans for distribution of the settlement funds in the Transfused Action and the Hemophiliac Action.

31 The Settlement Agreement creates the following two Plans:

(1) the Transfused HCV Plan to compensate persons who are or were infected with HCV through a blood transfusion received in Canada in the Class Period, their secondarily-infected Spouses and children and their other family members; and
(2) the Hemophiliac HCV Plan to compensate hemophiliacs who received or took blood or blood products in Canada in the Class Period and who are or were infected with HCV, their secondarily-infected Spouses and children and their other family members.

32 To fund the Agreement, the federal, provincial and territorial governments have promised to pay the settlement amount of $1,118,000,000 plus interest accruing from April 1, 1998. This will total approximately $1,207,000,000 as of September 30, 1999.

33 The Funding Agreement contemplates the creation of a Trust Fund on the following basis:

(i) a payment by the Federal Government to the Trust Fund, on the date when the last judgment or order approving the settlement of the Class Actions becomes final, of 8/11ths of the settlement amount, being the sum of approximately $877,818,181, subject to adjustments plus interest accruing after September 30, 1999 to the date of payment; and
(ii) a promise by each Provincial and Territorial Government to pay a portion of its share of the 3/11ths of the unpaid balance of the settlement amount as may be requested from time to time until the outstanding unpaid balance of the settlement amount together with interest accruing has been paid in full.

34 The Governments have agreed that no income taxes will be payable on the income earned by the Trust, thereby adding, according to the calculations submitted to the court, a present value of about $357,000,000 to the settlement amount.

35 The Agreement provides that the following claims and expenses will be paid from the Trust Fund:

(a) persons who qualify in accordance with the provisions of the Transfused HCV Plan;
(b) persons who qualify in accordance with the provisions of the Hemophiliac HCV Plan;
(c) spouses and children secondarily-infected with HIV to a maximum of 240 who qualify pursuant to the Program established by the Governments (which is not subject to Court approval);
(d) final judgments or Court approved settlements payable by any FPT Government to a Class Member or Family Class Member who opts out of one of the Class Actions or is not bound by the provisions of the Agreement or a person who

claims over or brings a third-party claim in respect of the Class Member's receiving or taking of blood or blood products in Canada in the Class Period and his or her infection with HCV, plus one-third of Court-approved defence costs;

(e) subject to the Courts' approval, the costs of administering the Plans, including the costs of the persons hereafter enumerated to be appointed to perform various functions under the Agreement;

(f) subject to the Courts' approval, the costs of administering the HIV Program, which Program administration costs, in the aggregate, may not exceed $2,000,000; and

(g) subject to Court approval, fees, disbursements, costs, GST and other applicable taxes of Class Action Counsel.

Class Members Surviving as of January 1, 1999

36 Other than the payments to the HIV sufferers, which I will deal with in greater detail below, the plans contemplate that compensation to the class members who were alive as of January 1, 1999, will be paid according to the severity of the medical condition of each class member. All class members who qualify as HCV infected persons are entitled to a fixed payment as compensation for pain and suffering and loss of amenities of life based upon the stage of his or her medical condition at the time of qualification under the Plan. However, the class member will be subsequently entitled to additional compensation if and when his or her medical condition deteriorates to a medical condition described at a higher compensation level. This compensation ranges from a single payment of $10,000, for a person who has cleared the disease and only carries the HCV antibody, to payments totaling $225,000 for a person who has decompensation of the liver or a similar medical condition.

37 The compensation ranges are described in the Agreement as "Levels". In addition to the payments for loss of amenities, class members with conditions described as being at compensation Level 3 or a higher compensation Level (4 or above), and whose HCV caused loss of income or inability to perform his or her household duties, will be entitled to compensation for loss of income or loss of services in the home.

38 The levels, and attendant compensation, for class members are described as follows:

(i) Level 1

Qualification	Compensation
A blood test demonstrates that the HCV an-	A lump sum payment of $10,000 plus reimbursement

tibody is present in the blood of a class member.	of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(ii) Level 2

Qualification	Compensation
A polymerase chain reaction test (PCR) demonstrates that HCV is present in the blood of a class member.	Cumulative compensation of $30,000 which comprises the the $10,000 payment at level 1, plus a payment of $15,000 immediately and another $5000 when the court determines that the Fund is sufficient to do so, plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(iii) Level 3

Qualification	Compensation
If a class member develops non-bridging fibrosis, or receives compensable drug therapy (i.e. Interferon or Ribavirin), or meets a protocol for HCV compensable treatment regardless of whether the treatment is taken, then the class member qualifies for Level 3 benefits.	Option 1 - $60,000 comprised of the level 1 and 2 payments plus an additional $30,000 Option 2 - $30,000 from the Level 1 and 2 benefits, and if the additional $30,000 from Option 1 is waived, compensation for loss of income or loss of income or loss of services in the home, subject to a threshold qualification.

In addition, at this level, the class member is entitled to an additional $1000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reiumbursement for out-of-pocket expenses.

(iv) Level 4

Qualification	Compensation
If a class member develops bridging fibrosis, he or she qualifies as a Level 4 claimant	There is no further fixed payment beyond that of Level 3 at this level. In addition to those previously defined benefits, the claimant is entitled to compensation for loss of income or loss of services in the home, $1000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reiumbursement for out-of-pocket expenses.

(v) Level 5

Qualification	Compensation
A class member who develops (a) cirrhosis; (b) unresponsive porphyria cutanea tarda which is causing significant disfigurement and disability; (c) unresponsive thrombocytopenia (low platelets) which result in certain other conditions; or (d) glomerulonephritis not requiring dialysis, he or she qualifies as a Level 5 claimant.	$125,000 which consists of the prior $60,000, if the claimant elected Option 1 at Level 3, plus an additional $65,0000 plus the claimant is entitled to compensation for loss of income or loss of services in the home, $1,000 per month for each month of completed drug therapy, plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses.

(vi) Level 6

Qualification	Compensation
If a class member receives a liver transplant, or develops: (a) decompensation of the liver; (b) hepatocellular cancer; (c) B-cell lymphoma; (d) symptomatic mixed cryoglobullinemia; (e) glomerulonephritis requiring	$225,000 which consists of the $125,000 available at at the prior levels plus an additional $100,000 plus the claimant is entitled to compensation for loss of income or loss of services in the home, $1,000 per month for each month of completed drug therapy,

dialysis; or (f) renal failure, he or she qualifies as a Level 6 claimant.	plus reimbursement of uninsured treatment and medication costs and reimbursement for out-of-pocket expenses. The claimant is also entitled to reiumbursement for costs of care up to $50,000 per year.

39 There are some significant "holdbacks" of compensation at certain levels. As set out in the table above, a claimant who is entitled to the $20,000 compensation payment at level 2 will initially be paid $15,000 while $5,000 will be held back in the Fund. If satisfied that there is sufficient money in the Fund, the Courts may then declare that the holdback shall be removed in accordance with Section 10.01(1)(i) of the Agreement and Section 7.03 of the Plans. Claimants with monies held back will then receive the holdback amount with interest at the prime rate from the date they first became entitled to the payment at Level 2. In addition, any claimant that qualifies for income replacement at Level 4 or higher will be subjected to a holdback of 30% of the compensation amount. This holdback may be removed, and the compensation restored, on the same terms as the Level 2 payment holdback.

40 There is a further limitation with respect to income, namely, that the maximum amount subject to replacement has been set at $75,000 annually. Again this limitation is subject to the court's review. The court may increase the limit on income, after the holdbacks have been removed, and the held benefits restored, if the Fund contains sufficient assets to do so.

41 Payment of loss of income is made on a net basis after deductions for income tax that would have been payable on earned income and after deduction of all collateral benefits received by the Class Member. Loss of income payments cease upon a Class Member reaching age 65. A claim for the loss of services in the home may be made for the lifetime of the Class Member.

Class Members Dying Before January 1, 1999

42 If a Class Member who died before January 1, 1999, would have qualified as a HCV infected person but for the death, and if his or her death was caused by HCV, compensation will be paid on the following terms:

(a) the estate will be entitled to receive reimbursement for uninsured funeral expenses to a maximum of $5,000 and a fixed payment of $50,000, while approved family members will be entitled to compensation for loss of the deceased's guidance, care and companionship on the scale set out in the chart at paragraph 82 below and approved dependants may be entitled to compensation for their loss of support from the deceased or for the loss of the deceased's services in the home ("Option 1"); or

(b) at the joint election of the estate and the approved family members and dependants of the deceased, the estate will be entitled to reimbursement for uninsured funeral expenses to a maximum of $5,000, and the estate and the approved family members and dependants will be jointly entitled to

compensation of $120,000 in full settlement of all of their claims ("Option 2").

43 Under the Plans when a deceased HCV infected person's death is caused by HCV, the approved dependants may be entitled to claim for loss of support until such time as the deceased would have reached age 65 but for his death.

44 Payments for loss of support are made on a net basis after deduction of 30% for the personal living expenses of the deceased and after deduction of any pension benefits from CPP received by the dependants.

45 The same or similar holdbacks or limits will initially be imposed on the claim by dependants for loss of support under the Plans as are imposed on a loss of income claim. The $75,000 cap on pre-claim gross income will be applied in the calculation of support and only 70% of the annual loss of support will be paid. If the courts determine that the Trust Fund is sufficient and vary or remove the holdbacks or limits, the dependants will receive the holdbacks, or the portion the courts direct, with interest from the time when loss of support was calculated subject to the limit.

46 Failing agreement among the approved dependants on the allocation of loss of support between them, the Administrator will allocate loss of support based on the extent of support received by each of the dependants prior to the death of the HCV infected person.

Class Members Cross-Infected with HIV.

47 Notwithstanding any of the provisions of the Hemophiliac HCV Plan, a primarily infected hemophiliac who is also infected with HIV may elect to be paid $50,000 in full satisfaction of all of his or her claims and those of his or her family members and dependants.

48 Persons infected with HCV and secondarily-infected with HIV who qualify under a Plan (or, where the person is deceased, the estate and his or her approved family members and dependants) may not receive compensation under the Plan until entitlement exceeds the $240,000 entitlement under the Program after which they will be entitled to receive any compensation payable under the Plan in excess of $240,000.

49 Under the Hemophiliac HCV Plan, the estate, family members and dependants of a primarily-infected hemophiliac who was cross-infected with HIV and who died before January 1, 1999 may elect to receive a payment of $72,000 in full satisfaction of their claims.

The Family Class Claimants

50 Each approved family class member of a qualified HCV infected person whose death was caused by HCV is entitled to be paid the amount set out below for loss of the deceased's guidance, care and companionship:

Relationship	Compensation
Spouse	$25,000
Child under 21 at time of death of class member	$15,000
Child over 21 at time of death of class member	$5,000
Parent or sibling	$5,000
Grandparent or Grandchild	$500

51 If a loss of support claim is not payable in respect of the death of a HCV infected person whose death was caused by, his or her infection with HCV, but the approved dependants resided with that person at the time of the death, then these dependants are entitled to be compensated for the loss of any, services that the HCV infected person provided in the home at the rate of $12 per hour to a maximum of 20 hours per week.

52 The Agreement and/or the Plans also provide that:

(a) all compensation payments to claimants who live in Canada will be tax free;
(b) compensation payments will be indexed annually to protect against inflation;
(c) compensation payments other than payments for loss of income will not affect social benefits currently being received by claimants;
(d) life insurance payments received by or on behalf of claimants will not be taken into account for any purposes whatsoever under the Plans; and
(e) no subrogation payments will be paid directly or indirectly.

The Funding Calculations

53 Typically in settlements in personal injury cases, where payments are to be made on a periodic basis over an extended period of time, lump sum amounts are set aside to fund the extended liabilities. The amount set aside is based on a calculation which determines the "present value" of the liability. The present value is the amount needed immediately to produce payments in the agreed value over the agreed time. This calculation requires factoring in the effects of inflation, the return on the investment of the lump sum amount and any income or other taxes which might have to be paid on the award or the income it generates. Dealing with this issue in a single victim case may be relatively straightforward. Making an accurate determination in a class proceeding with a multitude of claimants suffering a broad range of damages is a complex matter.

54 Class counsel retained the actuarial firm of Eckler Partners Ltd. to calculate the present value of the liabilities for the benefits set out in the settlement. The calculations performed by Eckler were based on a natural history model of HCV constructed by the Canadian Association for the Study of the Liver ("CASL") at the request of the parties. As stated in the Eckler report at p. 3, "the results from the [CASL] study form the basis of our assumptions regarding the development of the various medical outcomes." However, the Eckler report also notes that in instances where the study was lacking in information, certain extensions to some of the probabilities were supplied by Dr. Murray Krahn who led the study. In certain other situations, additional or alternative assumptions were provided by class counsel.

55 The class in the Transfused Action is comprised of those persons who received blood transfusions during the class period and are either still surviving or have died from a HCV related cause. The CASL study indicates that the probable number of persons infected with HCV through blood transfusion in the class period, the "cohort" as it is referred to in the study, is 15,707 persons. The study also estimates the rates of survival of each infected person. From these estimates, Eckler projects that the cohort as of January 1, 1999 is 8,104 persons. Of those who have died in the intervening time, 76 are projected to be HCV related deaths and thus eligible for the death benefits under the settlement.

56 In the case of the Hemophiliac class, the added factor of cross-infection with HIV, and the provisions in the plan dealing with this factor, require some additional considerations. Eckler was asked to make the following assumptions based primarily on the evidence of Dr. Irwin Walker:

(a) the Hemophiliac cohort size is approximately 1645 persons
(b) 15 singularly infected and 340 co-infected members of this cohort have died prior to January 1, 1999; the 15 singularly infected and 15 of those co-infected will establish HCV as the cause of death and claim under the regular death provisions (but there is no $120,000 option in this plan); the remaining 325 co-infected will take the $72,000 option.
(c) a further 300 co-infected members are alive at January 1, 1999; of these, 80%, i.e. 240, will take the $50,000 option;
(d) 990 singularly infected hemophiliacs are alive at January 1, 1999

(e) the remaining 60 co-infected and the 990 singularly infected hemophiliacs will claim under the regular provisions and should be modeled in the same way as the transfused persons, i.e. apply the same age and sex profiles, and the same medical, mortality and other assumptions as for the transfused group, except that the 60 coinfected claimants will not have any losses in respect of income.

57 Because of the structure of this agreement, Eckler was not required to consider the impact of income or other taxes on the investment returns available from the Fund. With respect to the rate of growth of the Fund, Eckler states at p. 10 that:

> A precise present value calculation would require a formula incorporating the gross rate of interest and the rate of inflation as separate parameters. However, virtually the same result will flow from a simpler formula where the future payments are discounted at a net rate equal to the excess of the gross rate of interest over the assumed rate of inflation. Eckler calculates the annual rate of growth of the Fund will be 3.4% per year on this basis. This is referred to as the "net discount rate".

58 There is one other calculation that is worthy of particular note. In determining the requirements to fund the income replacement benefits set out in the settlement, Eckler used the average industrial aggregate earnings rate in Canada estimated for 1999. From this figure, income taxes and other ordinary deductions were made to arrive at a "pre-claim net income". Then an assumption is made that the class members claiming income compensation will have other earnings post-claim that will average 40% of the pre-claim amount. The 60% remaining loss, in dollars expressed as $14,500, multiplied by the number of expected claimants, is the amount for which funding is required. Eckler points out candidly at p. 20 that:

> [in regard to the assumed average of Post-claim Net Income] ... we should bring to your attention that without any real choice, the foregoing assumed level of 40% was still based to a large extent on anecdotal input and our intuitive judgement on this matter rather than on rigourous scientific studies which are simply not available at this time. There are other assumptions and estimates which will be dealt with in greater detail below.

59 The Eckler conclusion is that if the settlement benefits, including holdbacks, and the other liabilities were to be paid out of the Fund, there is a present value deficit of $58,533,000. Prior to the payment of holdbacks, the Fund would have a surplus of $34,173,000.

The Thalassemia Victims

60 Prior to analyzing the settlement, I turn to the concerns advanced by The Thalassemia Foundation of Canada. The organization raises the objection that the plan contains a fundamental unfairness as it relates to claims requirements for members of the class who suffer from

Thalassemia.

61 Thalassemia, also known as Mediterranean Anemia or Cooley's Anemia, is an inherited form of anemia in which affected individuals are unable to make normal hemoglobin, the oxygen carrying protein of the red blood cell. Mutations of the hemoglobin genes are inherited. Persons with a thalassemia mutation in one gene are known as carriers or are said to have thalassemia minor. The severe form of thalassemia, thalassemia major, occurs when a child inherits two mutated genes, one from each parent. Children born with thalassemia major usually develop the symptoms of severe anemia within the first year of life. Lacking the ability to produce normal adult hemoglobin, children with thalassemia major are chronically fatigued; they fail to thrive; sexual maturation is delayed and they do not grow normally. Prolonged anemia causes bone deformities and eventually will lead to death, usually by their fifth birthday.

62 The only treatment to combat thalassemia major is regular transfusions of red blood cells. Persons with thalassemia major receive 15 cubic centimeters of washed red blood cells per kilogram of weight every 21 to 42 days for their lifetime. That is, a thalassemia major person weighing 60 kilograms (132 pounds) may receive 900 cubic centimeters of washed red blood cells each and every transfusion. Such a transfusion corresponds to four units of blood. Persons with thalassemia major have not been treated with pooled blood. Therefore, in each transfusion a thalassemia major person would receive blood from four different donors and over the course of a year would receive 70 units of blood from potentially 70 different donors. Over the course of the Class Period, a class member with thalassemia major might have received 315 units of blood from potentially 315 different donors.

63 Over the past three decades, advances in scientific research have allowed persons with thalassemia major in Canada to live relatively normal lives. Life expectancy has been extended beyond the fourth decade of life, often with minimal physical symptoms. In Canada approximately 300 persons live with thalassemia major.

64 Of the 147 transfused dependent thalassemia major patients currently being treated in the Haemoglobinopathy Program at the Hospital for Sick Children and Toronto General Hospital, 48 have tested positive using HCV antibody tests. Fifty-one percent of the population at TGH have tested positive; only 14% of the population of HSC have tested positive. The youngest of these persons was born in 1988; 9 of them are 13 years of age or older but less than 18 years of age; the balance are adults. Nine thalassemia major patients in the Haemoglobinopathy Program have died since HCV testing was available in 1991. Seven of these persons were HCV positive. The Foundation estimates that there are approximately 100 thalassemia major patients across Canada who are HCV positive.

65 The unfairness pointed to by the Thalassemia Foundation is that class members suffering from thalassemia are included in the Transfused Class, and therefore must follow the procedures for that class in establishing entitlement. It is contended that this is fundamentally unfair to thalassemia

victims because of the number of potential donors from whom each would have received blood or blood products. It is said that by analogy to the hemophiliac class, and the lesser burden of proof placed on members of that class, a similar accommodation is justified. I agree.

66 This is a situation where it is appropriate to create a sub-class of thalassemia victims from the Transfused Class. Sub-classes are provided for in s. 5(2) of the CPA and the power to amend the certification order is contained in s. 8(3) of the Act. The settlement should be amended to apply the entitlement provisions in the Hemophiliac Plan mutatis mutandis to the Thalassemia sub-class.

Law and Analysis

67 Section 29(2) of the CPA provides that:

> A settlement of a class proceeding is not binding unless approved by the court.

68 While the approval of the court is required to effect a settlement, there is no explicit provision in the CPA dealing with criteria to be applied by the court on a motion for approval. The test to be applied was, however, stated by Sharpe J. in Dabbs v. Sun Life Assurance, [1998] O.J. No. 1598 (Gen. Div.) (Dabbs No. 1) at para. 9:

> ... the court must find that in all the circumstances the settlement is fair, reasonable and in the best interests of those affected by it.

69 In the context of a class proceeding, this requires the court to determine whether the settlement is fair, reasonable and in the best interests of the class as a whole, not whether it meets the demands of a particular member. As this court stated in Ontario New Home Warranty Program v. Chevron Chemical Co., [1999] O.J. No. 2245 (Sup. Ct.) at para. 89:

> The exercise of settlement approval does not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness.

70 Sharpe J. stated in Dabbs v. Sun Life Assurance (1998), 40 O.R. (3d) 429 (Gen. Div.), aff'd 41 O.R. (3d) 97 (C.A.). leave to appeal to S.C.C. dismissed October 22, 1998, (Dabbs No. 2) at 440, that "reasonableness allows for a range of possible resolutions." I agree. The court must remain flexible when presented with settlement proposals for approval. However, the reasonableness of any settlement depends on the factual matrix of the proceeding. Hence, the "range of reasonableness" is not a static valuation with an arbitrary application to every class proceeding, but rather it is an objective standard which allows for variation depending upon the subject matter of the litigation and the nature of the damages for which the settlement is to provide compensation.

71 Generally. in determining whether a settlement is "fair, reasonable and in the best interests of the class as a whole", courts in Ontario and British Columbia have reviewed proposed class

proceeding settlements on the basis of the following factors:

1. Likelihood of recovery, or likelihood of success;
2. Amount and nature of discovery evidence;
3. Settlement terms and conditions;
4. Recommendation and experience of counsel;
5. Future expense and likely duration of litigation;
6. Recommendation of neutral parties if any;
7. Number of objectors and nature of objections; and
8. The presence of good faith and the absence of collusion.

See Dabbs No. 1 at para. 13, Haney Iron Works Ltd v. Manufacturers Life Insurance Co. (1998), 169 D.L.R. (4th) 565 (B.C.S.C.) at 571, See also Conte, Newberg on Class Actions, (3rd ed) (West Publishing) at para. 11.43.

72 In addition to the foregoing, it seems to me that there are two other factors which might be considered in the settlement approval process: i) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation; and ii) information conveying to the court the dynamics of, and the positions taken by the parties during, the negotiation. These two additional factors go hand-in-glove and provide the court with insight into whether the bargaining was interest-based, that is reflective of the needs of the class members, and whether the parties were bargaining at equal or comparable strength. A reviewing court, in exercising its supervisory jurisdiction is, in this way, assisted in appreciating fully whether the concerns of the class have been adequately addressed by the settlement.

73 However, the settlement approval exercise is not merely a mechanical seriatim application of each of the factors listed above. These factors are, and should be, a guide in the process and no more. Indeed, in a particular case, it is likely that one or more of the factors will have greater significance than others and should accordingly be attributed greater weight in the overall approval process.

74 Moreover, the court must take care to subject the settlement of a class proceeding to the proper level of scrutiny. As Sharpe J. stated in Dabbs No. 2 at 439-440:

> A settlement of the kind under consideration here will affect a large number of individuals who are not before the court, and I am required to scrutinize the proposed settlement closely to ensure that it does not sell short the potential rights of those unrepresented parties. I agree with the thrust of Professor Watson's comments in "Is the Price Still Right? Class Proceedings in Ontario", a paper delivered at a CIAJ Conference in Toronto, October 1997, that class action settlements "must be seriously scrutinized by judges" and that they should be "viewed with some suspicion". On the other hand, all settlements are the product of compromise and a process of give and take and settlements rarely give all

parties exactly what they want. Fairness is not a standard of perfection.

75 The preceding admonition is especially apt in the present circumstances. Class counsel described the agreement before the court as "the largest settlement in a personal injury action in Canadian history." The settlement is Pan-Canadian in scope, affects thousands of people, some of whom are thus far unaware that they are claimants, and is intended to be administered for over 80 years. It cannot be seriously contended that the tragedy at the core of these actions does not have a present and lasting impact on the class members and their families. While the resolution of the litigation is a noteworthy aim, an improvident settlement would have repercussions well into the future.

76 Consequently, this is a case where the proposed settlement must receive the highest degree of court scrutiny. As stated in the Manual for Complex Litigation, 3rd Ed. (Federal Judicial Centre: West Publishing, 1995) at 238:

> Although settlement is favoured, court review must not be perfunctory; the dynamics of class action settlement may lead the negotiating parties - even those with the best intentions - to give insufficient weight to the interests of at least some class members. The court's responsibility is particularly weighty when reviewing a settlement involving a non-opt-out class or future claimants. (Emphasis added.)

77 The court has been assisted in scrutinizing the proposed settlement by the submissions of several intervenors and objectors. I note that some of the submissions, as acknowledged by counsel for the objectors, raised social and political concerns about the settlement. Without in any way detracting from the importance of these objections, it must be remembered that these matters have come before the court framed as class action lawsuits. The parties have chosen to settle the issues on a legal basis and the agreement before the court is part of that legal process. The court is therefore constrained by its jurisdiction, that is, to determine whether the settlement is fair and reasonable and in the best interests of the classes as a whole in the context of the legal issues. Consequently, extra-legal concerns even though they may be valid in a social or political context, remain extra-legal and outside the ambit of the court's review of the settlement.

78 However, although there may have been social or political undertones to many of the objections, legal issues raised by those objections, either directly or peripherally, are properly considered by the court in reviewing the settlement. Counsel for the objectors described the legal issues raised, in broad terms, as objections to:

(a) the adequacy of the total value of the settlement amount;
(b) the extent of compensation provided through the settlement;
(c) the sufficiency of the settlement Fund to provide the proposed compensation;
(d) the reversion of any surplus;

(e) the costs of administering the Plans; and
(f) the claims process applicable to Thalassemia victims.

I have dealt with the objection regarding the Thalassemia victims above. The balance of these objections will be addressed in the reasons which follow.

79 It is well established that settlements need not achieve a standard of perfection. Indeed, in this litigation, crafting a perfect settlement would require an omniscient wisdom to which neither this court nor the parties have ready recourse. The fact that a settlement is less than ideal for any particular class member is not a bar to approval for the class as a whole. The CPA mandates that class members retain, for a certain time, the right to opt out of a class proceeding. This ensures an element of control by allowing a claimant to proceed individually with a view to obtaining a settlement or judgment that is tailored more to the individual's circumstances. In this case, there is the added advantage in that a class member will have the choice to opt out while in full knowledge of the compensation otherwise available by remaining a member of the, class.

80 This settlement must be reviewed on an objective standard, taking into account the need to provide compensation for all of the class members while at the same time recognizing the inherent difficulty in crafting a universally satisfactory settlement for a disparate group. In other words, the question is does the settlement provide a reasonable alternative for those Class Members who do not wish to proceed to trial?

81 Counsel for the class and the Crown defendants urged this court to consider the question on the basis of each class member's likely recovery in individual personal injury tort litigation. They contend that the benefits provided at each level are similar to the awards class members who are suffering physical manifestations of HCV infection approximating those set out in the different levels of the structure of this settlement would receive in individual litigation. In my view, this approach is flawed in the present case.

82 An award of damages in personal injury tort litigation is idiosyncratic and dependent on the individual plaintiff before the court. Here, although the settlement is structured to account for Class Members with differing medical Conditions by establishing benefits on an ascending classification scheme, no allowances are made for the spectrum of damages which individual class members within each level of the structure may suffer. The settlement provides for compensation on a "one-size fits all" basis to all Class Members who are grouped at each level. However, it is apparent from the evidence before the court on this motion that the damages suffered as a result of HCV infection are not uniform, regardless of the degree of progression.

83 The evidence of Dr. Frank Anderson, a leading practitioner working with HCV patients in Vancouver, describes in detail the uncertain prognosis that accompanies HCV and the often debilitating, but unevenly distributed, symptomology that can occur in connection with infection. He states:

Once infected with HCV, a person will either clear HCV after an acute stage of develop chronic HCV infection. At present, the medical literature establishes that approximately 20-25% of all persons infected clear HCV within approximately one year of infection. Those persons will still test positive for the antibody and will probably do so for the rest of their lives, but will not test positive on a PCR test, nor will they experience any progressive liver disease due to HCV.

Persons who do not clear the virus after the acute stage of the illness have chronic HCV. They may or may not develop progressive liver disease due to HCV, depending on the course HCV takes in their body and whether treatment subsequently achieves a sustained remission. A sustained remission means that the virus is not detectable in the blood 6 months after treatment, the liver enzymes are normal, and that on a liver biopsy, if one were done, there would be no inflammation. Fibrosis in the liver is scar tissue caused by chronic inflammation, and as such is not reversible, and will remain even after therapy. It is also possible to spontaneously clear the virus after the acute phase of the illness but when this happens and why is not well understood. The number of patients spontaneously clearing the virus is small.

HCV causes inflammation of the liver cells. The level of inflammation varies among HCV patients. ... the inflammation may vary in intensity from time to time.

...

Inflammation and necrosis of liver cells results in scarring of liver tissue (fibrosis). Fibrosis also appears in various patterns in HCV patients .... Fibrosis can stay the same or increase over time, but does not decrease, because although the liver can regenerate cells, it cannot reverse scarring. On average it takes approximately 20 years from point of infection with Hepatitis C until cirrhosis develops, and so on a scale of 1 to 4 units the best estimate is that the rate of fibrosis progression is 0. 133 units per year.

...

Once a patient is cirrhotic, they are either a compensated cirrhotic, or a decompensated cirrhotic, depending on their liver function. In other words, the

liver function may, still be normal even though there is fibrosis since there may, be enough viable liver cells remaining to maintain function. These persons would have compensated cirrhosis. If liver function fails the person would then have decompensated cirrhosis. The liver has very many functions and liver failure may involve some or many of these functions. Thus decompensation may present in a number of ways with a number of different signs and symptoms.

A compensated cirrhotic person has generally more than one third of the liver which is still free from fibrosis and whose liver can still function on a daily basis. They may have some of the symptoms discussed below, but they may also be asymptomatic.

Decompensated cirrhosis occurs when approximately 2/3 of the liver is compromised (functioning liver cells destroyed) and the liver is no longer able to perform one or more of its essential functions. It is diagnosed by the presence of one or more conditions which alone or in combination is life threatening without a transplant. This clinical stage of affairs is also referred to as liver failure or end stage liver disease. The manifestations of decompensation are discussed below. Once a person develops decompensation, life expectancy is short and they will generally die within approximately 2-3 years unless he or she receives a liver transplant.

Patients who progress to cirrhosis but not to decompensated cirrhosis may develop hepatocellular cancer ("HCC"). This is a cancer, which originates from liver cells, but the exact mechanism is uncertain. The simple occurrence of cirrhosis may predispose to HCC, but the virus itself may also stimulate the occurrence of liver cell cancer. Life expectancy after this stage is approximately 1-2 years.

...

The symptoms of chronic HCV infection, prior to the disease progressing to cirrhosis or HCC include: fatigue, weight loss, upper right abdominal pain, mood disturbance, and tension and anxiety ...

Of those symptoms, fatigue is the most common, the most subjective and the most difficult to assess .... There is also general consensus that the level of

> fatigue experienced by an individual infected with HCV does not correlate with liver enzyme levels, the viral level in the blood, or the degree of inflammation or fibrosis on biopsy. It is common for the degree of fatigue to fluctuate from time to time.

Dr. Anderson identifies some of the symptoms associated with cirrhosis which can include skin lesions, swelling of the legs, testicular atrophy in men, enlarged spleen and internal hemorrhaging. Decompensated cirrhosis symptomatic effects, he states, can include jaundice, hepatic encephalopathy, protein malnutrition, subacute bacterial peritonitis and circulatory and pulmonary changes. Dr. Anderson also states, in respect of his own patients, that "at least 50% of my HCV infected patients who have not progressed to decompensated cirrhosis or HCC are clinically asymptomatic."

84 It is apparent, in light of Dr. Anderson's evidence, that in the absence of evidence of the individual damages sustained by class members, past precedents of damage awards in personal injury actions cannot be applied to this case to assess the reasonableness of the settlement for the class.

85 This fact alone is not a fatal flaw. There have long been calls for reform of the "once and for all" lump sum awards that are usually provided in personal injury actions. As stated by Dickson J, in Andrews v. Grand & Toy Alberta Ltd, [1978] 2 S.C.R. 229 at 236:

> The subject of damages for personal injury is an area of the law which cries out for legislative reform. The expenditure of time and money in the determination of fault and of damage is prodigal. The disparity resulting from lack of provision for victims who cannot establish fault must be disturbing. When it is determined that compensation is to be made, it is highly irrational to be tied to a lump sum system and a once-and-for-all award.
>
> The lump sum award presents problems of great importance. It is subject to inflation, it is subject to fluctuation on investment, income from it is subject to tax. After judgment new needs of the plaintiff arise and present needs are extinguished; yet, our law of damages knows nothing of periodic payment. The difficulties are greatest where there is a continuing need for intensive and expensive care and a long-term loss of earning capacity. It should be possible to devise some system whereby payments would be subject to periodic review and variation in the light of the continuing needs of the injured person and the cost of meeting those needs.

86 The "once-and-for-all" lump sum award is the common form of compensation for damages in tort litigation. Although the award may be used to purchase annuities to provide a "structured" settlement, the successful claimant receives one sum of money that is determined to be proper

compensation for all past and future losses. Of necessity, there is a great deal of speculation involved in determining the future losses. There is also the danger that the claimant's future losses will prove to be much greater than are contemplated by the award of damages received because of unforeseen problems or an inaccurate calculation of the probability of future contingent events. Thus even though the claimant is successful at trial, in effect he or she bears the risk that there may be long term losses in excess of those anticipated. This risk is especially pronounced when dealing with a disease or medical condition with an uncertain prognosis or where the scientific knowledge is incomplete.

87 The present settlement is imaginative in its provision for periodic subsequent claims should the class member's condition worsen. The underlying philosophy upon which the settlement structure is based is set forth in the factum of the plaintiffs in the Transfused Action. They state at para. 10 that:

> The Agreement departs from the common law requirement of a single, once-and-for-all lump sum assessment and instead establishes a system of periodic payments to Class Members and Family Class Members depending on the evolving severity of their medical condition and their needs.

88 This forward-looking provision addresses the concern expressed by Dickson J. with respect to the uncertainty and unfairness of a once and for all settlement. Indeed, the objectors and intervenors acknowledge this in that they do not take issue with the benefit distribution structure of the settlement as much as they challenge the benefits provided at the levels within the structure.

89 These objections mirror the submissions in support of the settlement, in that they are largely based on an analogy to a tort model compensation scheme. For the reasons already stated, this analogy is not appropriate because the proper application of the tort model of damages compensation would require an examination of each individual case. In the absence of an individualized examination, the reasonableness, or adequacy, of the settlement cannot be determined by a comparison to damages that would be obtained under the tort model. Rather the only basis on which the court can proceed in a review of this settlement is to consider whether the total amount of compensation available represents a reasonable settlement, and further, whether those monies are distributed fairly and reasonably among the class members.

90 The total value of the Pan-Canadian settlement is estimated to be $1.564 billion dollars. This is calculated as payment or obligation to pay by the federal, provincial and territorial governments in the an amount of $1.207 billion on September 30, 1999, plus the tax relief of $357 million over the expected administrative term of the settlement. This amount is intended to settle the class proceedings in Ontario, British Columbia and Quebec. The Ontario proceeding, as stated above, covers all of those class members in Canada other than those included in the actions in British Columbia and Quebec.

91 Counsel for the plaintiffs and for the settling defendants made submissions to the court with

respect the length and intensity of the negotiations leading up to the settlement. There was no challenge by any party as to the availability of any additional compensation. I am satisfied on the evidence that the negotiations achieved the maximum total funding that could be obtained short of trial.

92 In applying the relevant factors set out above to the global settlement figure proposed, I am of the view that the most significant consideration is the substantial litigation risk of continuing to trial with these actions. The CRCS is the primary defendant. It is now involved in protracted insolvency proceedings. Even if the court-ordered stay of litigation proceedings against it were to be lifted, it is unlikely that there would be any meaningful assets available to satisfy a judgment. Secondly, there is a real question as to the liability of the Crown defendants. Counsel for the plaintiffs candidly admit that there is a probability, which they estimate at 35%, that the Crown defendants would not be found liable at trial. Counsel for the federal government places the odds on the Crown successfully defending the actions somewhat higher at 50%. I note that none of the opposing intervenors or objectors challenge these estimates. In addition to the high risk of failure at trial, given the plethora of complex legal issues involved in the proceedings, there can be no question that the litigation would be lengthy, protracted and expensive, with a final result, after all appeals are exhausted, unlikely until years into the future.

93 Moving to the remaining factors, although there have been no examinations for discovery, the extensive proceedings before the Krever Commission serve a similar purpose. The settlement is supported by the recommendation of experienced counsel as well as many of the intervenors. There is no suggestion of bad faith or collusion tainting the settlement. The support of the intervenors, particularly the Canadian Hemophilia Society which made submissions regarding the meetings held with class members, is indicative of communication between class counsel and the class members. Although, there were some objectors who raised concerns about the degree of communication with the Transfused Class members, these complaints were not strenuously pursued. Perhaps the most compelling evidence of the adequacy of the communications with the class members regarding the settlement is the relatively low number of objections presented to the court considering the size of the classes. Finally, counsel for all parties made submissions, which I accept, regarding the rigourous negotiations that resulted in the final settlement.

94 In conclusion, I find that the global settlement represents a reasonable settlement when the significant and very real risks of litigation are taken into account.

95 The next step in the analysis is to determine whether the monies available are allocated in such a way as to provide for a fair and reasonable distribution among the class members. In my view, as the settlement agreement is presently constituted, they are not. My concern lies with the provision dealing with opt out claimants. Under the agreement, if opt out claimants are successful in individual litigation, any award such a claimant receives will be satisfied out of the settlement Fund. While this has the potential of depleting the Fund to the detriment of the class members, thus rendering the settlement uncertain, the far greater concern is the risk of inequity that this creates in

the settlement distribution. The Manual for Complex Litigation states at 239 that whether "claimants who are not members of the class are treated significantly differently" than members of the class is a factor that may "be taken into account in the determination of the settlement's fairness, adequacy and reasonableness ...".

96 In principle, there is nothing egregious about the payment of settlement funds to non-class members. Section 26(6) of the CPA provides the court with the discretion to sanction or direct payments to non-class members. In effect, the opt out provision reflects the intention of the defendants to settle all present and future litigation. This objective is not contrary to the scheme of the CPA per se. See, for example, the reasons of Brenner J. in Sawatzky v. Societe Chirurgiale Instrumentarium Inc. [1999] B.C.J. No. 1814 (S.C.), adopted by this court in Bisignano v. La Corporation Instrumentarium Inc. (September 1, 1999, Court File No. 22404/96, unreported.)

97 However, given that the settlement must be "fair, reasonable and in the best interests of the class", the court cannot sanction a provision which gives opt out claimants the potential for preferential treatment in respect of access to the Fund. The opt out provision as presently written has this potential effect where an opt out claimant either receives an award or settlement in excess of the benefits that he or she would have received had they not opted out and which must be satisfied out of the Fund. Alternatively, the preferential treatment could also occur where the opt out claimant receives an award similar to their entitlement under the settlement in quantum but without regard for the time phased payment structure of the settlement.

98 In my view, where a defendant wishes to settle a class proceeding by providing a single Fund to deal with both the claims of the class members and the claims of individuals opting out of the settlement, the payments out of the Fund must be made on an equitable basis amongst all of the claimants. Fairness does not require that each claimant receive equal amounts but what cannot be countenanced is a situation where an opt out claimant who is similarly situated to a class member receives a preferential payment.

99 The federal government argues that fairness ensues, even in the face of the different treatment, because the opt out claimant assumes the risk of individual litigation. I disagree. Because the defendants intend that all claims shall be satisfied from a single fund, individual litigation by a claimant opting out of the class pits that claimant against the members of the class. The opt out claimant stands to benefit from success because he or she may achieve an award in excess of the benefits provided under the settlement. This works to the detriment of the class members by the reducing the total amount of the settlement. More importantly however, the benefits to the class members will not increase as a result of unsuccessful opt out claimants.

100 In the instant case, fairness requires a modification to the opt out claimant provision of the settlement. The present opt out provision must be deleted and replaced with a provision that in the event of successful litigation by an opt out claimant, the defendants are entitled to indemnification from the Fund only to the extent that the claimant would have been entitled to claim from the Fund

had he or she remained in the class. This must of necessity include the time phasing factor. Such a provision ensures fairness in that there is no prospect of preferential distribution from the Fund, nor will the class suffer any detrimental effect as a result of the outcome of the individual litigation. The change also provides a complete answer to the complaint that the current opt out provision renders the settlement uncertain. Similarly, the modification renders the provision for defence costs to be paid out of the Fund unnecessary and thus it must be deleted.

101 Accordingly, the opt out provision of the settlement would not bean impediment to court approval with the modifications set out above.

102 In my view, the remainder of distribution scheme is fair and reasonable with this alteration to the opt out provision. It is beyond dispute that the compensation at any level will not be perfect, nor will it be tailored to individual cases but perfection is not the standard to be applied. The benefit levels are fair. More pointedly, fairness permeates the settlement structure in that each and every class member is provided an opportunity to make subsequent claims if his or her condition deteriorates. An added advantage is that there is a pre-determined, objective qualifying scheme so that class members will be able to readily assess their eligibility for additional benefits. Thus, while a claimant may not be perfectly compensated at any particular level, the edge to be gained by a scheme which terminates the litigation while avoiding the pitfalls of an imperfect, one-time-only lump sum settlement is compelling.

103 In any, event, the settlement structure also provides a reasonable basis for the distribution of the funds available. Class counsel described the distribution method as a "need not greed" system, where compensation is meant, within limits, to parallel the extent of the damages. There were few concerns raised about the compensation provided at the upper levels of the scheme. Rather, the majority of the objections centred on the benefits provided at Levels 1, 2 and 3. The damages suffered by those whose conditions fall within these Levels are clearly the most difficult to assess. This is particularly true in respect of those considered to be at Level 2. However, in order to provide for the subsequent claims, compromises must be made and in this case, I am of the view that the one chosen is reasonable.

104 Regardless of the submissions made with respect to comparable awards under the tort model, it is clear from the record that the compensatory, benefits assigned to claimants at different levels were largely influenced by the total of the monies available for allocation. As stated in the CASL study at p. 3:

> At the request of the Federal government of Canada, provincial governments, and Hepatitis C claimants, i.e. individuals infected with hepatitis C virus during the period of 1986 to 1990, an impartial group, the Canadian Association for the Study of the Liver (CASL) was asked to construct a natural history model of Hepatitis C. The intent of this effort was to generate a model that would be used by all parties, as guide to disbursing funds set aside to compensate patients

infected with hepatitis C virus through blood transfusion.

105 Of necessity, the settlement cannot, within each broad category, deal with individual differences between victims. Rather it must be general in nature. In my view, the allocation of the monies available under the settlement is "fair, reasonable and in the best interests of the class as a whole."

106 In making this determination, I have not ignored the submissions made by certain objectors and intervenors regarding the sufficiency of the Fund. They asserted that the apparent main advantage of this settlement, the ability to "claim time and time again" is largely illusory because the Fund may well be depleted by the time that the youngest members of the class make claims against it.

107 I cannot accede to this submission. The Eckler report states that with the contemplated holdbacks of the lump sum at Level 2 and the income replacement at Level 4 and above, the Fund will have a surplus of $334,173,000. Admittedly, Eckler currently projects a deficit of $58,533,000 if the holdbacks are released.

108 However, the Eckler report contains numerous caveats regarding the various assumptions that have been made as a matter of necessity, including the following, which is stated in section 12.2:

> A considerable number of assumptions have been made in order to calculate the liabilities in this report. Where we have made the assumptions, we used our best efforts based on our understanding of the plan benefits; in general, where we have made simplifying assumptions or approximations, we have tried to err on the conservative side, i.e. increasing costs and liabilities. In many instances we have relied on counsel for the assumptions and understand that they, have used their best efforts in making these. Nevertheless, the medical outcomes are very unclear - e.g. the CASL report indicates very wide ranges in its confidence intervals for the various probabilities it developed. There is substantial room for variation in the results. The differences will emerge in the ensuing years as more experience is obtained on the actual cohort size and characteristics of the infected claimants. These differences and the related actuarial assumptions will be re-examined at each periodic assessment of the Fund.

109 Unfortunately, but not unexpectedly, the limitations of the underlying medical studies upon which Eckler has based its report require the use of assumptions. For example. the report prepared by Dr. Remis, dated July 6, 1999, states at p. 642:

> There are important limitations to the analyses presented here and, in particular, with the precision of the estimates of the number of HCV-infected recipients who are likely to qualify for benefits under the Class Action Settlement ...

> The proportion of transfusion recipients who will ultimately be diagnosed is particularly important in this regard and has substantial impact on the final estimate. We used an estimate of 70% as the best case estimate for this proportion based on the BC experience but the actual proportion could be substantially different from this, depending on the type, extent and success of targeted notification activities that will be undertaken, especially, in Ontario and Quebec. This could alter the ultimate number who eventually qualify for benefits by as much as 1,500 in either direction.

110 The report of the CASL study states at. 22:

> Our attempt to project the natural history of the 1986-1990 post transfusion HCV infected cohort has limitations. Perhaps foremost among these is our lack of understanding of the long-term prognosis of the disease. For periods beyond 25 years, projections remain particularly uncertain. The wide confidence intervals surrounding long-term projections highlight this uncertainty.
>
> Other key, limitations are lack of applicability of these projections to children and special groups.

111 The size of the cohort and the percentage of the cohort which will make claims against the Fund are critical assumptions. Significant errors in either assumption will have a dramatic impact on the sufficiency of the Fund. Recognizing this, Eckler has chosen to use the most conservative estimates from the information available. The cohort size has been estimated from the CASL study rather than other studies which estimate approximately 20% less surviving members. Furthermore, Eckler has calculated liabilities on the basis that 100% of the estimated cohort will make claims against the Fund.

112 Class counsel urged the court to consider the empirical evidence of the "take-up rate" demonstrated in the completed class proceeding, Nantais v. Telectronics Proprietary (Canada) Ltd. (1995), 25 O.R. (3d) 331 (Gen. Div.), leave to appeal dismissed (1995), 129 D.L.R. (4th) 110 (Ont. Div. Ct.), to support a conclusion that the Fund is sufficient. In Nantais, all of the class members were known and accordingly received actual notice of the settlement. Seventy-two percent of the class chose to make claims, or "take-up" the settlement. It was contended that this amounted to strong evidence that less than one hundred per cent of the classes in these proceedings would take up this settlement. I cannot accept the analogy. While I agree that it is unlikely that the entire estimated cohort will take up the settlement, it is apparent from the caveats expressed in the reports provided to the court that the estimate of the cohort size may be understated by a significant number. Accordingly, for practical purposes, a less than one hundred per cent take up rate could well be counter-balanced by a concurrent miscalculation of the cohort size.

113 Although I cannot accept the Nantais experience as applicable on this particular point, the Eckler report stands alone as the only and best evidence before the court from which to determine the sufficiency of the Fund. Eckler has recognized the deficiencies inherent in the information available by using the most conservative estimates throughout. This provides the court with a measure of added comfort. Not to be overlooked as well, the distribution of the Fund will be monitored by this court and the courts in Quebec and British Columbia, guided by periodically, revised actuarial projections. In my view, the risk that the Fund will be completely depleted for latter claimants is minimal.

114 Consequently, given the empirical evidence proffered by Dr. Anderson as to the asymptomatic potential of HCV infection, the conservative approach taken by Eckler in determining the likely claims against the Fund and the role of the courts in monitoring the ongoing distributions, I am of the view that the projected shortfall of $58,000.000 considered in the context of the size of the overall settlement, is within acceptable limits. I find on the evidence before me, that the Fund is sufficient to provide the benefits and, thus, in this respect, the settlement is reasonable.

115 I turn now to the area of concern raised by counsel for the intervenor the Hepatitis C Society of Canada (the "Society"), namely the provision that mandates reversion of the surplus of the Plans to the defendants. The Society contends that this provision simpliciter is repugnant to the basis on which this settlement is constructed. It argues that the benefit levels were established on the basis of the total monies available, rather than a negotiation of benefit levels per se. Thus, it states there is a risk that the Fund will not be sufficient to provide the stated benefits and further, that this risk lies entirely with the class members because the defendants have no obligation to supplement the Fund if it proves to be deficient for the intended purpose. Moreover, the Society argues that the use of conservative estimates in defining the benefit levels, although an attempt at ensuring sufficiency, has the ancillary negative effect of minimizing the benefits payable to each class member under the settlement. Therefore, the Society contends that a surplus, if any develops in the ongoing administration of the Fund, should be used to augment the benefits for the class members.

116 The issue here is whether a reversion clause is appropriate in a settlement agreement in this class proceeding, and by extension, whether the inclusion of this clause is such that it would render the overall settlement unacceptable.

117 It is important to frame the submission of the Society in the proper context. This is not a case where the question of entitlement to an existing surplus is presented. Indeed, given the deficit projected by the Eckler report, it is conjectural at this stage whether the Fund will ever generate a surplus. If the Fund accumulates assets over and above the current Eckler projections, they must first be directed toward eliminating the deficit so that the holdbacks may be released.

118 The plan also provides that after the release of the holdbacks, the administrator may make an application to raise the $75,000 annual cap on income replacement if the Fund has sufficient assets to do so. It is only after these two areas of concern have been fully addressed that a surplus could be

deemed to exist.

119 The clause in issue does not, according to the interpretation given to the court by class counsel, permit the withdrawal by the defendants of any actuarial surplus that may be identified in the ongoing administration of the Fund. Rather, they state that it is intended that the remainder of the Fund, if any, revert to the defendants only after the Plans have been fully administered in the year 2080.

120 Remainder provisions in trusts are not unusual. Further, I reiterate that it is, at this juncture, complete speculation as to whether a surplus, either ongoing or in a remainder amount, will exist in the Fund. However, accepting the submission of class counsel at face value, the reversion provision is anomalous in that it is neither in the best interests of the plaintiff classes nor in the interests of defendants. The period of administration of the Fund is 80 years. No party took issue with class counsel's submission that the defendants are not entitled under the current language to withdraw any surplus in the Fund until this period expires. Likewise, there is no basis within the settlement agreement upon which the class members could assert any entitlement to access any surplus during the term of the agreement. Thus, any surplus would remain tied up, benefitting neither party during the entire 80 year term of the settlement.

121 Quite apart from the question of tying up the surplus for this unreasonable period of time, there is the underlying question of whether in the context of this settlement, it is appropriate for the surplus to revert in its entirety to the defendants.

122 The court is asked to approve the settlement even though the benefits are subject to fluctuation and regardless that the defendants are not required to make up any shortfall should the Fund prove deficient. This is so notwithstanding that the benefit levels are not perfect. It is therefore in keeping with the nature of the settlement and in the interests of consistency and fairness that some portion of a surplus may be applied to benefit class members.

123 This is not to say that it is necessary, as the Society suggests, that in order to be in the best interests of the class members, any surplus must only be used to augment the benefits within the settlement agreement. There are a range of possible uses to which any surplus may be put so as to benefit the class as a whole without focusing on any particular class member or group of class members. This is in keeping with the CPA which provides in s. 26(4) that surplus funds may "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 ...". On the other hand, in the proper circumstances, it may not be beyond the realm of reasonableness to allow the defendants access to a surplus within the Fund prior to the expiration of the 80 year period.

124 To attempt to determine the range of reasonable solutions at present, when the prospect of a surplus is uncertain at best, would be to pile speculation upon speculation. In the circumstances therefore, the only appropriate course, in my opinion, is to leave the question of the proper application of any surplus to the administrator of the Fund. The administrator may recommend to

the court from time to time, based on facts, experience with the Fund and future considerations, that all or a portion of the surplus be applied for the benefit of the class members or that all or a portion be released to the defendants. In the alternative, the surplus may be retained within the Fund if the administrator determines that this is appropriate. Any option recommended by the administrator would, of course, be subject to requisite court approval. This approach is in the best interests of the class and creates no conflicts between class members. Moreover, it resolves the anomaly created by freezing any surplus for the duration of the administration of the settlement. If the present surplus reversion clause is altered to conform with the foregoing reasons, it would meet with the court's approval.

125 There was an expressed concern as to the potential for depletion of the Fund through excessive administrative costs. The court shares this concern. However, the need for efficient access to the plan benefits for the class members and the associated costs that this entails must also be recognized. This requires an ongoing balancing so as to keep administrative costs in line while at the same time providing a user friendly claims administration. The courts, in their supervisory role, will be vigilant in ensuring that the best interests of the class will be the predominant criterion.

Disposition

126 In ordinary circumstances, the court must either approve or reject a settlement in its entirety. As stated by Sharpe J. in Dabbs No. 1 at para. 10:

> It has often been observed that the court is asked to approve or reject a settlement and that it is not open to the court to rewrite or modify its terms; Poulin v. Nadon, [1950] O.R. 219 (C.A.) at 222-3.

127 These proceedings, emanating from the blood tragedy, are novel and unusually complex. The parties have adverted to this in the settlement agreement which contemplates the necessity for changes of a non-material nature in Clause 12.01:

> This Agreement will not be effective unless and until it is approved by the Court in each of the Class Actions, and if such approvals are not granted without any material differences therein, this Agreement will be thereupon terminated and none of the Parties will be liable to any other Parties hereunder. (Emphasis added.)

128 The global settlement submitted to the court for approval is within the range of reasonableness having regard for the risk inherent in carrying this matter through to trial. Moreover, the levels of benefits ascribed within the settlement are acceptable having regard for the accessibility of the plan to successive claims in the event of a worsening of a class member's condition. This progressive approach outweighs any deficiencies which might exist in the levels of benefits.

129 I am satisfied based on the Eckler report that the Fund is sufficient, within acceptable tolerances to provide the benefits stipulated. There are three areas which require modification, however, in order for the settlement to receive court approval. First, regarding access to the Fund by opt out claimants, the benefits provided from the Fund for an opt out claimant cannot exceed those available to a similarly injured class member who remains in the class. This modification is necessary for fairness and the certainty of the settlement. Secondly, the surplus provision must be altered so as to accord with these reasons. Thirdly, in the interests of fairness, a sub-class must be created for the thalassemia victims to take into account their special circumstances.

130 The defendants have expressed their intention to be bound by the settlement if it receives court approval absent any material change. As stated, this reflects their acknowledgment of the complexity of the case, the scientific uncertainty surrounding the infections and the fact this settlement is crafted with a degree of improvisation.

131 The changes to the settlement required to obtain the approval of this court are not material in nature when viewed from the perspective of the defendants. Accepting the assumed value of $10,000,000 attributed to the opt outs by class counsel, a figure strongly supported by counsel for the defendants, the variation indicated is de minimis in the context of a $1.564 billion dollar settlement. The change required in respect of the surplus provision resolves the anomaly of tying up any surplus for the entire 80 year period of the administration of the settlement. In any event, given the projected $58,000,000 deficit, the question of a surplus is highly conjectural. The creation of the sub-class of thalassemia victims, in the context of the cohort size is equally de minimis. I am prepared to approve the settlement with these changes.

132 However, should the parties to the agreement not share the view that these changes are not material in nature, they may consider the proposed changes as an indication of "areas of concern" within the meaning the words of Sharpe J. in Dabbs No. 1 at para. 10:

> As a practical matter, it is within the power of the court to indicate areas of concern and afford the parties the opportunity to answer and address those concerns with changes to the settlement ...

133 The victims of the blood tragedy in Canada cannot be made whole by this settlement. No one can undo what has been done. This court is constrained in these settlement approval proceedings by its jurisdiction and the legal framework in which these proceedings are conducted. Thus, the settlement must be reviewed from the standpoint of its fairness, reasonableness and whether it is in the best interests of the class as a whole. The global settlement, its framework and the distribution of money within it, as well the adequacy of the funding to produce the specified benefits, with the modifications suggested in these reasons, are fair and reasonable. There are no absolutes for purposes of comparison, nor are there any assurances that the scheme will produce a perfect solution for each individual. However, perfection is not the legal standard to be applied nor could it be achieved in crafting a settlement of this nature. All of these points considered, the settlement,

with the required modifications, is in the best interests of the class as a whole.

133a I am obliged to counsel, the parties and the intervenors and especially to the individual objectors who took the time to either file a written objection or appear in person at the hearings. [The Court did not number this paragraph. QL has assigned the number 133a.] WINKLER J.

cp/s/jjy/qljyw

Case Name:

Robertson v. ProQuest Information and Learning Co.

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 Canwest Publishing Inc./Publications Canwest Inc., Canwest Books Inc. and Canwest (Canada) Inc.
AND RE: Heather Robertson, Plaintiff, and ProQuest Information and Learning Company, Cedrom-SNI Inc., Toronto Star Newspapers Ltd., Rogers Publishing Limited and Canwest Publishing Inc., Defendants

[2011] O.J. No. 1160

2011 ONSC 1647

Court File Nos. 03-CV-252945CP, CV-10-8533-00CL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

March 15, 2011.

(34 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Settlements -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would

resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Settlements -- Approval -- Application by the representative plaintiff and by one of the defendants, who was governed by an order under the Companies' Creditors Arrangement Act, for approval of a settlement that would resolve plaintiff's class proceeding and claim under the Act allowed -- Settlement would result in fair and reasonable outcome -- Settlement was recommended by all of the involved parties and it was not opposed by the defendants in the class proceeding who were not included in it.

Application by Robertson and by the defendant Canwest Publishing Inc. for approval of a settlement. Robertson, who was a plaintiff in her own capacity and was also the representative plaintiff in a class proceeding, commenced this action in July 2003. The action was certified as a class proceeding in October 2008. Robertson claimed compensatory damages of $500 million and punitive and exemplary damages of $250 million against the defendants for copyright infringement. In January 2010 Canwest was granted an initial order pursuant to the Companies' Creditors Arrangement Act. In April 2010 Robertson filed a claim under the Arrangement Act for $500 million. The Monitor's opinion was that this claim was worth $0. The proposed settlement would resolve the class proceeding and the proceeding under the Arrangement Act. Court approval was not required for the claim under the Arrangement Act but it was required for the class proceeding. Under the settlement the claim under the Arrangement Act would be allowed in the amount of $7.5 million for voting and distribution purposes. Robertson undertook to vote in favour of the proposed Plan under the Arrangement Act. The action would be dismissed against Canwest, which did not admit liability. The action would not be dismissed against the other defendants. The Monitor was involved in the negotiation of the settlement and recommended approval for it concluded that the settlement agreement was a fair and reasonable resolution for Canwest.

HELD: Application allowed. The settlement agreement met the tests for approval under the Arrangement Act and under the Class Act. No one, including the non-settling defendants who received notice, opposed the settlement. Robertson was a very experienced and sophisticated litigant who previously resolved a similar class proceeding against other media companies. The settlement agreement was recommended by experienced counsel and it was entered into after serious negotiations between sophisticated parties. It would result in a fair and reasonable outcome, partly because Canwest was in an insolvency proceeding with all of its attendant risks and uncertainties.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 29, s. 34

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36,

Counsel:

Kirk Baert, for the Plaintiff.

Peter J. Osborne and *Kate McGrann*, for Canwest Publishing Inc.

Alex Cobb, for the CCAA Applicants.

Ashley Taylor and *Maria Konyukhova*, for the Monitor.

REASONS FOR DECISION

S.E. PEPALL J.:--

Overview

1 On January 8, 2010, I granted an initial order pursuant to the provisions of the *Companies' Creditors Arrangement Act* ("*CCAA*") in favour of Canwest Publishing Inc. ("CPI") and related entities (the "LP Entities"). As a result of this order and subsequent orders, actions against the LP Entities were stayed. This included a class proceeding against CPI brought by Heather Robertson in her personal capacity and as a representative plaintiff (the "Representative Plaintiff"). Subsequently, CPI brought a motion for an order approving a proposed notice of settlement of the action which was granted. CPI and the Representative Plaintiff then jointly brought a motion for approval of the settlement of both the class proceeding as against CPI and the *CCAA* claim. The Monitor supported the request and no one was opposed. I granted the judgment requested and approved the settlement with endorsement to follow. Given the significance of the interplay of class proceedings with *CCAA* proceedings, I have written more detailed reasons for decision rather than simply an endorsement.

Facts

2 The Representative Plaintiff commenced this class proceeding by statement of claim dated July 25, 2003 and the action was case managed by Justice Cullity. He certified the action as a class proceeding on October 21, 2008 which order was subsequently amended on September 15, 2009.

3 The Representative Plaintiff claimed compensatory damages of $500 million plus punitive and exemplary damages of $250 million against the named defendants, ProQuest Information and Learning LLC, Cedrom-SNI Inc., Toronto Star Newspapers Ltd., Rogers Publishing Limited and CPI for the alleged infringement of copyright and moral rights in certain works owned by class

members. She alleged that class members had granted the defendants the limited right to reproduce the class members' works in the print editions of certain newspapers and magazines but that the defendant publishers had proceeded to reproduce, distribute and communicate the works to the public in electronic media operated by them or by third parties.

4 As set out in the certification order, the class consists of:

A. All persons who were the authors or creators of original literary works ("Works") which were published in Canada in any newspaper, magazine, periodical, newsletter, or journal (collectively "Print Media") which Print Media have been reproduced, distributed or communicated to the public by telecommunication by, or pursuant to the purported authorization or permission of, one or more of the defendants, through any electronic database, excluding electronic databases in which only a precise electronic reproduction of the Work or substantial portion thereof is made available (such as PDF and analogous copies) (collectively "Electronic Media"), excluding:

(a) persons who by written document assigned or exclusively licensed all of the copyright in their Works to a defendant, a licensor to a defendant, or any third party; or

(b) persons who by written document granted to a defendant or a licensor to a defendant a license to publish or use their Works in Electronic Media; or

(c) persons who provided Works to a not for profit or non-commercial publisher of Print Media which was licensor to a defendant (including a third party defendant), and where such persons either did not expect or request, or did not receive, financial gain for providing such Works; or

(d) persons who were employees of a defendant or a licensor to a defendant, with respect to any Works created in the course of their employment.

Where the Print Media publication was a Canadian edition of a foreign publication, only Works comprising of the content exclusive to the Canada edition shall qualify for inclusion under this definition.

(Persons included in clause A are thereinafter referred to as "Creators". A "licensor to a defendant" is any party that has purportedly authorized or provided permission to one or more defendants to make Works available in Electronic Media. References to defendants or licensors to defendants include their predecessors and successors in interest)

B. All persons (except a defendant or a licensor to a defendant) to whom a Creator,

or an Assignee, assigned, exclusively licensed, granted or transmitted a right to publish or use their Works in Electronic Media.

(Persons included in clause B are hereinafter referred to as "Assignees")

C. Where a Creator or Assignee is deceased, the personal representatives of the estate of such person unless the date of death of the Creator was on or before December 31, 1950.

5 As part of the *CCAA* proceedings, I granted a claims procedure order detailing the procedure to be adopted for claims to be made against the LP Entities in the *CCAA* proceedings. On April 12, 2010, the Representative Plaintiff filed a claim for $500 million in respect of the claims advanced against CPI in the action pursuant to the provisions of the claims procedure order. The Monitor was of the view that the claim in the *CCAA* proceedings should be valued at $0 on a preliminary basis.

6 The Representative Plaintiff's claim was scheduled to be heard by a claims officer appointed pursuant to the terms of the claims procedure order. The claims officer would determine liability and would value the claim for voting purposes in the *CCAA* proceedings.

7 Prior to the hearing before the claims officer, the Representative Plaintiff and CPI negotiated for approximately two weeks and ultimately agreed to settle the *CCAA* claim pursuant to the terms of a settlement agreement.

8 When dealing with the consensual resolution of a *CCAA* claim filed in a claims process that arises out of ongoing litigation, typically no court approval is required. In contrast, class proceeding settlements must be approved by the court. The notice and process for dissemination of the settlement agreement must also be approved by the court.

9 Pursuant to section 34 of the *Class Proceedings Act*, the same judge shall hear all motions before the trial of the common issues although another judge may be assigned by the Regional Senior Judge (the "RSJ") in certain circumstances. The action had been stayed as a result of the CCAA proceedings. While I was the supervising CCAA judge, I was also assigned by the RSJ to hear the class proceeding notice and settlement motions.

10 Class counsel said in his affidavit that given the time constraints in the *CCAA* proceedings, he was of the view that the parties had made reasonable attempts to provide adequate notice of the settlement to the class. It would have been preferable to have provided more notice, however, given the exigencies of insolvency proceedings and the proposed meeting to vote on the *CCAA* Plan, I was prepared to accept the notice period requested by class counsel and CPI.

11 In this case, given the hybrid nature of the proceedings, the motion for an order approving

notice of the settlement in both the class action proceeding and the *CCAA* proceeding was brought before me as the supervising *CCAA* judge. The notice procedure order required:

1) the Monitor and class counsel to post a copy of the settlement agreement and the notice order on their websites;
2) the Monitor to publish an English version of the approved form of notice letter in the National Post and the Globe and Mail on three consecutive days and a French translation of the approved form of notice letter in La Presse for three consecutive days;
3) distribution of a press release in an approved form by Canadian Newswire Group for dissemination to various media outlets; and
4) the Monitor and class counsel were to maintain toll-free phone numbers and to respond to enquiries and information requests from class members.

12 The notice order allowed class members to file a notice of appearance on or before a date set forth in the order and if a notice of appearance was delivered, the party could appear in person at the settlement approval motion and any other proceeding in respect of the class proceeding settlement. Any notices of appearance were to be provided to the service list prior to the approval hearing. In fact, no notices of appearance were served.

13 In brief, the terms of the settlement were that:

a) the *CCAA* claim in the amount of $7.5 million would be allowed for voting and distribution purposes;
b) the Representative Plaintiff undertook to vote the claim in favour of the proposed *CCAA* Plan;
c) the action would be dismissed as against CPI;
d) CPI did not admit liability; and
e) the Representative Plaintiff, in her personal capacity and on behalf of the class and/or class members, would provide a licence and release in respect of the freelance subject works as that term was defined in the settlement agreement.

14 The claims in the action in respect of CPI would be fully settled but the claims which also involved ProQuest would be preserved. The licence was a non-exclusive licence to reproduce one or more copies of the freelance subject works in electronic media and to authorize others to do the same. The licence excluded the right to licence freelance subject works to ProQuest until such time as the action was resolved against ProQuest, thereby protecting the class members' ability to pursue ProQuest in the action. The settlement did not terminate the lawsuit against the other remaining defendants. Under the *CCAA* Plan, all unsecured creditors, including the class, would be entitled to share on a pro rata basis in a distribution of shares in a new company. The Representative Plaintiff would share pro rata to the extent of the settlement amount with other affected creditors of the LP

Entities in the distributions to be made by the LP Entities, if any.

15 After the notice motion, CPI and the Representative Plaintiff brought a motion to approve the settlement. Evidence was filed showing, among other things, compliance with the claims procedure order. Arguments were made on the process and on the fairness and reasonableness of the settlement.

16 In her affidavit, Ms. Robertson described why the settlement was fair, reasonable and in the best interests of the class members:

> In light of Canwest's insolvency, I am advised by counsel, and verily believe, that, absent an agreement or successful award in the Canwest Claims Process, the prospect of recovery for the Class against Canwest is minimal, at best. However, under the Settlement Agreement, which preserves the claims of the Class as against the remaining defendants in the class proceeding in respect of each of their independent alleged breaches of the class members' rights, as well as its claims as against ProQuest for alleged violations attributable to Canwest content, there is a prospect that members of the Class will receive some form of compensation in respect of their direct claims against Canwest.
>
> Because the Settlement Agreement provides a possible avenue of recovery for the Class, and because it largely preserves the remaining claims of the Class as against the remaining defendants in the class proceeding, I am of the view that the Settlement Agreement represents a reasonable compromise of the Class claim as against Canwest, and is both fair and reasonable in the circumstances of Canwest's insolvency.

17 In the affidavit filed by class counsel, Anthony Guindon of the law firm Koskie Minsky LLP noted that he was not in a position to ascertain the approximate dollar value of the potential benefit flowing to the class from the potential share in a pro rata distribution of shares in the new corporation. This reflected the unfortunate reality of the *CCAA* process. While a share price of $11.45 was used, he noted that no assurance could be given as to the actual market price that would prevail. In addition, recovery was contingent on the total quantum of proven claims in the claims process. He also described the litigation risks associated with attempting to obtain a lifting of the *CCAA* stay of proceedings. The likelihood of success was stated to be minimal. He also observed the problems associated with collection of any judgment in favour of the Representative Plaintiff. He went on to state:

> ... The Representative Plaintiff, on behalf of the Class, could have elected to challenge Canwest's initial valuation of the Class claim of $0 before a Claims Officer, rather than entering into a negotiated settlement. However, a number of factors militated against the advisability of such a course of action. Most

> importantly, the claims of the Class in the class proceeding have not been proven, and the Class does not enjoy the benefit of a final judgment as against Canwest. Thus, a hearing before the Claims Officer would necessarily necessitate a finding of liability as against Canwest, in addition to a quantification of the claims of the Class against Canwest.
>
> ... a negative outcome in a hearing before a Claims Officer could have the effect of jeopardizing the Class claims as against the remaining defendants in the class proceeding. Such a finding would not be binding on a judge seized of a common issues trial in the class proceeding; however, it could have persuasive effect.
>
> Given the likely limited recovery available from Canwest in the Claims Process, it is the view of Class Counsel that a negotiated resolution of the quantification of Class claim as against Canwest is preferable to risking a negative finding of liability in the context of a contested Claims hearing before a Claims Officer.

18 The Monitor was also involved in the negotiation of the settlement and was also of the view that the settlement agreement was a fair and reasonable resolution for CPI and the LP Entities' stakeholders. The Monitor indicated in its report that the settlement agreement eliminated a large degree of uncertainty from the *CCAA* proceeding and facilitated the approval of the Plan by the requisite majorities of stakeholders. This of course was vital to the successful restructuring of the LP Entities. The Monitor recommended approval of the settlement agreement.

19 The settlement of the class proceeding action was made prior to the creditors' meeting to vote on the Plan for the LP Entities. The issues of the fees and disbursements of class counsel and the ultimate distribution to class members were left to be dealt with by the class proceedings judge if and when there was a resolution of the action with the remaining defendants.

Discussion

20 Both motions in respect of the settlement were heard by me but were styled in both the *CCAA* proceedings and the class proceeding.

21 As noted by Jay A. Swartz and Natasha J. MacParland in their article "*Canwest Publishing - A Tale of Two Plans*"[1]:

> "There have been a number of *CCAA* proceedings in which settlements in respect of class proceedings have been implemented including *McCarthy v. Canadian Red Cross Society, (Re:) Grace Canada Inc., Muscletech Research and Development Inc.*, and *(Re:) Hollinger Inc.* ... The structure and process for notice and approval of the settlement used in the LP Entities restructuring

> appears to be the most efficient and effective and likely a model for future approvals. Both motions in respect of the Settlement, discussed below, were heard by the *CCAA* judge but were styled in both proceedings." [citations omitted]

(a) Approval

(i) *CCAA* Settlements in General

22 Certainly the court has jurisdiction to approve a *CCAA* settlement agreement. As stated by Farley J. in *Re Lehndorff General Partner Ltd.*,[2] the *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Very broad powers are provided to the *CCAA* judge and these powers are exercised to achieve the objectives of the statute. It is well settled that courts may approve settlements by debtor companies during the *CCAA* stay period: *Re Calpine Canada Energy Ltd.*[3]; *Re Air Canada*[4]; and *Re Playdium Entertainment Corp.*[5] To obtain approval of a settlement under the *CCAA*, the moving party must establish that: the transaction is fair and reasonable; the transaction will be beneficial to the debtor and its stakeholders generally; and the settlement is consistent with the purpose and spirit of the *CCAA*. See in this regard *Re Air Canada*[6] and *Re Calpine*.[7]

(ii) Class Proceedings Settlement

23 The power to approve the settlement of a class proceeding is found in section 29 of the *Class Proceedings Act*, 1992[8]. That section states:

> 29(1) A proceeding commenced under this *Act* and a proceeding certified as a class proceeding under this *Act* may be discontinued or abandoned only with the approval of the court, on such terms as the court considers appropriate.
>
> (2) A settlement of a class proceeding is not binding unless approved by the court.
>
> (3) A settlement of a class proceeding that is approved by the court binds all class members.
>
> (4) In dismissing a proceeding for delay or in approving a discontinuance, abandonment or settlement, the court shall consider whether notice should be given under section 19 and whether any notice should include,

(a) an account of the conduct of the proceedings;
(b) a statement of the result of the proceeding; and
(c) a description of any plan for distributing settlement funds.

24 The test for approval of the settlement of a class proceeding was described in *Dabbs v. Sun Life Assurance Co. of Canada*[9]. The court must find that in all of the circumstances the settlement is fair, reasonable and in the best interests of those affected by it. In making this determination, the court should consider, amongst other things:

a) the likelihood of recovery or success at trial;
b) the recommendation and experience of class counsel; and
c) the terms of the settlement.

As such, it is clear that although the *CCAA* and class proceeding tests for approval are not identical, a certain symmetry exists between the two.

25 A perfect settlement is not required. As stated by Sharpe J. (as he then was) in *Dabbs v. Sun Life Assurance Co. of Canada*[10]:

> Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs of litigation.

26 Where there is more than one defendant in a class proceeding, the action may be settled against one of the defendants provided that the settlement is fair, reasonable and in the best interests of the class members: *Ontario New Home Warranty Program et al. v. Chevron Chemical et al.*[11]

(iii) The Robertson Settlement

27 I concluded that the settlement agreement met the tests for approval under the *CCAA* and the *Class Proceedings Act*.

28 As a general proposition, settlement of litigation is to be promoted. Settlement saves time and expense for the parties and the court and enables individuals to extract themselves from a justice system that, while of a high caliber, is often alien and personally demanding. Even though settlements are to be encouraged, fairness and reasonableness are not to be sacrificed in the process.

29 The presence or absence of opposition to a settlement may sometimes serve as a proxy for reasonableness. This is not invariably so, particularly in a class proceeding settlement. In a class proceeding, the court approval process is designed to provide some protection to absent class members.

30 In this case, the proposed settlement is supported by the LP Entities, the Representative Plaintiff, and the Monitor. No one, including the non-settling defendants all of whom received notice, opposed the settlement. No class member appeared to oppose the settlement either.

31 The Representative Plaintiff is a very experienced and sophisticated litigant and has been so recognized by the court. She is a freelance writer having published more than 15 books and having been a regular contributor to Canadian magazines for over 40 years. She has already successfully resolved a similar class proceeding against Thomson Canada Limited, Thomson Affiliates, Information Access Company and Bell Global Media Publishing Inc. which was settled for $11 million after 13 years of litigation. That proceeding involved allegations quite similar to those advanced in the action before me. In approving the settlement in that case, Justice Cullity described the involvement of the Representative Plaintiff in the class proceeding:

> The Representative Plaintiff, Ms. Robertson, has been actively involved throughout the extended period of the litigation. She has an honours degree in English from the University of Manitoba, and an M.A. from Columbia University in New York. She is the author of works of fiction and non-fiction, she has been a regular contributor to Canadian magazines and newspapers for over 40 years, and she was a founder member of each of the Professional Writers' Association of Canada and the Writers' Union of Canada. Ms. Robertson has been in communication with class members about the litigation since its inception and has obtained funds from them to defray disbursements. She has clearly been a driving force behind the litigation: *Robertson v. Thomson Canada*[12].

32 The settlement agreement was recommended by experienced counsel and entered into after serious and considered negotiations between sophisticated parties. The quantum of the class members' claim for voting and distribution purposes, though not identical, was comparable to the settlement in *Robertson v. Thomson Canada*. In approving that settlement, Justice Cullity stated:

> Ms. Robertson's best estimate is that there may be 5,000 to 10,000 members in the class and, on that basis, the gross settlement amount of $11 million does not appear to be unreasonable. It compares very favourably to an amount negotiated among the parties for a much wider class in the U.S. litigation and, given the risks and likely expense attached to a continuation of the proceeding, does not appear to be out of line. On this question I would, in any event, be very reluctant to second guess the recommendations of experienced class counsel, and their well informed client, who have been involved in all stages of the lengthy litigation.[13]

33 In my view, Ms. Robertson's and Mr. Guindon's description of the litigation risks in this class proceeding were realistic and reasonable. As noted by class counsel in oral argument, issues relating

to the existence of any implied license arising from conduct, assessment of damages, and recovery risks all had to be considered. Fundamentally, CPI was in an insolvency proceeding with all its attendant risks and uncertainties. The settlement provided a possible avenue for recovery for class members but at the same time preserved the claims of the class against the other defendants as well as the claims against ProQuest for alleged violations attributable to CPI content. The settlement brought finality to the claims in the action against CPI and removed any uncertainty and the possibility of an adverse determination. Furthermore, it was integral to the success of the consolidated plan of compromise that was being proposed in the *CCAA* proceedings and which afforded some possibility of recovery for the class. Given the nature of the CCAA Plan, it was not possible to assess the final value of any distribution to the class. As stated in the joint factum filed by counsel for CPI and the Representative Plaintiff, when measured against the litigation risks, the settlement agreement represented a reasonable, pragmatic and realistic compromise of the class claims.

34 The Representative Plaintiff, Class Counsel and the Monitor were all of the view that the settlement resulted in a fair and reasonable outcome. I agreed with that assessment. The settlement was in the best interests of the class and was also beneficial to the LP Entities and their stakeholders. I therefore granted my approval.

S.E. PEPALL J.

cp/e/qllxr/qlvxw/qlbdp

1 Annual Review of Insolvency Law, 2010, J.P. Sarra Ed, Carswell, Toronto at page 79.

2 (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) at 31.

3 2007 ABQB 504 at para. 71; leave to appeal dismissed 2007 ABCA 266 (Alta. C.A.).

4 (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J.).

5 (2001), 31 C.B.R. (4th) 302 (Ont. S.C.J.) at para. 23.

6 *Supra.* at para. 9.

7 *Supra.* at para. 59.

8 S.O. 1992, c. 6.

9 [1998] O.J. No. 1598 (Ont. Gen. Div.) at para. 9.

10 (1998), 40 O.R. (3d) 429 at para 30.

11 [1999] O.J. No. 2245 (Ont. S.C.J.) at para. 97.

12 [2009] O.J. No. 2650 at para. 15.

13 *Robertson v. Thomson Canada*, [2009] O.J. No. 2650 para. 20.

Case Name:

Robinson v. Rochester Financial Ltd.

**RE: Kathryn Robinson and Rick Robinson,
Plaintiffs/Moving Parties, and
Rochester Financial Limited et al., Defendants/Respondents**

[2012] O.J. No. 534

2012 ONSC 911

[2012] 5 C.T.C. 24

2012 CarswellOnt 1368

212 A.C.W.S. (3d) 20

Court File No. 08-CV-349792 CP

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: January 17, 2012.
Judgment: February 7, 2012.

(45 paras.)

Counsel:

David Thompson and Matthew G. Moloci, for the Plaintiffs.

Glenn Smith and Sean O'Donnell, for the Defendant Fraser Milner Casgrain LLP.

John Finnigan, for the Monitor, Grant Thornton Limited.

ENDORSEMENT

(Settlement Approval and Class Counsel Fee Approval)

1 **G.R. STRATHY J.**:-- This endorsement sets out my reasons for approving the settlement of this class action and approving the fees and disbursements of class counsel, an Order to that effect having been issued on January 17, 2012.

2 The action relates to a tax shelter called the Banyan Tree Foundation Gift Program, which operated in 2003-2007. It has been referred to as a "leveraged" charitable donation program because, in return for a proportionately small out-of-pocket payment, a taxpayer was purportedly entitled to ratchet-up his or her donation and to receive a charitable tax receipt equivalent to 3 1/2 times the amount of his or her cash outlay.

3 The leverage was supposed to be provided by a "loan" to the participant, made by one of the defendants, Rochester Financial Limited, secured by a promissory note. Part of the participant's cash payment was described as a "security deposit", which was supposed to be invested so that it would pay off the loan before the taxpayer was ever called upon to pay it.

4 The effect of this was to allow the taxpayer to profit from his or her donation -- in the case of a taxpayer in the highest bracket, a payment of $2,700 would secure a tax credit of $4,600, resulting in a profit of about $1,900.

5 The program was promoted by the Banyan Tree Foundation through a network of salespeople who were paid substantial commissions.

6 Canada Revenue Agency ("C.R.A.") disallowed the charitable donation tax credits claimed by participants in the Gift Program. It took the position that the "donation" made by the taxpayer was not a gift for the purposes of the *Income Tax Act*, because the loan was not *bona fide* and there were nothing more than book-keeping entries to give an aura of respectability to the transaction. It said that the participants were never at risk to repay their loans and that the program was a sham, designed to have the appearance of a legitimate charitable donation, when the real purpose was to enrich the taxpayer rather than benefit a charity. It therefore disallowed the charitable donation tax credits, and the participants were required to repay the taxes they had deducted, with interest.

7 Not only did the participants lose their deductions, their security deposits have disappeared, apparently due to defalcation by the investment manager.

8 In January 2010, Justice Lax certified this action as a class proceeding: *Robinson v. Rochester Financial Ltd.*, 2010 ONSC 463, [2010] O.J. No. 187.

9 There is no realistic prospect of recovery from any of the parties directly responsible for the Gift Program. This leaves the defendant law firm, Fraser Milner Casgrain LLP ("FMC"), as the last party standing. It provided legal opinions that the Gift Program complied with the applicable tax

legislation and that the tax receipts issued by the Banyan Tree Foundation should be recognized by C.R.A.

10 As a result of mediation before a former judge of this Court, class counsel negotiated a settlement, subject to Court approval, of class members' claims against FMC for the total sum of $11 million. Approximately $7.75 million of this amount will be paid to class members in proportion to the charitable contributions they made, under a distribution plan that will be administered by class counsel. The balance will be used to pay the fees and disbursements of class counsel and the costs of administration of the settlement. In addition to this cash distribution, the plaintiffs asked the Court to make a declaration that the promissory notes executed by class members in connection with the Gift Program are unenforceable.

11 The proposed settlement, and the order I have granted, are somewhat unusual in that all individuals who have previously opted-out of this action, will have the opportunity to opt back in and to enjoy the benefits of the settlement. One of the reasons for this is that, following certification, Banyan Tree Foundation engaged in a misinformation campaign, designed to encourage class members to opt-out of this proceeding, suggesting that class members who opted out would be unable to challenge their C.R.A. reassessments. When this was brought to my attention by class counsel, I issued an order dated June 25, 2010, providing for further notice to class members and an opportunity to revoke their opt-outs. I am satisfied that, in the particular circumstances of this case, it is appropriate to extend this relief in connection with the settlement.

12 Those class members who have previously opted-out, and wish to remain outside the Class, need not do anything further.

13 There were approximately 2,825 participants in the Gift Program. They have received extensive individual notice of the proposed settlement. Approximately 500 objections to the settlement have been delivered. Almost all of these objectors have sent a standard form letter that appears to have been authored by Mr. Tim Millard, an accountant who was also a salesman for the Gift Program and who had approximately 40 clients who are class members. Mr. Millard and two other class members, Mr. Harrington and Dr. Maier, attended the hearing and made submissions. About seven or eight other class members attended the hearing but made no submissions.

14 The uniform concern expressed by Mr. Millard, Mr. Harrington and Dr. Maier, who spoke at the hearing, and by those class members who sent in the standard form letter, related not to the amount of the settlement, but rather to the proposed term of the settlement that would declare the "loan" portion of the taxpayer's contribution to the Gift Program (i.e., the leveraged portion), void and unenforceable. These objectors were concerned that a declaration to this effect would potentially adversely affect any future appeals they may make of their tax assessments or re-assessments.

15 This issue was raised at the hearing and, as a result of further discussions between class counsel and the objectors, a revised form of order, satisfactory to Messrs Millard, Harrington and

Maier, was approved. That form of order, simply declares that the loan agreements and promissory notes executed by class members in connection with the Gift Program are unenforceable by the defendants, their successors and assigns.

16 A handful of objectors who sent written communications were concerned about the relatively modest amount they would receive under the settlement in comparison to the loss of their contributions, the loss of their anticipated deductions and any penalties and interest they may be required to pay. I will discuss this issue below.

17 In order to approve a settlement, the court must be satisfied that it is fair, reasonable and in the best interests of the class: *Nunes v. Air Transat A.T. Inc.*, [2005] O.J. No. 2527, 2005 CarswellOnt 2503 (S.C.J.) at para. 7; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd*., [2005] O.J. No. 1118 (S.C.J.). The "fairness and reasonableness" analysis will vary from case to case, but courts frequently turn to the factors set out in *Dabbs v. Sun Life Assurance Company of Canada*, [1998] O.J. No. 1598 at 13 (Gen. Div.); and (1998), 40 O.R. (3d) 429 at 440-444 (Gen. Div.); aff'd (1998), 41 O.R. (3d) 97 (C.A.); leave to appeal to S.C.C. denied [1998] S.C.C.A. No. 372:

(a) the presence of arm's length bargaining and the absence of collusion;
(b) the proposed settlement terms and conditions;
(c) the number of objectors and nature of objections;
(d) the amount and nature of discovery, evidence or investigation;
(e) the likelihood of recovery or likelihood of success;
(f) the recommendations and experience of counsel;
(g) the future expense and likely duration of litigation;
(h) information conveying to the court the dynamics of, and the positions taken by the parties during the negotiations;
(i) the recommendation of neutral parties, if any; and
(j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation.

18 I am satisfied that most of these factors have been addressed in this settlement. The settlement is clearly the product of hard bargaining at arms' length, facilitated by an experienced mediator. It comes with the recommendation of highly qualified and reputable counsel, who have engaged the assistance of expert tax counsel. The concerns of the overwhelming majority of objectors have been satisfied. The settlement is clearly a compromise, but liability of FMC was a very contentious issue. FMC would argue, if the matter proceeded to trial, that its opinions were consistent with the state of the law as it existed at the time and that the subsequent hardening of the position of C.R.A. and, it would appear, the appellate case law, was not something that could have been foreseen at the time. There were other issues that would also be brought into play by FMC, including whether class members relied on its opinions. A significant discount of the claim was warranted to reflect the real risk that the claim against FMC would not succeed.

19 While a very small number of objectors have expressed concerns about the amount of the settlement, the vast majority of the objectors were concerned only with the issue of the proposed relief in relation to their loans. Over eighty percent of class members have made no comment on the settlement. I acknowledge, however, that some class members think that the settlement amount is too low. Every settlement is necessarily a compromise. It reflects the possibility that the class may recover nothing if the action goes to trial and that there is a benefit to early resolution.

20 For the purposes of a settlement approval motion, I should assume that if the settlement is not approved, the action will proceed to trial. In effect, I would be substituting my view of the prospects of success for the views of class counsel, who have lived with this action since its outset and who are familiar with the risks and benefits of continuing with the action. While I can, in appropriate cases, appoint *amicus* to assist my examination of the settlement, I have in this case a high level of confidence in the fairness and reasonableness of the settlement and I approve it.

Fee of Class Counsel

21 Class counsel entered into a contingency fee retainer agreement with the representative plaintiffs that provided for a contingent fee of 25% of the total value of any settlement. They request approval of the payment of $3,252,682.65 for their fees, disbursements and taxes.

22 I find that the fee agreement meets the requirements of s. 32(1) of the *Class Proceedings Act,* S.O. 1992, c. 6 (the "*C.P.A.*") and that it is fair and reasonable, having regard to the factors set out in the case law, as summarized in *Vitapharm Canada Ltd. v. F. Hoffmann-LaRoche Ltd*., [2005] O.J. NO. 1117 (S.C.J.) at para. 67.

23 In this case, I consider the following circumstances of particular significance:

(a) this action would never have been commenced, let alone successfully resolved, had it not been for the initiative, tenacity and persistence of class counsel in the face of widespread apathy on the part of all class members;
(b) class counsel funded disbursements of almost $200,000, making it unnecessary to apply to the Class Proceedings Fund;
(c) class counsel have gone without any compensation at all through four years of litigation;
(d) class counsel gave an indemnity to the representative plaintiffs with respect to any adverse costs award -- the assumption of a significant risk of not only receiving no fees and disbursements, but the possibility of a substantial six figure costs award against them;
(e) the matter was complex and the outcome was far from certain;
(f) the result achieved is financially significant and every class member will receive actual cash compensation;
(g) in addition to the cash value of the settlement, class members will receive the added benefit of a declaration that their loans and promissory notes are

unenforceable, a matter of some concern to class members;

(h) the time spent by class counsel was about 4,600 hours with a face value of about $1.8 million, and the proposed fee represents a multiplier of less than 2;

(i) there has been no real opposition to class counsel's fee by class members, whose only significant objection related to the scope of the proposed declaration; and

(j) the payment of the proposed fee does not significantly dilute the recovery by class members, and their ability to pay the fee is not an issue.

24 Having supervised this proceeding for more than two years, I am satisfied that class counsel have demonstrated commendable diligence, perseverance and skill in pursuing a very challenging piece of litigation and bringing it to a successful conclusion.

25 I do not propose to repeat the observations I made in *Baker Estate v. Sony BMG Music (Canada) Inc.*, [2011] O.J. No. 5781, concerning the value of contingency fees in the fair compensation of class counsel. In my view, with the benefit of hindsight, it is fair and reasonable that class members should pay the fee requested by class counsel and I approve that fee.

Compensation for the Representative Plaintiffs

26 Class counsel have made a request for compensation in the amount of $5,000 for each of the representative plaintiffs, relying on the authority of *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.), on the basis that the plaintiffs have rendered "active and necessary assistance" in the prosecution of the case.

27 In *Baker Estate v. Sony BMG Music* (Canada Inc.), 2011 ONSC 7105, [2011] O.J. No. 5781, I set out the principles applicable to this request at para. 93:

> The payment of compensation to a representative plaintiff is exceptional and rarely done: *McCarthy v. Canadian Red Cross Society* [2007] O.J. No. 2314 (S.C.J.) at para. 20; *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.); *Sutherland v. Boots Pharmaceutical plc*, [2002] O.J. No. 1361 (S.C.J.); *Bellaire v. Daya* [2007] O.J. No. 4819 (S.C.J.) at para. 71. It should not be done as a matter of course. Any proposed payment should be closely examined because it will result in the representative plaintiff receiving an amount that is in excess of what will be received by any other member of the class he or she has been appointed to represent: *McCutcheon v. Cash Store Inc.* [2008] O.J. No. 5241 (S.C.J.) at para. 12. That said, where a representative plaintiff can show that he or she rendered active and necessary assistance in the preparation or presentation of the case and that such assistance resulted in monetary success for the class, it may be appropriate to award some compensation: *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.) at para. 28.

28 Class counsel says that this is one of those exceptional cases in which compensation should be paid. As I have noted, class counsel faced considerable apathy on the part of class members and it was exceedingly difficult to find someone prepared to take on the role of representative plaintiff until Mr. and Mrs. Robinson stepped up to the plate. Taking on that role required that they expose private personal financial information, including their income tax returns for the years they participated in the Gift Program. They each spent more than 300 hours in assisting class counsel in the prosecution of the action. In comparison, they will receive a modest award of about $6,000 under the settlement.

29 In *Windisman*, above, Sharpe J. observed, at para. 28:

> Ordinarily, an individual litigant is not entitled to be compensated for the time and effort expended in relation to prosecuting an action. In my view, there is an important distinction to be drawn with reference to class proceedings. The representative plaintiff undertakes the proceedings on behalf of a wider group and that wider group will, if the action is successful, benefit by virtue of the representative plaintiff's effort. If the representative plaintiff is not compensated in some way for time and effort, the plaintiff class would be enriched at the expense of the representative plaintiff to the extent of that time and effort. In my view, where a representative plaintiff can show that he or she rendered active and necessary assistance in the preparation or presentation of the case and that such assistance resulted in monetary success for the class, the representative plaintiff may be compensated on a quantum meruit basis for the time spent. I agree with the American commentators that such awards should not be seen as routine. The evidence here is that Ms. Windisman took a very active part at all stages of this action. It seems clear that the case would not have been brought but for her initiative. She assumed the risk of costs and she devoted an unusual amount of time and effort to communicating with other class members, acting as a liaison with the solicitors, and assisting the solicitors at all stages of the proceeding. She kept careful records of her time and effort.

30 In that case, the representative plaintiff had kept docketed time entries showing 81.2 hours of time and estimated a further 25 hours of undocketed time. Sharp J. awarded compensation of $4,000, to be deducted from the net recovery of the class.

31 This issue brings into play some conflicting values. On the one hand, we do not wish to create a conflict of interest between the representative plaintiffs and the class, by giving the former more substantial contribution. This was discussed by Winkler J. in *Sutherland v. Boots Pharmaceutical Plc.*, [2002] O.J. No. 1361 (S.C.J.):

> In the present circumstances the work of the Representative Plaintiffs was unnecessary to the preparation or presentation of the case. Indeed, their work did

> not begin until after the settlement had been structured. Their work did not result in any monetary success for the class. If they were to be compensated in the manner requested they would be the only class members to receive any direct monetary compensation. The entire settlement is in the form of Cy-pres distribution. The representative plaintiffs are seeking some $80,000 in total which is to be deducted from the settlement. By way of contrast, in Windisman, the representative plaintiff took an active part at all stages of the proceeding, the case would not have been brought except for her initiative, she assumed the risk of costs, and devoted an unusual amount of time communicating with class members and assisting counsel. The class members received a direct monetary benefit due in part to her efforts.
>
> While the work of the representative plaintiffs is commendable, to compensate them for the work when the settlement funds for the entire class are being donated to research without a single penny finding its way into the hands of a class member would be contrary to the precept of the Cy-pres distribution in particular and to a class proceeding generally. Compensation for representative plaintiffs must be awarded sparingly. The operative word is that the functions undertaken by the Representative Plaintiffs must be "necessary", such assistance must result in monetary success for the class and in any event, if granted, should not be in excess of an amount that could be purely compensatory on a quantum meruit basis. Otherwise, where a representative plaintiff benefits from the class proceeding to a greater extent than the class members, and such benefit is as a result of the extraneous compensation paid to the representative plaintiff rather than the damages suffered by him or her, there is an appearance of a conflict of interest between the representative plaintiff and the class members. A class proceeding cannot be seen to be a method by which persons can seek to receive personal gain over and above any damages or other remedy to which they would otherwise be entitled on the merits of their claims. This request is denied.

32 In *Hislop v. Canada (Attorney General)*, [2004] O.J. No. 1867 (S.C.J.), an action claiming CPP survivor's pensions for same sex partners, E. Macdonald J. awarded compensation of $15,000 to one representative plaintiff, two others received $10,000 each and two others received $5,000 each.

33 In *Garland v. Enbridge Gas Distribution Inc.*, [2006] O.J. No. 4907, Cullity J. awarded the representative plaintiff $25,000 for his efforts, which he described as an "exceptional contribution". He made the following observations at paras. 45 and 46:

> ... Mr Garland has, in my judgment, made out a strong case for compensation. He took the initiative in seeking legal advice with respect to the legality of late

> payment penalties and in instructing counsel to commence the proceedings. He was instrumental in keeping the legal team together when members of the class counsel sought to withdraw from the proceedings on the ground of a business conflict, and he accepted a large part of the responsibility for communicating with class members personally or through interviews with representatives of the media. He also played an active part in the settlement negotiations and, in particular, in obtaining agreement to the nature and details of the *cy pres* distribution -- one of the matters for which he found it desirable to retain separate counsel.
>
> The litigation was commenced, and continued, by Mr Garland in the public interest and, I am satisfied, that throughout it his primary concern has been to protect and serve the interests of the class. It was on this ground that he firmly opposed counsel's proposal to replace the method of calculating their fee under the 1998 fee agreement with the application of a multiplier to be applicable irrespective of the gross recovery.

34 In *McCutcheon v. Cash Store Inc.*, [2008] O.J. No. 5241, Cullity J. approved a payment of $10,000, stating at paras. 22 and 23:

> Although I am not oblivious to the risk of engendering expectations that such payments will be approved as a matter of course, the request in this case is strongly supported by class counsel who have sworn to the significant amount of time expended by Mr McCutcheon in advancing the interests of the class. His efforts were not confined to meetings with class counsel but extended to communicating with other class members, monitoring developments in the pay-day loan industry and providing input and assistance to class counsel in the settlement negotiations. Counsel have testified to his active part in all stages of the litigation and his time and energy spent in liaising between them and class members. They have sworn that he accepted the personal exposure to an adverse costs award and, to the benefit of the class, that he did not choose to seek assistance from the Class Proceedings Fund. They have stated that the request for compensation was made entirely at their suggestion. While I consider the amount requested to be on the high side, I am satisfied that, independently of this payment and the payment of counsel fees, the settlement merits approval and that the total amount of class counsel fees and the representative plaintiff's compensation could be justified if, as in *Garland*, it consisted of counsel fees from which the representative plaintiff's compensation was to be paid. On the basis of the strong support provided by class counsel, I will approve the amount of $10,000. I will, however, reiterate what I have said in other cases that, as a general rule, all benefits and payments to be made by defendants should be

> treated as a single package when considering the fairness and reasonableness of a settlement from the viewpoint of a class. This, I believe, should be accepted whether or not there are expressed to be separate agreements for fees to be paid directly by defendants rather than out of a settlement amount otherwise earmarked for the benefit of the class. As in other parts of the law, substance must prevail over form.

35 In *Fakhri v. Alfalfa's Canada Inc.*, 2005 BCSC 1123, [2005] B.C.J. No. 1723, Gerow J. of the British Columbia Supreme Court awarded $5,000 as compensation for the representative plaintiff. In that case, the defendant had agreed to pay the amount directly to the representative, with the result that it would not dilute the recovery of the class. It was found that the plaintiff had delivered multiple affidavits, reviewed pleadings, provided instructions, attended the mediation and court hearings, and helped shape the final settlement. The judge found that the plaintiff's efforts on behalf of the class had an impact on the successful resolution of the proceeding.

36 In *Walker v. Union Gas, Ltd.*, [2009] O.J. No. 536, Cumming J. approved a payment of $5,000 to the representative payment, out of the fees of class counsel. He observed that the plaintiff had spent more than 70 hours in the conduct of the litigation, including reviewing some 10 bankers' boxes of documents, cross-referencing documents and isolating bills, and traveling to Toronto for the meeting with the Class Proceedings Committee.

37 In the recent case of *Smith Estate v. National Money Mart Co.* 2011 ONCA 233, [2011] O.J. No. 1321, the Court of Appeal affirmed the motion judge's decision to award $3,000 compensation to the representative plaintiff. It suggested that generally such a fee should be paid out of the settlement fund, rather than out of class counsel's fees, to avoid any spectre of fee-splitting. In that case, the Court of Appeal observed, at para. 134, that judges of this court have taken different approaches with respect to the payment of fees for the representative plaintiffs. It noted that it had not previously dealt with the issue. We can take from the Court of Appeal's decision that the court may award compensation to a representative plaintiff in an "appropriate case".

38 In *McCarthy v. Canadian Red Cross Society* [2007] O.J. No. 2314 (S.C.J.) there was a request for fees and disbursements to be paid to the representative plaintiff, in the amount of $75,000. In dismissing the request, Winkler J. observed at para. 20:

> Mr. McCarthy has fulfilled his obligation to the class as their representative. However, a distinction must be drawn between the professional advisors to the class and the representative plaintiff with respect to fees. Where it is necessary for the representative plaintiff to incur out-of-pocket expenses in acting in that capacity, such as attendance at discoveries as one example, it may be appropriate for class counsel to reimburse such amounts and claim it as a disbursement subject to recovery on approval by the Court. While each case turns on its facts, in my view, it is not generally appropriate for a representative plaintiff to receive

> a payment for fees or for time expended in the pursuit of the action. Further, any payment made to a representative plaintiff in connection with the action, whether directly or indirectly, and whether for reimbursement or otherwise, must be disclosed to the Court.

39 It would appear that judges in British Columbia have been less reluctant to award compensation for representative plaintiffs. In addition to *Fakhi v. Alfalfa's Canada Inc.*, above, I will mention *Reid v. Ford Motor Co.,* 2006 BCSC 1454, in which a payment of $3,000 was approved on a *quantum meruit* basis, to be paid from class counsel fees and *MacKinnon v. Vancouver City Savings Credit Union,* 2004 BCSC 1604, 34 B.C.L.R. (4th) 322 in which a payment of $5,000 was approved to be paid as a disbursement.

40 In a recent decision of the British Columbia Court of Appeal in *Parsons v. Coast Capital Savings Credit Union,* 2010 BCCA 311, [2010] B.C.J. No. 1184, the representative plaintiff appealed an order of the settlement approval motion judge refusing to award compensation to the representative plaintiff in the amount of $10,000. The motion judge had concluded that British Columbia law only permitted compensation to be paid to the representative plaintiff where he or she has made a contribution that is over and above the contribution expected of a representative plaintiff, although it need not be an extraordinary contribution.

41 After a thorough review of the authorities in both Canada and the United States, the Court of Appeal concluded that it was not necessary for the class representative to show that he or she performed services of special significance. It said that where the representative plaintiff has fulfilled his or her duties, and a favourable settlement has been achieved, a "modest award in recognition of the effort expended on behalf of the class" would be appropriate. The Court stated, at paras. 20-3:

> I consider it is too narrow to say, as the judge did here, that services of special significance beyond the usual responsibilities under the *Act* are required for a separate award to the representative plaintiff. Where the representative plaintiff has fulfilled his or her duties, which will include attendance for examination in discovery, providing instructions on all steps taken in the litigation and on the settlement (which necessarily requires immersion in the substance of the case), and where a monetary settlement in favour of the class members is achieved, a modest award in recognition of the effort expended on behalf of the class members is consistent with restitutionary principles and recognition of the principle of *quantum meruit.* This expectation is further justified by the exposure to costs assumed by the representative plaintiff in commencing the action. While that risk is mitigated upon certification, there is a real exposure to costs assumed on commencing the action. Other intangible costs also are borne by such a plaintiff, including the sometimes not inconsiderable weight of being the leader of the claimants.

> In other words, I do not consider exceptional service is required. Rather competent service accompanied by positive results should be sufficient for recognition in this way, weighing in this factor the quantum of personal benefit achieved by the representative plaintiff with the overall benefit achieved for the class.
>
> In considering the quantum of such a payment, where the representative plaintiff's personal benefit is small but the collective benefit is great, there may be disproportion between personal benefit on the one hand and effort and responsibility on the other, so as to weigh in favour of a somewhat larger award. Nevertheless, in no case should the award be so large as to create the impression that the representative plaintiff was put into a conflict of interest. The outer bounds of what could be an appropriate compensatory award may vary from case to case, depending on factors such as the terms of settlement or award at issue and the personal circumstances of the representative plaintiff.
>
> In this case Ms. Parsons was a representative plaintiff in another action, and in the course of that proceeding her counsel observed the overdraft payment that grounded this action. In other words, Ms. Parsons did not initiate the claim. Nonetheless she exposed herself to costs in any proceedings that might have arisen prior to the certification application, she assumed responsibility for deriving benefit for others, she attended at an examination for discovery, she was available for conversation during the mediation, and in the end result she fronted an action that was significantly successful. In my view these features of the case, while not extraordinary, militate in favour of payment to her of a modest sum, described by her counsel as an honourarium.

42 The Court held that an award of $3,500, payable as a disbursement, would be appropriate. I note that one of the factors the Court of Appeal considered was the representative plaintiff's exposure to costs, a factor not relevant in this case due to the indemnity agreement.

43 In this particular case, while I acknowledge the contribution made by Kathryn Robinson and by Rick Robinson, and commend them on the work they have done to bring this matter to a successful conclusion on behalf of their fellow class members, I am not prepared to award such compensation. In my respectful view, requests for compensation for the representative plaintiff are becoming routine, as Sharpe J. anticipated in *Windisman,* above. I agree with those who have expressed the opinion that compensation should be reserved to those cases where, considering all the circumstances, the contribution of the plaintiff has been exceptional. The factors that might be appropriate for consideration could include:

(a) active involvement in the initiation of the litigation and retainer of counsel;
(b) exposure to a real risk of costs;
(c) significant personal hardship or inconvenience in connection with the prosecution of the litigation;
(d) time spent and activities undertaken in advancing the litigation;
(e) communication and interaction with other class members; and
(f) participation at various stages in the litigation, including discovery, settlement negotiations and trial.

44 I conclude, with some regret, that in this particular case the application of these factors, considered as a whole, do not dictate payment of compensation.

Conclusion

45 The settlement is therefore approved, as are the fees and disbursements of class counsel. I have also issued an order, on consent, discharging the Monitor, Grant Thornton Limited.

G.R. STRATHY J.

cp/e/qlrxg/qlvxw/qlced/qlcas

Indexed as:

Sammi Atlas Inc. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
IN THE MATTER OF the Courts of Justice Act, R.S.O. 1990, c. C-43
IN THE MATTER OF a Plan of Compromise or Arrangement of Sammi Atlas Inc.

[1998] O.J. No. 1089

59 O.T.C. 153

3 C.B.R. (4th) 171

78 A.C.W.S. (3d) 10

Commercial List Nos. 97-BK-000219 and B230/97

Ontario Court of Justice (General Division)
Commercial List

Farley J.

Heard: February 27, 1998.
Judgment: February 27, 1998.

(7 pp.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval -- Arrangement, judicial approval -- Amendment of Plan.

Application by Sammi Atlas to approve its Plan of compromise and arrangement as amended and approved by its secured creditors. It was also a motion by Argo Partners for an order to direct that a person who held unsecured claims was entitled to elect treatment for each unsecured claim held by it on an individual basis, and not on an aggregate basis as provided for in the Plan. The Plan provided for a sliding scale of distribution. Claims of $7,500 were entitled to receive the highest

amount, namely cash of 95 per cent of the proven claim. Argo had acquired 40 claims. Each claim was under $100,000, but the aggregate of the claims was over $100,000. Argo wanted to treat its claims separately because it could have kept the individual claims separate by having them held by a different person.

HELD: Sammi's application was allowed. Argo's motion was denied. Sammi was a corporation to which the Companies' Creditors Arrangement Act applied. The Plan complied with the requirements of the Act. The Plan was fair and reasonable as no one opposed it being approved. Argo merely wanted the Plan amended to accommodate its particular concerns. Argo wanted to amend the Plan after it was voted upon. It wanted a substantive change, which the court lacked jurisdiction to grant under the Act. Argo's change was also not allowed because it was treated fairly and reasonably as a creditor as were all the unsecured creditors. An aggregation clause was not inherently unfair and the sliding scale provisions, which were intended to protect small investors, were reasonable.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Counsel:

Norman J. Emblem, for the applicant, Sammi Atlas Inc.
James Grout, for Argo Partners, Inc.
Thomas Matz, for the Bank of Nova Scotia.
Jay Carfagnini and Ben Zarnett, for Investors' Committee.
Geoffrey Morawetz, for the Trade Creditors' committee.
Clifton Prophet, for Duk Lee.

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1 FARLEY J. (endorsement):-- This endorsement deals with two of the motions before me today:

1) Applicant's motion for an order approving and sanctioning the Applicant's Plan of Compromise and Arrangement, as amended and approved by the Applicant's unsecured creditors on February 25, 1998; and
2) A motion by Argo Partners, Inc. ("Argo"), a creditor by way of assignment, for an order directing that the Plan be amended to provide that a person who, on the record date, held unsecured claims shall be entitled to elect treatment with respect to each unsecured claim held by it on a claim by claim basis (and not on an aggregate basis as provided for in the Plan).

2 As to the Applicant's sanction motion, the general principles to be applied in the exercise of the court's discretion are:

1) there must be strict compliance with all statutory requirements and adherence to the previous orders of the court;
2) all materials filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the Companies' Creditors Arrangement Act ("CCAA"); and
3) the Plan must be fair and reasonable.

See Re Northland Properties Limited (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.), affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.) at p. 201; Re Olympia & York Developments Ltd. (1993), 12 O.R. (3d) 500 (Gen. Div.) at p. 506.

3 I am satisfied on the material before me that the Applicant was held to be a corporation as to which the CCAA applies, that the Plan was filed with the court in accordance with the previous orders, that notices were appropriately given and published as to claims and meetings, that the meetings were held in accordance with the directions of the court and that the Plan was approved by the requisite majority (in fact it was approved 98.74% in number of the proven claims of creditors voting and by 96.79% dollar value, with Argo abstaining). Thus it would appear that items one and two are met.

4 What of item 3 - is the Plan fair and reasonable? A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment. One must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights: see Re Campeau Corp. (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) at p. 109. It is recognized that the CCAA contemplates that a minority of creditors is bound by the Plan which a majority have approved - subject only to the court determining that the Plan is fair and reasonable: see Northland at p. 201; Olympia & York at p. 509. In the present case no one appeared today to oppose the Plan being sanctioned; Argo merely wished that the Plan be amended to accommodate its particular concerns. Of course, to the extent that Argo would be benefited by such an amendment, the other creditors would in effect be disadvantaged since the pot in this case is based on a zero sum game.

5 Those voting on the Plan (and I note there was a very significant "quorum" present at the meeting) do so on a business basis. As Blair J. said at p. 510 of Olympia & York:

> As the other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment

> of the participants. The parties themselves know best what is in their interests in those areas.

The court should be appropriately reluctant to interfere with the business decisions of creditors reached as a body. There was no suggestion that these creditors were unsophisticated or unable to look out for their own best interests. The vote in the present case is even higher than in Re Central Guaranty Trustco Ltd. (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div.) where I observed at p. 141:

> ... This on either basis is well beyond the specific majority requirement of CCAA. Clearly there is a very heavy burden on parties seeking to upset a plan that the required majority have found that they could vote for; given the overwhelming majority this burden is no lighter. This vote by sophisticated lenders speaks volumes as to fairness and reasonableness.
>
> The Courts should not second guess business people who have gone along with the Plan ...

6 Argo's motion is to amend the Plan - after it has been voted on. However I do not see any exceptional circumstances which would support such a motion being brought now. In Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11 (Ont. C.A.) the Court of Appeal observed at p. 15 that the court's jurisdiction to amend a plan should "be exercised sparingly and in exceptional circumstances only" even if the amendment were merely technical and did not prejudice the interests of the corporation or its creditors and then only where there is jurisdiction under the CCAA to make the amendment requested. I was advised that Argo had considered bringing the motion on earlier but had not done so in the face of "veto" opposition from the major creditors. I am puzzled by this since the creditor or any other appropriate party can always move in court before the Plan is voted on to amend the Plan; voting does not have anything to do with the court granting or dismissing the motion. The court can always determine a matter which may impinge directly and materially upon the fairness and reasonableness of a plan. I note in passing that it would be inappropriate to attempt to obtain a preview of the court's views as to sanctioning by bringing on such a motion. See my views in Central Guaranty at p. 143:

> ... In Algoma Steel Corp. v. Royal Bank (1992), 8 O.R. (3d) 449, the Court of Appeal determined that there were exceptional circumstances (unrelated to the Plan) which allowed it to adjust where no interest was adversely affected. The same cannot be said here. FSTQ aside from s. 11(c) of the CCAA also raised s. 7. I am of the view that s. 7 allows an amendment after an adjournment - but not after a vote has been taken. (Emphasis in original)

What Argo wants is a substantive change; I do not see the jurisdiction to grant same under the CCAA.

7 In the subject Plan creditors are to be dealt with on a sliding scale for distribution purposes only; with this scale being on an aggregate basis of all claims held by one claimant:

i) $7,500 or less to receive cash of 95% of the proven claim;
ii) $7,501 - $100,000 to receive cash of 90% of the first $7,500 and 55% of balance; and;
iii) in excess of $100,000 to receive shares on a formula basis (subject to creditor agreeing to limit claims to $100,000 so as to obtain cash as per the previous formula).

8 Such a sliding scale arrangement has been present in many proposals over the years. Argo has not been singled out for special treatment; others who acquired claims by assignment have also been affected. Argo has acquired 40 claims; all under $100,000 but in the aggregate well over $100,000. Argo submitted that it could have achieved the result that it wished if it had kept the individual claims it acquired separate by having them held by a different "person"; this is true under the Plan as worded. Conceivably if this type of separation in the face of an aggregation provision were perceived to be inappropriate by a CCAA applicant, then I suppose the language of such a plan could be "tightened" to eliminate what the applicant perceived as a loophole. I appreciate Argo's position that by buying up the small claims it was providing the original creditors with liquidity but this should not be a determinative factor. I would note that the sliding scale provided here does recognize (albeit imperfectly) that small claims may be equated with small creditors who would more likely wish cash as opposed to non-board lots of shares which would not be as liquidate as cash; the high percentage cash for those proven claims of $7,500 or under illustrates the desire not to have the "little person" hurt - at least any more than is necessary. The question will come down to balance - the plan must be efficient and attractive enough for it to be brought forward by an applicant with the realistic chance of its succeeding (and perhaps in that regard be "sponsored" by significant creditors) and while not being too generous so that the future of the applicant on an ongoing basis would be in jeopardy; at the same time it must gain enough support amongst the creditor body for it to gain the requisite majority. New creditors by assignment may provide not only liquidity but also a benefit in providing a block of support for a plan which may not have been forthcoming as a small creditor may not think it important to do so. Argo of course has not claimed it is a "little person" in the context of this CCAA proceeding.

9 In my view Argo is being treated fairly and reasonably as a creditor as are all the unsecured creditors. An aggregation clause is not inherently unfair and the sliding scale provisions would appear to me to be aimed at "protecting (or helping out) the little guy" which would appear to be a reasonable policy.

10 The Plan is sanctioned and approved; Argo's aggregation motion is dismissed.

POSTSCRIPT

11 I reviewed with the insolvency practitioners (legal counsel and accountants) the aspect that

industrial and commercial concerns in a CCAA setting should be distinguished from "bricks and mortgage" corporations. In their reorganization it is important to maintain the goodwill attributable to employee experience and customer (and supplier) loyalty; this may very quickly erode with uncertainty. Therefore it would, to my mind, be desirable to get down to brass tacks as quickly as possible and perhaps a reasonable target (subject to adjustment up or down according to the circumstances including complexity) would be for a six month period from application to Plan sanction.

FARLEY J.

qp/d/mii/DRS/DRS

Case Name:

Semple v. Canada (Attorney General)

Between

Christine Semple, Jane McCallum, Stanley Thomas Nepetaypo, Peggy Good, Adrian Yellowknee, Kenneth Sparvier, Denis Smokeday, Rhonda Buffalo, Marie Gagnon, Simon Scipio, as representatives and claimants on behalf of themselves and all other individuals who attended residential schools in Canada, including but not limited to all residential schools' clients of the proposed class counsel, Merchant Law Group, as listed in part Schedule 1 to this claim and the John and Jane Does named herein, and such further John and Jane Does and other individuals belonging to the proposed class, including John Doe I, Jane Doe I, John Doe II, Jane Doe II, John Doe III, Jane Doe III, John Doe IV, Jane Doe IV, John Doe V, Jane Doe V, John Doe VI, Jane Doe VI, John Doe VII, Jane Doe VII, John Doe VIII, Jane Doe VIII, John Doe IX, Jane Doe IX, John Doe X, Jane Doe X, John Doe XI, Jane Doe XI, John Doe XII, Jane Doe XII, John Doe XIII, Jane Doe XIII being a Jane and John Doe for each Canadian Province and Territory, and other John and Jane Does, individual, estates next-of-kin and entities to be added, Plaintiffs, and

The Attorney General of Canada, the Presbyterian Church in Canada, the General Synod of the Anglican Church of Canada, the United Church of Canada, the Board of Home Missions in the United Church of Canada, the Women's Missionary Society of the Presbyterian Church, the Baptist Church in Canada, Board of Home Missions and Social Services of the Presbyterian Church in Bay, the Canada Impact North Ministries, the Company for the Propagation of the Gospel in New England (also known as the New England Company), the Diocese of Saskatchewan, the Diocese of

the Synod of Cariboo, the Foreign Mission of the Presbyterian Church in Canada, the Incorporated Synod of the Diocese of Huron, the Methodist Church of Canada, the Missionary Society of the Anglican Church of Canada, the Missionary Society of the Methodist Church of Canada (also known as the Methodist Missionary Society of Canada), the Incorporated Synod of the Diocese of Algoma, the Synod of the Anglican Church of the Diocese of Quebec, the Synod of the Diocese of Athabasca, the Synod of the Anglican Church of the Diocese of Brandon, the Anglican Synod of the Diocese of British Columbia, the Synod of the Diocese of Calgary, the Synod of the Diocese of Keewatin, the Synod of the Diocese of Qu'appelle, the Synod of the Diocese of New Westminster, the Synod of the Diocese of Yukon, the Trustee Board of the Presbyterian Church in Canada, the Board of Home Missions and Social Service of the Presbyterian Church of Canada, the Women's Missionary Society of the United Church of Canada, Sisters of Charity, a body corporate also known as Sisters of Charity of St. Vincent de Paul, Halifax, also known known as Sisters of Charity Halifax, Roman Catholic Episcopal Episcopal Corporation of Halifax, Les Soeurs de Notre Dame-Auxiliatrice, les Soeurs de St. Francois d'Assise, Institut des Soeurs du Bon Conseil, les Soeurs de Saint-Joseph de Saint-Hyacinthe, les Oeuvres de Jesus-Marie, les Soeurs de l'Assomption de la Sainte Vierge, les Soeurs de l'Assomption de la Saint Vierge de l'Alberta, les Soeurs de la Charite de St.-Hyacinthe, les Soeurs Oblates de l'Ontario, les Residences Oblates du Quebec, la Corporation Episcopale Catholique Romaine de la Baie James (the Roman Catholic Episcopal Corporation of James Bay) the Catholic Diocese of Moosonee, Soeurs Grises de Montreal/Grey Nuns of Montreal, Sisters of Charity (Grey Nuns) of Alberta, les Soeurs de la Charite des T.N.O. Hotel-Dieu de Nicolet, the Grey Nuns of Manitoba Inc. - les Soeurs Grises du Manitoba Inc., la Corporation Episcopale Catholique Romaine de la

Baie d'Hudson-the Roman Catholic Episcopal Corporation of Hudson's Bay, Missionary Oblates-Grandin, les Oblats de Marie Immaculee du Manitoba, the Archiepiscopal Corporation of Regina, the Sisters of the Presentation, the Sisters of St. Joseph of Sault St. Marie, Sisters of Charity of Ottawa, Oblates of Mary Immaculate-St. Peter's Province, the Sisters of Saint Ann, Sisters of Instruction of the Child Jesus, the Benedictine Sisters of Mt. Angel Oregon, les Peres Montfortains, the Roman Catholic Bishop of Kamloops Corporation Sole, the Bishop of Victoria, Corporation Sole, the Roman Catholic Bishop of Nelson Corporation Sole, order of the Oblates of Mary Immaculate in the Province of British Columbia, the Sisters of Charity of Providence of Western Canada, la Corporation Episcopale Catholique Romaine de Grouard, Roman Catholic Episcopal Corporation of Keewatin, la Corporation Archiepiscopale Catholique Romaine de St. Boniface, les Missionaires Oblates Sisters de St. Boniface - the Missionary Oblates Sisters of St. Boniface, Roman Catholic Archiepiscopal Corporation of Winnipeg, la Corporation Episcopale Catholique Romaine de Prince Albert, the Roman Catholic Bishop of Thunder Bay, Immaculate Heart Community of Los Angeles CA, Archdiocese of Vancouver-the Roman Catholic Archbishop of Vancouver, Roman Catholic Diocese of Whitehorse, the Catholic Episcopale Corporation of Mackenzie-Fort Smith, the Roman Catholic Episcopal Corporation of Prince Rupert, Episcopal Corporation of Saskatoon, OMI Lacombe Canada Inc., Defendants

[2006] M.J. No. 498

2006 MBQB 285

40 C.P.C. (6th) 314

213 Man.R. (2d) 220

156 A.C.W.S. (3d) 751

2006 CarswellMan 482

Docket: CI 05-01-43585

Manitoba Court of Queen's Bench
Winnipeg Centre

Schulman J.

Judgment: December 15, 2006.

(34 paras.)

Civil procedure -- Parties -- Class or representative actions -- Certification -- Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- There were 78,000 Aboriginal persons alive who attended residential schools -- Motion allowed -- Class proceeding was preferable proceeding to alternative which faced 78,000 claimant.

Civil procedure -- Settlements -- Approval of -- Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- Proposed settlement provided for payment by Canada with participation by several church defendants of six kinds of payments and for payment of legal costs from separate fund -- Motion allowed -- Settlement approved unconditionally -- Settlement negotiated with legal counsel and consented to by all parties -- Expectation had been created on part of class members that they would receive payments and many had received interim payments.

Motion for certification of class action and approving settlement of residential school litigation -- Plaintiff Aboriginal people were former residential school residents and sued for damages for sexual, physical and emotional abuse -- There were 78,000 Aboriginal persons alive who attended residential schools -- Numerous actions had been commenced -- Proposed settlement provided for payment by Canada with participation by several church defendants of six kinds of payments, two of which were to residential students directly -- Rest addressed broad social implications of the residential school legacy -- Canada established fund of $1.9 billion dollars to fund payments to every student -- Canada bore risk of any insufficiency in fund -- Any surplus to be paid according to formula -- Settlement provided for initial payment of $8,000 -- Class members entitled to seek additional payments for serious physical abuse, sexual abuse and specified wrongful acts through Independent Assessment Process -- Settlement provided for Canada to fund setting up of Truth and Reconciliation process and for commemorative initiatives at national and community levels and to

fund Aboriginal healing programs -- Canada to be paying from separate fund legal fees for conduct of various Court actions and for negotiation of settlement agreement -- All parties consented to settlement -- HELD: Motion allowed -- All criteria met for certification of action as class action -- Action certified as class action -- Settlement approved unconditionally -- Class action preferable proceeding to alternative which faced 78,000 claimants -- Proposed settlement was reasonable and in best interest of parties -- Settlement negotiated with help of experienced counsel -- Settlement was historic and, once implemented, Canadians would look back with pride on way parties agreed to put to rest issues arising from residential school legacy -- Expectation had been created on part of class members that they would receive payments and many had received interim payments.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, C.C.S.M. c. C130, s. 4(a), s. 4(b), s. 4(c), s. 4(d), s. 4(e), s. 35(1), s. 35(2), s. 35(3)

Legal Profession Act, S.M. 2002 c. 44, s. 55

Limitation of Actions Act, C.C.S.M. c. L 150,

Counsel:

Plaintiffs:

National Certification Committee: Mr. K. Baert, Ms. C. Poltak, Mr. W. Percy and Mr. J. Horyski.

Assembly of First Nations and National Chief Phil Fontaine: Mr. J.K. Phillips.

Merchant Law Group: Mr. N. Rosenbaum.

Defendants:

The Attorney General of Canada: Ms. K. Coughlan, Ms. J. Oltean and Ms. A. Kenshaw.

United Church of Canada, Anglican Church in Canada, Presbyterian Church in Canada: Mr. A. Pettingill.

All Catholic entities: Mr. R. Donlevy and Mr. P. Baribeau.

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1 SCHULMAN J.:-- It is rare for this Court to have an opportunity to determine an issue of national and historic importance. This motion for an order certifying a class action and approving settlement of Residential School Litigation presents this Court with such an opportunity.

2 The motion has been brought with the consent of all parties. For more than a century the Government of Canada, hereafter referred to as Canada, implemented a policy under which it compelled Aboriginal children to leave their homes and attend Indian Residential Schools, hereafter referred to as IRS, that were supervised by Canada and run by various churches. This policy was designed to reengineer Aboriginal people into a European model by educating them to abandon their language, culture and way of life and adopt the language, culture and religions of other Canadians. Looking back on the policy in 2006, it is an understatement to say that it is well below standards by which we like to think we treat other people and created problems for the Aboriginal people which require being addressed on a pan Canadian basis. There were 130 schools and they were located in all the provinces and territories of Canada except Newfoundland, New Brunswick and Prince Edward Island. While attending the schools many of the children were abused physically, sexually and emotionally and they suffered damage that in turn has adversely affected generations of Aboriginal people. The proposed settlement, which the parties are anxious to have concluded, provides for and creates unique and comprehensive remedies to solve a serious problem that has confronted this country for decades. The agreement provides that it must be approved by judges in nine provinces and territorial courts and the settlement will fail unless all nine judges approve the settlement on substantially the same terms and conditions as provided in the settlement agreement.

3 As in all cases where a Court is asked to approve a settlement involving vulnerable plaintiffs, this Court must ask itself before considering a rejection of the settlement, whether it can guarantee a better result. Before granting approval subject to conditions which call for significant changes to the agreement, a Court must ask itself whether it is worth risking the unravelling of the agreement and leaving nearly 80,000 Aboriginal people and their families to pursue the remedies available to them prior to the agreement being signed.

4 As I understand it one or more of the judgments released by my colleagues in other provinces attach at least four conditions to their approval of the settlement. One of the conditions relates to the question of who is going to supervise the administration of the settlement. The agreement provides that the administration is to be supervised by the defendant, the Attorney General of Canada, whom I refer to as Canada. The condition of the judgments is that there be independent supervision subject to reporting to the Court. The judgment suggests that this may not be a material change in the agreement. I will discuss the risks that are created by the attaching of that and other conditions, in para. 33 of this judgment.

5 In addressing the issues presented, I deal with the following matters;

a) the present plight of litigants and other persons who may wish to make a claim;
b) an outline of the proposed settlement;
c) the principles applicable to a motion for certification and how they relate to this case;

d) the principles relating to Court approval and how they relate to this case;
e) the recommendation of counsel for the represented parties;
f) the positions advanced by persons not represented by counsel either in writing or in person;
g) improvements suggested by Winkler J. in the Baxter case;
h) the risks of a conditional approval; and
i) conclusion.

a) The present plight of litigants and other injured persons;

6 There are approximately 78,000 Aboriginal persons alive who attended and resided in Indian Residential Schools. Most of them live in Canada, although some live in the United States. Their numbers reduce weekly as 25 of them die. Ten thousand of them have sued the federal government and churches and perpetrators of abuse. Of them, 11 per cent or 1100 have sued in Manitoba in one or another of 289 actions. If these 78,000 people were to pursue the remedies to which they may be entitled, through the court process, it would present our court system and all those people with a daunting challenge. As a result of pre-trial procedures including Judicially Assisted Dispute Resolution Conferences the vast majority of civil actions in Manitoba are settled before trial. In our Court fewer than 100 civil cases each year are brought to trial. These abuse claims are claims which are least likely to settle before trial. It is hard to imagine, in the event of claims being commenced for 11 percent of 78,000 or 8500 persons, when we would next take on any other civil trial if all the Manitoba claims were readied for trial. What would happen to the workload of the other Courts in Canada if the rest of the claims were sued and set down for trial?

7 Now let us look at the situation confronting Aboriginal people who were devastated over the years by the events referred to in the pleadings. Many of them are impoverished. Many of them are illiterate. Culturally many of them are shy, reserved and reluctant to give evidence in Court. Relatively few of their claims have been tried to date. At the trials held to date, the plaintiffs have suffered the embarrassment of being required to give evidence publicly about the abuse they suffered many years before. In many of the cases they were required to recount their painful experience on prolonged examinations for discovery. One case took 16 years to wend its way to trial, appeal and the Supreme Court. The trial lasted 60 days. Another claim by 26 plaintiffs lasted six years. The trial was conducted in three segments a total of 108 days. Other cases have taken between two and six years from start to finish. Many of the plaintiffs are of very modest means and the cost of engaging experts, conducting assessments and leading the evidence at trial is very great.

8 In the context of this litigation, every plaintiff must overcome enormous hurdles in order to succeed in an action and realize on any judgment obtained. Starting with the question of realizing a judgment, it is in most cases of abuse, not good enough to obtain judgment against the perpetrator of abuse, because he or she may not have sufficient assets to pay the judgment. Consequently, it is necessary for each and every plaintiff to find a legal basis for holding Canada or a church liable, and in the case of the churches there is a real question of their ability to pay one or more of the judgments.

9 While we live in an era where unrepresented litigants are filing their own claims in unprecedented numbers, making a claim in these circumstances requires the preparation of a written pleading which will test the skills of an experienced pleader. Pleadings prepared below the minimum standard run the risk of being struck out or dismissed fairly early in a proceeding. Legal representation is pretty well a must in these claims.

10 If the Aboriginal plaintiffs find lawyers who will represent them and have the required expertise, one of the first problems to be addressed is whether the claim can be brought on a timely basis or whether it will be barred by the **Limitation of Actions Act** C.C.S.M. c. L 150 and like legislation in other provinces. In Manitoba the legislature attempted in 2002 to amend the statute and relieve plaintiffs from the harshness of a 30 year ultimate limitation period (S.M. 2002, c. 5, s. 4) but the amendment is unlikely to help many of this class of plaintiff because it is a principle of law that a defendant acquires a vested right to have the benefit of any limitation period in place at the time a wrong is committed even if the limitation provision is later repealed.

11 If a member of this class of plaintiffs is able to overcome the limitation problem which is inherent in these decades old claims, the claims may be met with attempts by the defendants to defeat the claims on a long list of grounds, a few of which I will describe briefly, many of which have not been tested in Court. Firstly, it may be argued that loss of language, culture and identity is not an item of damage for which Courts are able to award compensation. Secondly, the only legal basis for imposing liability against the federal government is by proof that a servant of Canada would be personally liable, if sued and that Canada is vicariously liable. In the case of claims pre-dating 1953, one would have to base the claim in negligence and show that the acts in question took place in the course of the wrong-doers employment. It was only by means of a legislative change in 1953 that Canada became liable for intentional torts of its servants. However, it may be argued that Canada is not liable for the tortious acts of all its employees. In one case the Supreme Court held that in order to support a finding of vicarious liability there had to be a strong connection between what the employer was asking the employee to do and the wrongful conduct. The Court rejected a claim against a school where a man who was employed as a baker, driver and odd-job man assaulted a student in his living quarters. In negligence claims defendants might try to justify the actions of their servants by establishing that the operation of the schools and treatment of students met the standards of the times or contemporary standards. When one makes a claim in a civil action against another based on conduct that amounts to a crime, the burden of proof to be satisfied is proof on a balance of probabilities commensurate with the seriousness of the allegation. This is higher than the usual burden of proof in a civil trial.

12 In November 2003 Canada created an ADR system as an alternative to litigation. Under the ADR program victims of IRS are permitted to make claims for damages for acts of physical and sexual abuse by school employees. The amount of the award is set by one of 32 full time adjudicators based on a grid consisting of several categories for which an adjudicator is able to make an award to a limit of $245,000.00. The amounts awarded vary from province to province. The adjudicators do not have the authority to award damages for lost earnings. Canada pays 70

percent of the amount of the award leaving it to the claimant to collect the other 30 percent from the church sponsor of the IRS in question. Since inception 5000 claims have been filed and 4000 of them are outstanding.

b) An outline of the proposed settlement;

13 The settlement makes provision for payment by Canada with participation by several church defendants, of six kinds of payments, two of which are to residential students directly provided they were alive on May 30, 2005, and the rest of which address the broad social implications of the IRS legacy. Firstly, all former students alive at the above date will receive the sum of $10,000.00 for the first year of attendance in an IRS and a further sum of $3,000.00 for each year of attendance thereafter. An IRS student who attended one or more schools for say 12 years will receive $10,000.00 plus 11 times $3,000.00 or $43,000.00 without proof of legal liability on the part of anyone else and without proof of physical or sexual abuse. This category of payment is described as a Common Experience Payment (C.E.P.). It recognizes the common experience of all former students and arguably recognizes the loss of their culture, family ties and identity. Unless the student intends to make a claim for serious physical or sexual abuse or wrongful acts which are defined, the recipient must sign a release of all claims in exchange for payment. Canada has established a fund of $1.9 billion dollars to fund payments to every student. Canada bears the risk of any insufficiency in the fund. If there is a surplus it is not repaid to Canada but is to be paid according to a formula. The first sum up to $40 million goes to the National Indian Brotherhood Trust Fund and the Inuvialuit Education Foundation to be used for educational programs for all class members. If the surplus exceeds that amount, each C.E.P. recipient receives a pro rata share in the form of personal credits for personal or group education up to $3,000.00. Canada also pays the cost of verifying the claims and the administrative cost of distribution.

14 Under the terms of the proposed settlement, Canada has instituted a process under which it pays, pending finalization of the settlement, the sum of $8,000.00 as an interim payment to all persons otherwise entitled to a C.E.P. who were on May 30, 2005 over the age of 65.

15 Secondly, class members have the right to seek and obtain payment of additional compensation for serious physical abuse, sexual abuse and specified wrongful acts through an Independent Assessment Process known as IAP. The parties, having observed the ADR process in action for more than a year, conducted studies, noted the shortcomings and proposed a series of significant improvements that have been incorporated into the settlement agreement. The awards under IAP consist not only of the damage award of the ADR process with a limit increasing to $275,000.00 but also compensation for lost earnings of up to $250,000.00. Compensation is paid in full by Canada not only for acts of employees but also for acts of any adult lawfully on the IRS premises. Where the claim is for abuse by fellow students the onus shifts to Canada and the Churches to show that it had reasonable supervision in place at the time. Unlike the Court process, the IAP process follows the inquisitorial mode. The adjudicator questions the witnesses at a closed or private hearing. Canada has committed itself to provide resources to ensure that at least 2500 IAP

hearings will be conducted each year and that all claims described as continuing claims be resolved within 6 years. There is provision for claims being referred to the courts in some circumstances, for example where the amount that a court might award exceeds the limit that the adjudicator might award. Any major changes to the IAP requires Court approval.

16 In addition to the fact that the IAP process is an improvement over the former ADR system as described in para. 15, there are eight additional improvements as follows: an expanded list of compensable acts; a decreased threshold for proof of abuse; for claims resolved prior to the IAP without church contribution, a 30 per cent top up where less than 100 per cent was received; for claims processed under IAP payment on a scale that is uniform across the country; for claims referred to the Courts, a waiver of all limitation defences; a means to compensate non student invitees for abuse suffered up to the age of 21; an independent screening process for IAP claims; and a means for claimants to give evidence by video conference in cases of failing health.

17 Thirdly, the settlement provides for Canada to fund to the extent of $60 million for five years, the setting up of a Truth and Reconciliation process, directed by a Commission consisting of nominees of former students, Aboriginal organizations, Churches and Canada. The goals of the Commission are to acknowledge the IRS experience; provide a safe setting for individuals to address the Commission; witness, promote and facilitate truth and reconciliation events at both national and community levels; educate the Canadian public about the IRS system and its impacts; create and make public a record for future study; prepare a report on the legacy of the IRS; and support commemorative events.

18 Fourthly, the settlement provides for a number of commemorative initiatives at national and community levels with a budget of $20 million and for the establishment of a $125 million dollar endowment over five years to fund Aboriginal healing programs.

19 In addition, Canada has made the following commitment:

> Health Canada will expand its current Indian Residential Schools Mental Health Support Program to be available to individuals who are eligible to receive compensation through the Independent Assessment Process, as well as to Common Experience Payment Recipients, and to those participating in Truth and Reconciliation and Commemoration activities. It will offer mental health counselling, transportation to access counselling and/or Elder/Traditional Healer services and emotional support services, which include Elder support. Health Canada will offer these services through its regional offices, including the Northern Secretariat which has an office located in Whitehorse, Yukon.

20 In addition, the Church organizations have agreed as part of the settlement to provide cash and in-kind services to a maximum of $102.8 million to develop new programs for class members and their families.

21 Importantly, Canada will be paying from a separate fund legal fees for the conduct of the various Court actions, for negotiation of the settlement agreement, for conduct of the C.E.P. claims and a contribution toward legal fees to be earned on the IAP claims to the extent of 15 percent of the awards. I will say more about this in para. 30 and 31.

22 The settlement agreement does not bind any member of the class to seek or accept the benefits provided in the agreement. It makes provision for class members to opt out of making a claim for C.E.P. and proceeding with a court claim. Para. 4.14 creates a threshold that if 5,000 persons opt out the agreement is invalidated and court approval set aside unless Canada chooses to waive compliance within a prescribed period.

c) The principles applicable to a motion for certification of a class action;

23 This motion for certification has been brought pursuant to **The Class Proceedings Act** C.C.S.M. c. C130. Section 4 provides:

> **Certification of class proceeding**
>
> 4. The court must certify a proceeding as a class proceeding on a motion under section 2 or 3 if
>
> (a) the pleadings disclose a cause of action;
> (b) there is an identifiable class of two or more persons;
> (c) the claims of the class members raise a common issue, whether or not the common issue predominates over issues affecting only individual members;
> (d) a class proceeding would be the preferable procedure for the fair and efficient resolution of the common issues; and
> (e) there is a person who is prepared to act as the representative plaintiff who
>
> (i) would fairly and adequately represent the interests of the class,
> (ii) has produced a plan for the class proceeding that sets out a workable method of advancing the class proceeding on behalf of the class of notifying class members of the class proceeding, and
> (iii) does not have, on the common issues, an interest that conflicts with the interests of other class members.

All parties consent to the order being made. However the consent of the defendants is conditional

on the settlement being confirmed by this Court and the Courts in eight other jurisdictions. The statute provides with regard to settlements:

> **Settlement, discontinuance and abandonment**
>
> 35(1) A class proceeding may be settled, discontinued or abandoned only
>
> (a) with the approval of the court; and
> (b) on the terms the court considers appropriate.
>
> **Court approval of settlement**
>
> 35(2) A settlement may be concluded in relation to the common issues affecting a subclass only
>
> (a) with the approval of the court; and
> (b) on the terms the court considers appropriate.
>
> **Settlement not binding unless approved**
>
> 35(3) A settlement is not binding unless approved by the court.

It does not specify the matters to be considered in deciding whether to approve a settlement.

24 In my view it is clear that all of the criteria have been met for certification of the action as a class action. I wish to discuss briefly the requirement of s. 4(d) that a class proceeding be "the preferable procedure for the fair and efficient resolution of the common issues."

25 For the purpose of this section the class proceeding is the class proceeding sought by the parties including the implementation of the settlement with the C.E.P. payments (para. 13), IAP payments (para. 15), national and community based programs (paras. 17 to 20) and regime for payment of legal fees (paras. 30 and 31). That this procedure is preferable to the alternative which faces 78,000 claimants, our court systems and our community is self evident. I agree with the submissions of counsel that without rubber stamping a consent order a Court may properly be flexible and relax the standards that might be expected of a moving party in a contested motion. In the case of **Gariepy v. Shell Oil Co.** [2002] O.J. No. 4022, Nordheimer J. stated at para. 27:

> [paragraph]27 The first issue is whether this action should be certified as a class proceeding for the purposes of the proposed settlement. The requirements for certification in a settlement context are the same as they are in a litigation context and are set out in section 5 of the Class Proceedings Act, 1992. However, their application need not, in my view, be as rigorously applied in the settlement context as they should be in the litigation context, principally because the underlying concerns over the manageability of the ongoing proceeding are removed.

In my view that means that the preferable procedure requirement has been satisfied in the circumstances of this case leaving any question of manageability or administration of the carrying out of the settlement agreement as a matter to be considered along with all other aspects of the settlement in deciding whether to approve it.

d) Principles relating to approval of a settlement;

26 The minimum standards for obtaining court approval of a settlement have been described by the author in Class Actions in Canada by Ward K. Branch 2006 Canada Law Book Aurora, as follows:

> **16.30** While the Acts do not specify the test for approval, courts have held that the court must find that in all the circumstances the settlement is fair, reasonable and in the best interest of those affected by it. The settlement must be in the best interests of the class as a whole, not any particular member. Settlement approval should not lead the court to a dissection of the settlement with an eye to perfection in every aspect. Rather, the settlement must fall within a zone or range of reasonableness. In *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598, the court stated that the following factors were a useful list of criteria for assessing the reasonableness of a proposed settlement:
>
> (1) likelihood of recovery, or likelihood of success;
> (2) amount and nature of discovery evidence;
> (3) settlement terms and conditions;
> (4) recommendation and experience of counsel;
> (5) future expense and likely duration of litigation;
> (6) recommendation of neutral parties if any;
> (7) number of objectors and nature of objections;
> (8) the presence of good faith and the absence of collusion.
>
> These factors have been adopted in many other cases both inside and outside Ontario. It is not necessary that all of the enumerated factors be

> present in each case, nor is it necessary that each factor be given equal weight in the consideration of any particular settlement.

To these factors I would add that the court should also consider whether the refusal of approval or attaching of conditions to approval, puts the settlement in jeopardy of being unravelled. It should be remembered that there is no obligation on parties to resume negotiations, that sometimes parties who have reached their limit in negotiation, resile from their positions or abandon the effort. The reality is that based on the assertions made at our hearing, many unrepresented Aboriginal people want the agreement affirmed, want the process expedited and not delayed, and the fact is that expectations have been created by announcement of the settlement and by the making of interim payments referred to in para. 14.

27 While the proposed settlement may not be perfect, it certainly is within a zone of reasonableness. In my view it is fair, reasonable and in the best interest of the parties. In a companion proceeding, the motion for certification and approval in Ontario in the case of **Charles Baxter, Sr. and others v. The Attorney General of Canada** [2006] O.J. No. 4968, 00-CV-192059CP Winkler J. raises a concern about the manageability of the settlement of the action. That is certainly a matter to be considered on a motion for approval of a settlement. If, for example, a settlement were made with a party whose financial stability was in doubt the question might be more significant than in a case like this where the principal payer is the Government of Canada. I will say more about my view of this question in para. 32 when I address the question of whether the issue is one which makes the settlement less than perfect but reasonable and whether Winkler J.'s proposal should be left as a suggestion for the parties to consider without making it a condition of approval.

e) Recommendation of counsel;

28 The settlement agreement was negotiated by all parties with the benefit of experienced counsel. Counsel have not only signed the agreement but they have jointly recommended to the Court that the settlement be approved. Moreover a number of them have provided affidavits in support of the motion.

f) Position of the parties who are not represented by counsel;

29 Fourteen persons filed written objections or comments in advance of the hearing. Several hundred persons, many of them members of the class, attended the hearing. Nineteen persons made oral presentations at the hearing touching on a number of subjects. Several of them supplemented the written presentations that they had filed in advance. Of those who complained about the settlement, more often it was because it was felt that payment should be made sooner rather than later. No substantive reason was offered for rejecting the settlement. Mr. Baert, counsel for the National Consortium responded to some of the points raised, providing clarification of the terms of the settlement. For my part I found the presentations moving and persuasive evidence as to how pervasive the damage caused to the Aboriginal community by the IRS policy and as to why it is in

everyone's interest that the settlement be implemented without delay.

g) The feature of the settlement relating to payment of legal fees;

30 The judges in the companion judgments have analyzed the provisions of the settlement agreement relating to payment of legal fees. The claims to fees are large, multiples of ten million, but many years work have gone into the various proceedings by experienced counsel. The fees in question are being paid by Canada from a fund which is separate from the source of payment to the members of the class. Most of the legal bills have been reviewed by or by persons employed by Canada's representative and he has recommended payment of them. There is an issue relating to the claim for fees of one law firm but the settlement agreement sets out a reasonable formula for determination of the firm's fees. The area of concern for me is the question of the absence of express provision in the agreement for review of legal fees on IAP claims. Under the settlement agreement Canada will on the making of an award, pay to each claimant's counsel an additional 15 percent of the award on account of legal fees. It appears that many of the lawyers who will be conducting the proceedings in the IAP claims are acting on contingency agreements entered into before the settlement agreement was made. None of the agreements are before the court but it appears that prior to the making of the settlement agreement many contingency agreements were entered into under which law firms may be entitled to claim 30 per cent or more of the recovery in a court action. One firm that claims to represent several thousand claimants has undertaken not to charge any IAP claimant more than 15 percent of the recovery in addition to the amount received from Canada. That is, the firm has agreed to limit its claim to fees to 30 percent of the amount of the recovery. Even if every law firm in Canada were to agree to do the same, there is a risk that IAP claimants may be called on to pay unreasonably large amounts. On the IAP claims, liability is not in issue as the parties must have contemplated in composing the contingency agreements. There may be settlements short of hearing in some cases. It is easy to visualize circumstances in which no or relative small fee might be justified in addition to the contribution made by Canada.

31 Under section 55 of the **Legal Profession Act** S.M. 2002 c. 44, lawyers practicing in Manitoba must give clients a copy of the contingency agreement on execution of it, failing which it will be unenforceable. Further, along with a copy of the agreement they must give the client a copy of the section that articulates their right to apply for a declaration that the agreement is unfair and unreasonable. However, the evidence shows that many members of the class are illiterate and likely not aware of their rights to have their legal bills reviewed. While no evidence was led on the point one presenter did tell us that she put her name on a list provided by a law firm which she believed related to an offer of information about making an IRS claim. She later was told that she had signed a contingency agreement and when she tried to terminate the services of the law firm she was told that she could not do so. Winkler J. has made a very practical suggestion in the *Baxter* case for implementing a procedure for review of legal fees in the IAP claim. I recommend that the parties give serious consideration to implementing his suggestion. Members of the class made negative comments at the hearing before me about the amounts paid to lawyers and about the conduct of lawyers who persuaded them to sign contingency agreements. In this paragraph I have approved the

settlement as it relates to payment for work done to this time. This settlement is historic and I feel sure that once implemented, Canadians will look back with pride on the way the parties have agreed to put to rest the issues arising from the IRS legacy. An effective review of the legal fees would ensure that the IRS legacy would not be viewed as a windfall to the legal profession.

Critique of the settlement

32 In the *Baxter* case Winkler J. has identified four deficiencies in the settlement agreement. The deficiencies have been summarized by Ball J. in para. 19 of his judgment in the companion case of **Sparvier v. The Attorney General of Canada** [2006] S.J. No. 752, SKQB (see his draft) as follows:

> (a) Financial information sufficient to enable the courts to make an informed decision regarding the anticipated cost of administration of the IAP will be provided for the purposes of approval and thereafter on a periodic basis (para. 52);
> (b) An autonomous supervisor or supervisory board will oversee the administration of the IAP, reporting ultimately to the court (para. 52);
> (c) The adjudicator hearing each case under the IAP will regulate counsel fees to be charged having regard to the complexity of the case, the result achieved, the intention to provide claimants with a reasonable settlement, and the fact that an additional 15% of the compensation award will be paid as fees by Canada (para. 78); and
> (d) The parties will establish a protocol for determining the manner in which issues relating to the ongoing administration of the settlement will be submitted to the courts in each jurisdiction for determination. This will ensure that the requirement for unanimous approval of all courts of any material amendment will not unduly hinder or delay the ability of the courts to make timely decisions (para. 81).

While I agree that the settlement might be better if the four changes were made, it might still be regarded imperfect for a variety of reasons. In para. 31 of my judgment I have articulated my concerns about the desirability of making provisions for review of counsel fees on IAP claims. However, I would not make such a provision a condition of approval. Of the remaining conditions the ones that raise a red flag are (a) and (b) relating to production of financial information and supervision of the administration of the CEP and IAP. Of this, Winkler J. has made the following findings in *Baxter*:

> [38] The potential for conflict for Canada between its proposed role as administrator and its role as continuing litigant is the first issue that must be addressed. One of the goals of this settlement is to resolve all ongoing litigation related to the residential schools. The structure of the administration must be

consistent with this aim and not such as to render itself subject to claims of bias and partiality based on apparent conflicts of interest. If such perception exists, it has the potential to taint even those areas where the neutrality is more enshrined such as the adjudication process. Accordingly, the administration of the plan must be neutral and independent of any concerns that Canada, as a party to the settlement, may otherwise have. In order to satisfactorily achieve this requisite separation, the administrative function must be completely isolated from the litigation function with an autonomous supervisor or supervisory board reporting ultimately to the courts. This separation will serve to protect the interests of the class members and insulate the government from unfounded conflict of interest claims. To effectively accomplish this separation and autonomy it is not necessary to alter the administrative scheme by replacing the proposed administration or by imposing a third party administrator on the settlement. Rather, the requisite independence and neutrality can be achieved by ensuring that the person, or persons, appointed by Canada with authority over the administration of the settlement shall ultimately report to and take direction, where necessary, from the courts and not from the government. By extension, such person, or persons, once appointed by the government and approved by the courts, is not subject to removal by the government without further approval from the courts. This is consistent with the approach taken in all class action administrations and there is no reason to depart from that approach in this instance.

[39] The autonomous supervisor or supervisory board envisioned by the court will have the authority necessary to direct the administration of the plan in accordance with its terms, to communicate with the supervisory courts and to be responsible to those courts. Simply put, it cannot be the case that the "administrator", once directed by the courts to undertake a certain task, must seek the ultimate approval from Canada. The administration of the settlement will be under the direction of the courts and they will be the final authority. Otherwise, the neutrality and independence of the administrator will be suspect and the supervisory authority of the courts compromised.

[40] The foregoing are organizational issues that relate to what may be called the "executive oversight" role in the administration. There are other issues in relation to the operational framework for delivery of the benefits under the settlement, particularly with respect to the costs of administration.

[42] Absent any explanation, the current costs of the ADR program appear to be

> excessively disproportionate when considered against the typical costs of administering a class action settlement. This court has never approved a settlement where the costs of administration exceed the compensation available let alone where the cost excess is a factor of three. It is no answer as was suggested in argument that since Canada, as defendant, has committed to funding the administrative costs separately from the settlement funding, the court need not be concerned with the quantum of that cost. This proposition must be rejected for two reasons. First, it ignores the court's supervisory role in class actions. Secondly, it fails to recognize how the peculiar aspects of certain terms of this settlement relating to funding can impact unfairly on the class members while at the same time leaving the courts powerless to provide a remedy. This is addressed in more detail below. Thirdly, it fails to recognize that this is not a settlement where the administration is being paid out of a fixed settlement fund. The administrative costs will be paid from the general revenues of the government. This leads to a certain precariousness in respect of the administration and leads to the prospect of the ongoing administration of the settlement becoming a political issue to the potential detriment of the class members.
>
> [44] This combination of inadequate information and absolute veto power over expenditures is unacceptable. The court cannot approve a settlement without adequate information to ensure that the class members' interests are being protected and that it will be able to maintain an effective ongoing supervisory role. As stated in *McCarthy* [2001] O.J. No. 2474 at para. 21:
>
> > ... a class proceeding by its very nature involves the issuance of orders or judgments that affect persons who are not before the Court. These absent class members are dependent on the Court to protect their interests. In order to do so, the Court must have all of the available information that has some bearing on the issues, whether favourable or unfavourable to the moving party.

It strikes me that an issue is being raised as to who, as between the courts and Canada, is to have ultimate control over the administration of the settlement. The settlement of this case is too important to the parties affected and is so fair and reasonable, that it is inappropriate to engage in that debate in this case. Canada has shown its good intentions in so many ways and the parties, after a lengthy and complex series of negotiations, have accepted that Canada will have the supervisory role. Issues like this one can well be left for other settings.

i) Risks of not unconditionally approving the settlement;

33 The settlement agreement provides:

> 16.01 Agreement is Conditional
>
> This Agreement will not be effective unless and until it is approved by the Courts, and if such approvals are not granted by each of the Courts on substantially the same terms and conditions save and except for the variations in membership contemplated in Sections 4.04 and 4.07 of this Agreement, this Agreement will thereupon be terminated and none of the Parties will be liable to any of the other Parties hereunder, except that the fees and disbursements of the members of the NCC will be paid in any event.

This provision largely mirrors the condition set out in the settlement agreement referred to in **Parsons v. Canadian Red Cross Society** [1999] O.J. No. 3572 at para. 127. However, one could argue that the four conditions referred to in Winkler J.'s judgment in the *Baxter* case are much more substantial than the two conditions imposed in *Parsons*. Winkler J. has stated in para. 36 of *Baxter*:

> [36] I turn now to the specific deficiencies that must be addressed in the proposed administrative scheme. In my view they are neither insurmountable nor do they require any material change to the settlement agreement itself.

In para. 85 of *Baxter* he also stated, "The changes that the court requires to the settlement are neither material nor substantial in the context of its scope and complexity." There is another view that is reasonably arguable, that the conditions are not "substantially the same as" the terms of the settlement agreement. If the alternative interpretation is adopted it will be open to Canada to treat the settlement agreement as terminated and 78000 Aboriginal claimants will be returned to their pre-settlement plight. Also there will be nothing to compel the parties to resume negotiation and if they do, there is a risk that they will resile from positions agreed to. In other words there is a risk that the settlement will unravel although it is in its present form well within a zone of reasonableness.

j) Conclusion.

34 Having reviewed the material that has been placed before this court I have reached the conclusion that the order of certification of a class action should be granted and the settlement should be approved unconditionally. An expectation has been created on the part of class members that they would receive payments and many have received interim payments. It would be unfortunate if this creative effort by all parties were brought to a halt and the whole settlement

unravelled because of the imposition of conditions which may well have been rejected in the course of negotiations of the agreement. Negotiation involves give and take on the part of negotiating parties and the negotiation concluded with a settlement which cries out for confirmation.

SCHULMAN J.

cp/e/qlrds/qlbrl/qlcas

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. 3627

2012 ONSC 4377

92 C.B.R. (5th) 99

2012 CarswellOnt 9430

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

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: June 26, 2012.
Judgment: July 27, 2012.

(98 paras.)

Bankruptcy and insolvency law -- Creditors and claims -- Claims -- Priorities -- Application by Sino-Forest Corporation ("SFC") for a declaration that the shareholder claims and the indemnity claims against SFC were "equity claims" as defined in the Companies' Creditors Arrangement Act ("CCAA"), allowed -- Shareholders had commenced actions against SFC and had joined SFC's auditors and underwriters as defendants -- Auditors and underwriters launched contribution and indemnity claims against SFC -- Characterization of indemnity claims were dependent on the characterization of the underlying shareholder claims -- Shareholder claims were clearly equity claims, as they related to the ownership, purchase or sale of SFC shares -- Accordingly, indemnity claims were also equity claims.

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters --

Application of Act -- Compromises and arrangements -- Claims -- Priority -- Application by Sino-Forest Corporation ("SFC") for a declaration that the shareholder claims and the indemnity claims against SFC were "equity claims" as defined in the Companies' Creditors Arrangement Act ("CCAA"), allowed -- Shareholders had commenced actions against SFC and had joined SFC's auditors and underwriters as defendants -- Auditors and underwriters launched contribution and indemnity claims against SFC -- Characterization of indemnity claims were dependent on the characterization of the underlying shareholder claims -- Shareholder claims were clearly equity claims, as they related to the ownership, purchase or sale of SFC shares -- Accordingly, indemnity claims were also equity claims.

Application by Sino-Forest Corporation ("SFC") for an order directing that the shareholder claims against SFC were "equity claims" as defined in s. 2 of the Companies' Creditors Arrangement Act ("CCAA") as well as any indemnity claims against SFC that were related to or arose from the shareholder claims. Shareholders had commenced claims against SFC in Ontario, Quebec, Saskatchewan and New York. While the claims varied in certain respects, they all alleged that SFC's actions and misrepresentations artificially inflated SFC's share prices and caused the shareholders to suffer a monetary loss resulting from the ownership, purchase or sale of the shares. The shareholders had joined the auditors and underwriters as defendants to their claims against SFC. The auditors and underwriters consequently claimed against SFC for contribution and indemnity. The auditors argued that their claims were not "equity claims", as they had distinct claims against SFC independent of the shareholders' claims which were not dependent on the success of the shareholders' claims. The underwriters also argued that SFC's application was premature. If the claims were determined to be equity claims, they would be subordinated to other claims.

HELD: Application allowed. SFC's application was not premature, as the threshold issue of whether or not the two sets of claims were equity claims did not depend on the determination or quantification of any claim. Rather, its effect established whether the claims of the auditors and the underwriters would be subordinated pursuant to the provisions of the CCAA. The characterization of the indemnity claims turned on the characterization of the underlying primary claims of the shareholders. The claims advanced in the shareholder claims were clearly equity claims and fell squarely within the definition in s. 2 of the CCAA. Those shareholder claims provided the basis for the indemnity claims. The focus of the definition of "equity claim" was not on the identity of the claimant but the nature of the claim. But for the shareholders' claims, it was inconceivable that the auditors and underwriters would have launched the sizable claims they did against SFC. It would have been inconsistent to have arrived at a conclusion that enabled either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors when the underlying shareholders actions could not have the same status. It did not matter whether the indemnity claims had been made at common law or whether they were based in contract.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2, s. 2, s. 6(8), s. 22(1)

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

Counsel:

Robert W. Staley and Jonathan Bell, for the Applicant.

Jennifer Stam, for the Monitor.

Kenneth Dekker, for BDO Limited.

Peter Griffin and Peter Osborne, for Ernst & Young LLP.

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

James Grout, for the Ontario Securities Commission.

Emily Cole and Joseph Marin, for Allen Chan.

Simon Bieber, for David Horsley.

David Bish, John Fabello and Adam Slavens, for the Underwriters Named in the Class Action.

Max Starnino and Kirk Baert, for the Ontario Plaintiffs.

Larry Lowenstein, for the Board of Directors.

ENDORSEMENT

G.B. MORAWETZ J.:--

Overview

1 Sino-Forest Corporation ("SFC" or the "Applicant") seeks an order directing that claims against SFC, which result from the ownership, purchase or sale of an equity interest in SFC, are "equity claims" as defined in section 2 of the *Companies' Creditors Arrangement Act* ("CCAA") including, without limitation: (i) the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" (collectively, the "Shareholder Claims"); and (ii) any indemnification claims against SFC related to or arising from the Shareholder Claims, including,

without limitation, those by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" (the "Related Indemnity Claims").

2 SFC takes the position that the Shareholder Claims are "equity claims" as defined in the CCAA as they are claims in respect of a monetary loss resulting from the ownership, purchase or sale of an equity interest in SFC and, therefore, come within the definition. SFC also takes the position that the Related Indemnity Claims are "equity claims" as defined in the CCAA as they are claims for contribution or indemnity in respect of a claim that is an equity claim and, therefore, also come within the definition.

3 On March 30, 2012, the court granted the Initial Order providing for the CCAA stay against SFC and certain of its subsidiaries. FTI Consulting Canada Inc. was appointed as Monitor.

4 On the same day, the Sales Process Order was granted, approving Sales Process procedures and authorizing and directing SFC, the Monitor and Houlihan Lokey to carry out the Sales Process.

5 On May 14, 2012, the court issued a Claims Procedure Order, which established June 20, 2012 as the Claims Bar Date.

6 The stay of proceedings has since been extended to September 28, 2012.

7 Since the outset of the proceedings, SFC has taken the position that it is important for these proceedings to be completed as soon as possible in order to, among other things, (i) enable the business operated in the Peoples Republic of China ("PRC") to be separated from SFC and put under new ownership; (ii) enable the restructured business to participate in the Q4 sales season in the PRC market; and (iii) maintain the confidence of stakeholders in the PRC (including local and national governmental bodies, PRC lenders and other stakeholders) that the business in the PRC can be successfully separated from SFC and operate in the ordinary course in the near future.

8 SFC has negotiated a Support Agreement with the Ad Hoc Committee of Noteholders and intends to file a plan of compromise or arrangement (the "Plan") under the CCAA by no later than August 27, 2012, based on the deadline set out in the Support Agreement and what they submit is the commercial reality that SFC must complete its restructuring as soon as possible.

9 Noteholders holding in excess of $1.296 billion, or approximately 72% of the approximately $1.8 billion of SFC's noteholders' debt, have executed written support agreements to support the SFC CCAA Plan as of March 30, 2012.

Shareholder Claims Asserted Against SFC

(i) Ontario

10 By Fresh as Amended Statement of Claim dated April 26, 2012 (the "Ontario Statement of Claim"), the Trustees of the Labourers' Pension Fund of Central and Eastern Canada and other

plaintiffs asserted various claims in a class proceeding (the "Ontario Class Proceedings") against SFC, certain of its current and former officers and directors, Ernst & Young LLP ("E&Y"), BDO Limited ("BDO"), Poyry (Beijing) Consulting Company Limited ("Poyry") and SFC's underwriters (collectively, the "Underwriters").

11 Section 1(m) of the Ontario Statement of Claim defines "class" and "class members" as:

> All persons and entities, wherever they may reside who acquired Sino's Securities during the Class Period by distribution in Canada or on the Toronto Stock Exchange or other secondary market in Canada, which securities include those acquired over the counter, and all persons and entities who acquired Sino's Securities during the Class Period who are resident of Canada or were resident of Canada at the time of acquisition and who acquired Sino's Securities outside of Canada, except the Excluded Persons.

12 The term "Securities" is defined as "Sino's common shares, notes and other securities, as defined in the OSA". The term "Class Period" is defined as the period from and including March 19, 2007 up to and including June 2, 2011.

13 The Ontario Class Proceedings seek damages in the amount of approximately $9.2 billion against SFC and the other defendants.

14 The thrust of the complaint in the Ontario Class Proceedings is that the class members are alleged to have purchased securities at "inflated prices during the Class Period" and that absent the alleged misconduct, sales of such securities "would have occurred at prices that reflected the true value" of the securities. It is further alleged that "the price of Sino's Securities was directly affected during the Class Period by the issuance of the Impugned Documents".

(ii) Quebec

15 By action filed in Quebec on June 9, 2011, Guining Liu commenced an action (the "Quebec Class Proceedings") against SFC, certain of its current and former officers and directors, E&Y and Poyry. The Quebec Class Proceedings do not name BDO or the Underwriters as defendants. The Quebec Class Proceedings also do not specify the quantum of damages sought, but rather reference "damages in an amount equal to the losses that it and the other members of the group suffered as a result of purchasing or acquiring securities of Sino at inflated prices during the Class Period".

16 The complaints in the Quebec Class Proceedings centre on the effect of alleged misrepresentations on the share price. The duty allegedly owed to the class members is said to be based in "law and other provisions of the *Securities Act*", to ensure the prompt dissemination of truthful, complete and accurate statements regarding SFC's business and affairs and to correct any previously-issued materially inaccurate statements.

(iii) Saskatchewan

17 By Statement of Claim dated December 1, 2011 (the "Saskatchewan Statement of Claim"), Mr. Allan Haigh commenced an action (the "Saskatchewan Class Proceedings") against SFC, Allen Chan and David Horsley.

18 The Saskatchewan Statement of Claim does not specify the quantum of damages sought, but instead states in more general terms that the plaintiff seeks "aggravated and compensatory damages against the defendants in an amount to be determined at trial".

19 The Saskatchewan Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities:

> The price of Sino's securities was directly affected during the Class Period by the issuance of the Impugned Documents. The defendants were aware at all material times that the effect of Sino's disclosure documents upon the price of its Sino's [sic] securities.

(iv) New York

20 By Verified Class Action Complaint dated January 27, 2012, (the "New York Complaint"), Mr. David Leapard and IMF Finance SA commenced a class proceeding against SFC, Mr. Allen Chan, Mr. David Horsley, Mr. Kai Kit Poon, a subset of the Underwriters, E&Y, and Ernst & Young Global Limited (the "New York Class Proceedings").

21 SFC contends that the New York Class Proceedings focus on the effect of the alleged wrongful acts upon the trading price of SFC's securities.

22 The plaintiffs in the various class actions have named parties other than SFC as defendants, notably, the Underwriters and the auditors, E&Y, and BDO, as summarized in the table below. The positions of those parties are detailed later in these reasons.

	Ontario	Quebec	Saskatchewan	New York
E&Y LLP	X	X	-	X
E&Y Global	-	-	-	X

BDO	X	-	-	-
Poyry	X	X	-	-
Underwriters	11	-	-	2

Legal Framework

23 Even before the 2009 amendments to the CCAA dealing with equity claims, courts recognized that there is a fundamental difference between shareholder equity claims as they relate to an insolvent entity versus creditor claims. Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise: *Blue Range Resource Corp. (Re)*, [2000] 4 W.W.R. 738 (Alta. Q.B.) [*Blue Range Resources*]; *Stelco Inc. (Re)*, 2006 CanLII 1773 (Ont. S.C.J.) [*Stelco*]; *Royal Bank of Canada v. Central Capital Corp*. (1996), 27 O.R. (3d) 494 (C.A.).

24 The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential: *Nelson Financial Group Limited (Re)*, 2010 ONSC 6229 [*Nelson Financial*].

25 As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement: *Blue Range Resource*, *supra*; *Stelco*, *supra*; *EarthFirst Canada Inc. (Re)* (2009), 56 C.B.R. (5th) 102 (Alta. Q.B.) [*EarthFirst Canada*]; and *Nelson Financial*, *supra*.

26 In 2009, significant amendments were made to the CCAA. Specific amendments were made with the intention of clarifying that equity claims are subordinated to other claims.

27 The 2009 amendments define an "equity claim" and an "equity interest". Section 2 of the CCAA includes the following definitions:

> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others, (...)
>
> (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase

or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

"Equity Interest" means

(a) in the case of a company other than an income trust, a share in the company - or a warrant or option or another right to acquire a share in the company - other than one that is derived from a convertible debt,

28 Section 6(8) of the CCAA prohibits a distribution to equity claimants prior to payment in full of all non-equity claims.

29 Section 22(1) of the CCAA provides that equity claimants are prohibited from voting on a plan unless the court orders otherwise.

Position of Ernst & Young

30 E&Y opposes the relief sought, at least as against E&Y, since the E&Y proof of claim evidence demonstrates in its view that E&Y's claim:

(a) is not an equity claim;
(b) does not derive from or depend upon an equity claim (in whole or in part);
(c) represents discreet and independent causes of action as against SFC and its directors and officers arising from E&Y's direct contractual relationship with such parties (or certain of such parties) and/or the tortious conduct of SFC and/or its directors and officers for which they are in law responsible to E&Y; and
(d) can succeed independently of whether or not the claims of the plaintiffs in the class actions succeed.

31 In its factum, counsel to E&Y acknowledges that during the periods relevant to the Class Action Proceedings, E&Y was retained as SFC's auditor and acted as such from 2007 until it resigned on April 5, 2012.

32 On June 2, 2011, Muddy Waters LLC ("Muddy Waters") issued a report which purported to reveal fraud at SFC. In the wake of that report, SFC's share price plummeted and Muddy Waters profited from its short position.

33 E&Y was served with a multitude of class action claims in numerous jurisdictions.

34 The plaintiffs in the Ontario Class Proceedings claim damages in the aggregate, as against all defendants, of $9.2 billion on behalf of resident and non-resident shareholders and noteholders. The

causes of action alleged are both statutory, under the *Securities Act (Ontario)* and at common law, in negligence and negligent misrepresentation.

35 In its factum, counsel to E&Y acknowledges that the central claim in the class actions is that SFC made a series of misrepresentations in respect of its timber assets. The claims against E&Y and the other third party defendants are that they failed to detect these misrepresentations and note in particular that E&Y's audit did not comply with Canadian generally accepted accounting standards. Similar claims are advanced in Quebec and the U.S.

36 Counsel to E&Y notes that on May 14, 2012 the court granted a Claims Procedure Order which, among other things, requires proofs of claim to be filed no later than June 20, 2012. E&Y takes issue with the fact that this motion was then brought notwithstanding that proofs of claim and D&O proofs of claim had not yet been filed.

37 E&Y has filed with the Monitor, in accordance with the Claims Procedure Order, a proof of claim against SFC and a proof of claim against the directors and officers of SFC.

38 E&Y takes the position that it has contractual claims of indemnification against SFC and its subsidiaries and has statutory and common law claims of contribution and/or indemnity against SFC and its subsidiaries for all relevant years. E&Y contends that it has stand-alone claims for breach of contract and negligent and/or fraudulent misrepresentation against the company and its directors and officers.

39 Counsel submits that E&Y's claims against Sino-Forest and the SFC subsidiaries are:

(a) creditor claims;
(b) derived from E&Y retainers by and/or on behalf of Sino-Forest and the SFC subsidiaries and E&Y's relationship with such parties, all of which are wholly independent and conceptually different from the claims advanced by the class action plaintiffs;
(c) claims that include the cost of defending and responding to various proceedings, both pre- and post-filing; and
(d) not equity claims in the sense contemplated by the CCAA. E&Y's submission is that equity holders of Sino-Forest have not advanced, and could not advance, any claims against SFC's subsidiaries.

40 Counsel further contends that E&Y's claim is distinct from any and all potential and actual claims by the plaintiffs in the class actions against Sino-Forest and that E&Y's claim for contribution and/or indemnity is not based on the claims against Sino-Forest advanced in the class actions but rather only in part on those claims, as any success of the plaintiffs in the class actions against E&Y would not necessarily lead to success against Sino-Forest, and vice versa. Counsel contends that E&Y has a distinct claim against Sino-Forest independent of that of the plaintiffs in the class actions. The success of E&Y's claims against Sino-Forest and the SFC subsidiaries, and

the success of the claims advanced by the class action plaintiffs, are not co-dependent. Consequently, counsel contends that E&Y's claim is that of an unsecured creditor.

41 From a policy standpoint, counsel to E&Y contends that the nature of the relationship between a shareholder, who may be in a position to assert an equity claim (in addition to other claims) is fundamentally different from the relationship existing between a corporation and its auditors.

Position of BDO Limited

42 BDO was auditor of Sino-Forest Corporation between 2005 and 2007, when it was replaced by E&Y.

43 BDO has a filed a proof of claim against Sino-Forest pursuant to the Claims Procedure Order.

44 BDO's claim against Sino-Forest is primarily for breach of contract.

45 BDO takes the position that its indemnity claims, similar to those advanced by E&Y and the Underwriters, are not equity claims within the meaning of s. 2 of the CCAA.

46 BDO adopts the submissions of E&Y which, for the purposes of this endorsement, are not repeated.

Position of the Underwriters

47 The Underwriters take the position that the court should not decide the equity claims motion at this time because it is premature or, alternatively, if the court decides the equity claims motion, the equity claims order should not be granted because the Related Indemnity Claims are not "equity claims" as defined in s. 2 of the CCAA.

48 The Underwriters are among the defendants named in some of the class actions. In connection with the offerings, certain Underwriters entered into agreements with Sino-Forest and certain of its subsidiaries providing that Sino-Forest and, with respect to certain offerings, the Sino-Forest subsidiary companies, agree to indemnify and hold harmless the Underwriters in connection with an array of matters that could arise from the offerings.

49 The Underwriters raise the following issues:

(i) Should this court decide the equity claims motion at this time?
(ii) If this court decides the equity claims motion at this time, should the equity claims order be granted?

50 On the first issue, counsel to the Underwriters takes the position that the issue is not yet ripe for determination.

51 Counsel submits that, by seeking the equity claims order at this time, Sino-Forest is attempting to pre-empt the Claims Procedure Order, which already provides a process for the determination of claims. Until such time as the claims procedure in respect of the Related Indemnity Claims is completed, and those claims are determined pursuant to that process, counsel contends the subject of the equity claims motion raises a merely hypothetical question as the court is being asked to determine the proper interpretation of s. 2 of the CCAA before it has the benefit of an actual claim in dispute before it.

52 Counsel further contends that by asking the court to render judgment on the proper interpretation of s. 2 of the CCAA in the hypothetical, Sino-Forest has put the court in a position where its judgment will not be made in the context of particular facts or with a full and complete evidentiary record.

53 Even if the court determines that it can decide this motion at this time, the Underwriters submit that the relief requested should not be granted.

Position of the Applicant

54 The Applicant submits that the amendments to the CCAA relating to equity claims closely parallel existing U.S. law on the subject and that Canadian courts have looked to U.S. courts for guidance on the issue of equity claims as the subordination of equity claims has long been codified there: see e.g. *Blue Range Resources*, *supra*, and *Nelson Financial*, *supra*.

55 The Applicant takes the position that based on the plain language of the CCAA, the Shareholder Claims are "equity claims" as defined in s. 2 as they are claims in respect of a "monetary loss resulting from the ownership, purchase or sale of an equity interest".

56 The Applicant also submits the following:

(a) the Ontario, Quebec, Saskatchewan and New York Class Actions (collectively, the "Class Actions") all advance claims on behalf of shareholders.
(b) the Class Actions also allege wrongful conduct that affected the trading price of the shares, in that the alleged misrepresentation "artificially inflated" the share price; and
(c) the Class Actions seek damages relating to the trading price of SFC shares and, as such, allege a "monetary loss" that resulted from the ownership, purchase or sale of shares, as defined in s. 2 of the CCAA.

57 Counsel further submits that, as the Shareholder Claims are "equity claims", they are expressly subordinated to creditor claims and are prohibited from voting on the plan of arrangement.

58 Counsel to the Applicant also submits that the definition of "equity claims" in s. 2 of the

CCAA expressly includes indemnity claims that relate to other equity claims. As such, the Related Indemnity Claims are equity claims within the meaning of s. 2.

59 Counsel further submits that there is no distinction in the CCAA between the source of any claim for contribution or indemnity; whether by statute, common law, contractual or otherwise. Further, and to the contrary, counsel submits that the legal characterization of a contribution or indemnity claim depends solely on the characterization of the primary claim upon which contribution or indemnity is sought.

60 Counsel points out that in *Return on Innovation Capital v. Gandi Innovations Limited*, 2011 ONSC 5018, leave to appeal denied, 2012 ONCA 10 [*Return on Innovation*] this court characterized the contractual indemnification claims of directors and officers in respect of an equity claim as "equity claims".

61 Counsel also submits that guidance on the treatment of underwriter and auditor indemnification claims can be obtained from the U.S. experience. In the U.S., courts have held that the indemnification claims of underwriters for liability or defence costs constitute equity claims that are subordinated to the claims of general creditors. Counsel submits that insofar as the primary source of liability is characterized as an equity claim, so too is any claim for contribution and indemnity based on that equity claim.

62 In this case, counsel contends, the Related Indemnity Claims are clearly claims for "contribution and indemnity" based on the Shareholder Claims.

Position of the Ad Hoc Noteholders

63 Counsel to the Ad Hoc Noteholders submits that the Shareholder Claims are "equity claims" as they are claims in respect of an equity interest and are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest" per subsection (d) of the definition of "equity claims" in the CCAA.

64 Counsel further submits that the Related Indemnity Claims are also "equity claims" as they fall within the "clear and unambiguous" language used in the definition of "equity claim" in the CCAA. Subsection (e) of the definition refers expressly and without qualification to claims for "contribution or indemnity" in respect of claims such as the Shareholder Claims.

65 Counsel further submits that had the legislature intended to qualify the reference to "contribution or indemnity" in order to exempt the claims of certain parties, it could have done so, but it did not.

66 Counsel also submits that, if the plain language of subsection (e) is not upheld, shareholders of SFC could potentially create claims to receive indirectly what they could not receive directly (*i.e.*, payment in respect of equity claims through the Related Indemnity Claims) - a result that could not

have been intended by the legislature as it would be inconsistent with the purposes of the CCAA.

67 Counsel to the Ad Hoc Noteholders also submits that, before the CCAA amendments in 2009 (the "CCAA Amendments"), courts subordinated claims on the basis of:

(a) the general expectations of creditors and shareholders with respect to priority and assumption of risks; and
(b) the equitable principles and considerations set out in certain U.S. cases: see e.g. *Blue Range Resources, supra*.

68 Counsel further submits that, before the CCAA Amendments took effect, courts had expanded the types of claims characterized as equity claims; first to claims for damages of defrauded shareholders and then to contractual indemnity claims of shareholders: see *Blue Range Resources, supra* and *EarthFirst Canada, supra*.

69 Counsel for the Ad Hoc Noteholders also submits that indemnity claims of underwriters have been treated as equity claims in the United States, pursuant to section 510(b) of the U.S. Bankruptcy Code. This submission is detailed at paragraphs 20-25 of their factum which reads as follows:

> 20. The desire to more closely align the Canadian approach to equity claims with the U.S. approach was among the considerations that gave rise to the codification of the treatment of equity claims. Canadian courts have also looked to the U.S. law for guidance on the issue of equity claims where codification of the subordination of equity claims has been long-standing.
>
> Janis Sarra at p. 209, Ad Hoc Committee's Book of Authorities, Tab 10.
>
> Report of the Standing Senate Committee on Banking, Trade and Commerce, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement act*" (2003) at 158, [...]
>
> *Blue Range* [*Resources*] at paras. 41-57 [...]
>
> 21. Pursuant to s. 510(b) of the *U.S. Bankruptcy Code*, all creditors must be paid in full before shareholders are entitled to receive any distribution. s. 510(b) of the *U.S. Bankruptcy Code* and the relevant portion of s. 502, which is referenced in s. 510(b), provide as follows:

s. 510. Subordination

(b) For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

s. 502. Allowance of claims or interests

(e) (1) Notwithstanding subsections (a), (b) and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that

...

(B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or

...

(2) A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.

22. U.S. appellate courts have interpreted the statutory language in s. 510(b) broadly to subordinate the claims of shareholders that have a nexus or causal relationship to the purchase or sale of securities, including damages arising from alleged

illegality in the sale or purchase of securities or from corporate misconduct whether predicated on pre or post-issuance conduct.

> *Re Telegroup Inc.* (2002), 281 F. 3d 133 (3rd Cir. U.S. Court of Appeals) [...]
>
> *American Broadcasting Systems Inc. v. Nugent*, U.S. Court of Appeals for the Ninth Circuit, Case Number 98-17133 (24 January 2001) [...]

23. Further, U.S. courts have held that indemnification claims of underwriters against the corporation for liability or defence costs when shareholders or former shareholders have sued underwriters constitute equity claims in the insolvency of the corporation that are subordinated to the claims of general creditors based on: (a) the plain language of s. 510(b), which references claims for "reimbursement or contribution" and (b) risk allocation as between general creditors and those parties that play a role in the purchase and sale of securities that give rise to the shareholder claims (i.e., directors, officers and underwriters).

> *In re Mid-American Waste Sys.*, 228 B.R. 816, 1999 Bankr. LEXIS 27 (Bankr. D. Del. 1999) [*Mid-American*] [...]
>
> *In re Jacom Computer Servs*., 280 B.R. 570, 2002 Bankr. LEXIS 758 (Bankr. S.D.N.Y. 2002) [...]

24. In *Mid-American*, the Court stated the following with respect to the "plain language" of s. 510(b), its origins and the inclusion of "reimbursement or contribution" claims in that section:

> *... I find that the plain language of s. 510(b), its legislative history, and applicable case law clearly show that s. 510(b) intends to subordinate the indemnification claims of officers, directors, and underwriters for both liability and expenses incurred in connection with the pursuit of claims for rescission or damages by purchasers or sellers of the debtor's securities.* The meaning of amended s. 510(b), specifically the language "for reimbursement or contribution . . . on account of [a claim arising from rescission or damages arising from the purchase or sale of a security]," can

> be discerned by a plain reading of its language.
>
> ... it is readily apparent that the rationale for section 510(b) is not limited to preventing shareholder claimants from improving their position vis-a-vis general creditors; *Congress also made the decision to subordinate based on risk allocation. Consequently, when Congress amended s. 510(b) to add reimbursement and contribution claims, it was not radically departing from an equityholder claimant treatment provision, as NatWest suggests; it simply added to the subordination treatment new classes of persons and entities involved with the securities transactions giving rise to the rescission and damage claims*. The 1984 amendment to s. 510(b) is a logical extension of one of the rationales for the original section -- *because Congress intended the holders of securities law claims to be subordinated, why not also subordinate claims of other parties (e.g., officers and directors and underwriters) who play a role in the purchase and sale transactions which give rise to the securities law claims?* As I view it, in 1984 Congress made a legislative judgment that claims emanating from tainted securities law transactions should not have the same priority as the claims of general creditors of the estate. [emphasis added] [...]

25. Further, the U.S. courts have held that the degree of culpability of the respective parties is a non-issue in the disallowance of claims for indemnification of underwriters; the equities are meant to benefit the debtor's direct creditors, not secondarily liable creditors with contingent claims.

> *In re Drexel Burnham Lambert Group,* 148 B.R. 982, 1992 Bankr. LEXIS 2023 (Bankr. S.D.N.Y. 1992) [...]

70 Counsel submits that there is no principled basis for treating indemnification claims of auditors differently than those of underwriters.

Analysis

Is it Premature to Determine the Issue?

71 The class action litigation was commenced prior to the CCAA Proceedings. It is clear that the claims of shareholders as set out in the class action claims against SFC are "equity claims" within the meaning of the CCAA.

72 In my view, this issue is not premature for determination, as is submitted by the Underwriters.

73 The Class Action Proceedings preceded the CCAA Proceedings. It has been clear since the outset of the CCAA Proceedings that this issue - namely, whether the claims of E&Y, BDO and the Underwriters as against SFC, would be considered "equity claims" - would have to be determined.

74 It has also been clear from the outset of the CCAA Proceedings, that a Sales Process would be undertaken and the expected proceeds arising from the Sales Process would generate proceeds insufficient to satisfy the claims of creditors.

75 The Claims Procedure is in place but, it seems to me that the issue that has been placed before the court on this motion can be determined independently of the Claims Procedure. I do not accept that any party can be said to be prejudiced if this threshold issue is determined at this time. The threshold issue does not depend upon a determination of quantification of any claim. Rather, its effect will be to establish whether the claims of E&Y, BDO and the Underwriters will be subordinated pursuant to the provisions of the CCAA. This is independent from a determination as to the validity of any claim and the quantification thereof.

Should the Equity Claims Order be Granted?

76 I am in agreement with the submission of counsel for the Ad Hoc Noteholders to the effect that the characterization of claims for indemnity turns on the characterization of the underlying primary claims.

77 In my view, the claims advanced in the Shareholder Claims are clearly equity claims. The Shareholder Claims underlie the Related Indemnity Claims.

78 In my view, the CCAA Amendments have codified the treatment of claims addressed in pre-amendment cases and have further broadened the scope of equity claims.

79 The plain language in the definition of "equity claim" does not focus on the identity of the claimant. Rather, it focuses on the nature of the claim. In this case, it seems clear that the Shareholder Claims led to the Related Indemnity Claims. Put another way, the inescapable conclusion is that the Related Indemnity Claims are being used to recover an equity investment.

80 The plain language of the CCAA dictates the outcome, namely, that the Shareholder Claims and the Related Indemnity Claims constitute "equity claims" within the meaning of the CCAA. This conclusion is consistent with the trend towards an expansive interpretation of the definition of "equity claims" to achieve the purpose of the CCAA.

81 In *Return on Innovation*, Newbould J. characterized the contractual indemnification claims of directors and officers as "equity claims". The Court of Appeal denied leave to appeal. The analysis in *Return on Innovation* leads to the conclusion that the Related Indemnity Claims are also equity claims under the CCAA.

82 It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the Underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of the shareholders cannot achieve the same status. To hold otherwise would indeed provide an indirect remedy where a direct remedy is not available.

83 Further, on the issue of whether the claims of E&Y, BDO and the Underwriters fall within the definition of equity claims, there are, in my view, two aspects of these claims and it is necessary to keep them conceptually separate.

84 The first and most significant aspect of the claims of E&Y, BDO and the Underwriters constitutes an "equity claim" within the meaning of the CCAA. Simply put, but for the Class Action Proceedings, it is inconceivable that claims of this magnitude would have been launched by E&Y, BDO and the Underwriters as against SFC. The class action plaintiffs have launched their actions against SFC, the auditors and the Underwriters. In turn, E&Y, BDO and the Underwriters have launched actions against SFC and its subsidiaries. The claims of the shareholders are clearly "equity claims" and a plain reading of s. 2(1)(e) of the CCAA leads to the same conclusion with respect to the claims of E&Y, BDO and the Underwriters. To hold otherwise, would, as stated above, lead to a result that is inconsistent with the principles of the CCAA. It would potentially put the shareholders in a position to achieve creditor status through their claim against E&Y, BDO and the Underwriters even though a direct claim against SFC would rank as an "equity claim".

85 I also recognize that the legal construction of the claims of the auditors and the Underwriters as against SFC is different than the claims of the shareholders against SFC. However, that distinction is not, in my view, reflected in the language of the CCAA which makes no distinction based on the status of the party but rather focuses on the substance of the claim.

86 Critical to my analysis of this issue is the statutory language and the fact that the CCAA Amendments came into force after the cases relied upon by the Underwriters and the auditors.

87 It has been argued that the amendments did nothing more than codify pre-existing common law. In many respects, I accept this submission. However, I am unable to accept this submission when considering s. 2(1) of the CCAA, which provides clear and specific language directing that "equity claim" means a claim that is in respect of an equity interest, including a claim for, among other things, "(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d)".

88 Given that a shareholder claim falls within s. 2(1)(d), the plain words of subsections (d) and (e) lead to the conclusions that I have set out above.

89 I fail to see how the very clear words of subsection (e) can be seen to be a codification of existing law. To arrive at the conclusion put forth by E&Y, BDO and the Underwriters would require me to ignore the specific words that Parliament has recently enacted.

90 I cannot agree with the position put forth by the Underwriters or by the auditors on this point. The plain wording of the statute has persuaded me that it does not matter whether an indemnity claim is seeking no more than allocation of fault and contribution at common law, or whether there is a free-standing contribution and indemnity claim based on contracts.

91 However, that is not to say that the full amount of the claim by the auditors and Underwriters can be characterized, at this time, as an "equity claim".

92 The second aspect to the claims of the auditors and underwriters can be illustrated by the following hypothetical: if the claim of the shareholders does not succeed against the class action defendants, E&Y, BDO and the Underwriters will not be liable to the class action plaintiffs. However, these parties may be in a position to demonstrate that they do have a claim against SFC for the costs of defending those actions, which claim does not arise as a result of "contribution or indemnity in respect of an equity claim".

93 It could very well be that each of E&Y, BDO and the Underwriters have expended significant amounts in defending the claims brought by the class action plaintiffs which, in turn, could give rise to contractual claims as against SFC. If there is no successful equity claim brought by the class action plaintiffs, it is arguable that any claim of E&Y, BDO and the Underwriters may legitimately be characterized as a claim for contribution or indemnity but not necessarily in respect of an equity claim. If so, there is no principled basis for subordinating this portion of the claim. At this point in time, the quantification of such a claim cannot be determined. This must be determined in accordance with the Claims Procedure.

94 However, it must be recognized that, by far the most significant part of the claim, is an "equity claim".

95 In arriving at this determination, I have taken into account the arguments set forth by E&Y, BDO and the Underwriters. My conclusions recognize the separate aspects of the Related Indemnity Claims as submitted by counsel to the Underwriters at paragraph 40 of their factum which reads:

> ...it must be recognized that there are, in fact, at least two different kinds of Related Indemnity Claims:
>
> (a) indemnity claims against SFC in respect of Shareholder Claims against the auditors and the Underwriters; and
> (b) indemnity claims against SFC in respect of the defence costs of the auditors and the Underwriters in connection with defending themselves against Shareholder Claims.

Disposition

96 In the result, an order shall issue that the claims against SFC resulting from the ownership, purchase or sale of equity interests in SFC, including, without limitation, the claims by or on behalf of current or former shareholders asserted in the proceedings listed in Schedule "A" are "equity claims" as defined in s. 2 of the CCAA, being claims in respect of monetary losses resulting from the ownership, purchase or sale of an equity interest. It is noted that counsel for the class action plaintiffs did not contest this issue.

97 In addition, an order shall also issue that any indemnification claim against SFC related to or arising from the Shareholders Claims, including, without limitation, by or on behalf of any of the other defendants to the proceedings listed in Schedule "A" are "equity claims" under the CCAA, being claims for contribution or indemnity in respect of a claim that is an equity claim. However, I feel it is premature to determine whether this order extends to the aspect of the Related Indemnity Claims that corresponds to the defence costs of the Underwriters and the auditors in connection with defending themselves against the Shareholder Claims.

98 A direction shall also issue that these orders are made without prejudice to SFC's rights to apply for a similar order with respect to (i) any claims in the statement of claim that are in respect of securities other than shares and (ii) any indemnification claims against SFC related thereto.

G.B. MORAWETZ J.

cp/e/qlmdl/qlpmg/qlana/qlgpr

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

[2012] O.J. No. 5500

2012 ONCA 816

Dockets: C56115, C56118 and C56125

Ontario Court of Appeal
Toronto, Ontario

S.T. Goudge, A. Hoy and S.E. Pepall JJ.A.

Heard: November 13, 2012.
Judgment: November 23, 2012.

(62 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Claims -- Priority -- Appeal by auditors and underwriters for Sino-Forest from order made under Companies' Creditors Arrangement Act dismissed -- Shareholders of Sino-Forest commenced several class action proceedings alleging misrepresentation of company's financial situation -- Appellants were named as defendants and claimed indemnity and contribution from Sino-Forest -- Order under appeal directed that appellants' contribution and indemnity claims were equity claims for purpose of s. 2(1) of CCAA -- Supervising judge made no error in interpreting provision or in determining that it was not premature to characterize appellants' claims -- Companies' Creditors Arrangement Act, ss. 2(1), 6(8).

Appeal by the auditors and underwriters for Sino-Forest from an order directing that certain claims were equity claims for the purpose of s. 2(1) of the Companies' Creditors Arrangement Act (CCAA). In 2009, the CCAA was amended to provide that general creditors were to be paid in full

before an equity claim. The appellants provided underwriting and auditor services relevant to several Sino-Forest equity and note offerings. In 2011 and 2012, several proposed class actions were commenced by shareholders against Sino-Forest and certain officers, directors, employees and the appellants. The actions sought damages on the basis Sino-Forest had caused losses to shareholders by misrepresenting its assets and financial situation, and that the appellants had failed to detect and disclose those misrepresentations. The appellants claimed against Sino-Forest for contribution and indemnity arising from the proposed class actions. Sino-Forest subsequently sought protection pursuant to the CCAA. In the judgment under appeal, the judge concluded that the shareholder and related indemnity claims were equity claims within the meaning of the CCAA. The appellants submitted that the judge erred in interpreting the meaning of an "equity claim" and erred in determining the issue prior to completion of the claims procedure in Sino-Forest's CCAA proceeding.

HELD: Appeal dismissed. The judge below properly found that the appellants' claims for contribution and indemnity were equity claims for the purpose of s. 2(1) of the CCAA, based on the expansive language used by Parliament, the absence of certain language, the avoidance of surplusage, the logic of the provision as a whole, and the purpose of the 2009 amendments. The shareholder claims were for a monetary loss resulting from ownership of an equity interest. There was an obvious link between the appellants' indemnity claims and the shareholders' claims. The provision as a whole supported a claim for contribution or indemnity by parties other than shareholders. The judge did not err in determining that the appellants' claims were equity claims prior to the completion of the claims procedure in Sino-Forest's CCAA proceeding. The need to immediately address the characterization of the appellants' claims was clear and did not result in prejudice to the appellants.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 2, s. 121

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2(1), s. 2(1), s. 2(1), s. 2(1)(d), s. 2(1)(e), s. 6(8)

Negligence Act, R.S.O. 1990, c. N.1, s. 2

Appeal From:

On appeal from the order of Justice Geoffrey B. Morawetz of the Superior Court of Justice, dated July 27, 2012, with reasons reported at 2012 ONSC 4377, 92 C.B.R. (5th) 99.

Counsel:

Peter H. Griffin, Peter J. Osborne and Shara Roy, for the appellant Ernst & Young LLP.

Sheila Block and David Bish, for the appellants Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), 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.

Kenneth Dekker, for the appellant BDO Limited.

Robert W. Staley, Derek J. Bell and Jonathan Bell, for the respondent Sino-Forest Corporation.

Benjamin Zarnett, Robert Chadwick and Julie Rosenthal, for the respondent the Ad Hoc Committee of Noteholders.

Clifton Prophet, for the Monitor FTI Consulting Canada Inc.

Kirk M. Baert, A. Dimitri Lascaris and Massimo Starnino, for the respondent the Ad Hoc Committee of Purchasers.

Emily Cole, for the respondent Allen Chan.

Erin Pleet, for the respondent David Horsley.

David Gadsden, for the respondent Pöyry (Beijing).

Larry Lowenstein and Edward A. Sellers, for the respondent the Board of Directors.

The following judgment was delivered by

THE COURT:--

I OVERVIEW

1 In 2009, the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA"), was amended to expressly provide that general creditors are to be paid in full before an equity claim is paid.

2 This appeal considers the definition of "equity claim" in s. 2(1) of the CCAA. More particularly, the central issue is whether claims by auditors and underwriters against the respondent debtor, Sino-Forest Corporation ("Sino-Forest"), for contribution and indemnity fall within that definition. The claims arise out of proposed shareholder class actions for misrepresentation.

3 The appellants argue that the supervising judge erred in concluding that the claims at issue are equity claims within the meaning of the CCAA and in determining the issue before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

4 For the reasons that follow, we conclude that the supervising judge did not err and accordingly dismiss this appeal.

II THE BACKGROUND

(a) The Parties

5 Sino-Forest is a Canadian public holding company that holds the shares of numerous subsidiaries, which in turn own, directly or indirectly, forestry assets located principally in the People's Republic of China. Its common shares are listed on the Toronto Stock Exchange. Sino-Forest also issued approximately $1.8 billion of unsecured notes, in four series. Trading in Sino-Forest shares ceased on August 26, 2011, as a result of a cease-trade order made by the Ontario Securities Commission.

6 The appellant underwriters[1] provided underwriting services in connection with three separate Sino-Forest equity offerings in June 2007, June 2009 and December 2009, and four separate Sino-Forest note offerings in July 2008, June 2009, December 2009 and October 2010. Certain underwriters entered into agreements with Sino-Forest in which Sino-Forest agreed to indemnify the underwriters in connection with an array of matters that could arise from their participation in these offerings.

7 The appellant BDO Limited ("BDO") is a Hong Kong-based accounting firm that served as Sino-Forest's auditor between 2005 and August 2007 and audited its annual financial statements for the years ended December 31, 2005 and December 31, 2006.

8 The engagement agreements governing BDO's audits of Sino-Forest provided that the company's management bore the primary responsibility for preparing its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP") and implementing internal controls to prevent and detect fraud and error in relation to its financial reporting.

9 BDO's Audit Report for 2006 was incorporated by reference into a June 2007 prospectus issued by Sino-Forest regarding the offering of its shares to the public. This use by Sino-Forest was governed by an engagement agreement dated May 23, 2007, in which Sino-Forest agreed to indemnify BDO in respect of any claims by the underwriters or any third party that arose as a result of the further steps taken by BDO in relation to the issuance of the June 2007 prospectus.

10 The appellant Ernst & Young LLP ("E&Y") served as Sino-Forest's auditor for the years 2007 to 2012 and delivered Auditors' Reports with respect to the consolidated financial statements of Sino-Forest for fiscal years ended December 31, 2007 to 2010, inclusive. In each year for which it

prepared a report, E&Y entered into an audit engagement letter with Sino-Forest in which Sino-Forest undertook to prepare its financial statements in accordance with GAAP, design and implement internal controls to prevent and detect fraud and error, and provide E&Y with its complete financial records and related information. Some of these letters contained an indemnity in favour of E&Y.

11 The respondent Ad Hoc Committee of Noteholders consists of noteholders owning approximately one-half of Sino-Forest's total noteholder debt.[2] They are creditors who have debt claims against Sino-Forest; they are not equity claimants.

12 Sino-Forest has insufficient assets to satisfy all the claims against it. To the extent that the appellants' claims are accepted and are treated as debt claims rather than equity claims, the noteholders' recovery will be diminished.

(b) The Class Actions

13 In 2011 and January of 2012, proposed class actions were commenced in Ontario, Quebec, Saskatchewan and New York State against, amongst others, Sino-Forest, certain of its officers, directors and employees, BDO, E&Y and the underwriters. Sino-Forest is sued in all actions.[3]

14 The proposed representative plaintiffs in the class actions are shareholders of Sino-Forest. They allege that: Sino-Forest repeatedly misrepresented its assets and financial situation and its compliance with GAAP in its public disclosure; the appellant auditors and underwriters failed to detect these misrepresentations; and the appellant auditors misrepresented that their audit reports were prepared in accordance with generally accepted auditing standards ("GAAS"). The representative plaintiffs claim that these misrepresentations artificially inflated the price of Sino-Forest's shares and that proposed class members suffered damages when the shares fell after the truth was revealed in 2011.

15 The representative plaintiffs in the Ontario class action seek approximately $9.2 billion in damages. The Quebec, Saskatchewan and New York class actions do not specify the quantum of damages sought.

16 To date, none of the proposed class actions has been certified.

(c) CCAA Protection and Proofs of Claim

17 On March 30, 2012, Sino-Forest sought protection pursuant to the provisions of the CCAA. Morawetz J. granted the initial order which, among other things, appointed FTI Consulting Canada Inc. as the Monitor and stayed the class actions as against Sino-Forest. Since that time, Morawetz J. has been the supervising judge of the CCAA proceedings. The initial stay of the class actions was extended and broadened by order dated May 8, 2012.

18 On May 14, 2012, the supervising judge granted an unopposed claims procedure order which established a procedure to file and determine claims against Sino-Forest.

19 Thereafter, all of the appellants filed individual proofs of claim against Sino-Forest seeking contribution and indemnity for, among other things, any amounts that they are ordered to pay as damages to the plaintiffs in the class actions. Their proofs of claim advance several different legal bases for Sino-Forest's alleged obligation of contribution and indemnity, including breach of contract, contractual terms of indemnity, negligent and fraudulent misrepresentation in tort, and the provisions of the *Negligence Act*, R.S.O. 1990, c. N.1.

(d) Order under Appeal

20 Sino-Forest then applied for an order that the following claims are equity claims under the CCAA: claims against Sino-Forest arising from the ownership, purchase or sale of an equity interest in the company, including shareholder claims ("Shareholder Claims"); and any indemnification claims against Sino-Forest related to or arising from the Shareholder Claims, including the appellants' claims for contribution or indemnity ("Related Indemnity Claims").

21 The motion was supported by the Ad Hoc Committee of Noteholders.

22 On July 27, 2012, the supervising judge granted the order sought by Sino-Forest and released a comprehensive endorsement.

23 He concluded that it was not premature to determine the equity claims issue. It had been clear from the outset of Sino-Forest's CCAA proceedings that this issue would have to be decided and that the expected proceeds arising from any sales process would be insufficient to satisfy the claims of creditors. Furthermore, the issue could be determined independently of the claims procedure and without prejudice being suffered by any party.

24 He also concluded that both the Shareholder Claims and the Related Indemnity Claims should be characterized as equity claims. In summary, he reasoned that:

* The characterization of claims for indemnity turns on the characterization of the underlying primary claims. The Shareholder Claims are clearly equity claims and they led to and underlie the Related Indemnity Claims;
* The plain language of the CCAA, which focuses on the nature of the claim rather than the identity of the claimant, dictates that both Shareholder Claims and Related Indemnity Claims constitute equity claims;
* The definition of "equity claim" added to the CCAA in 2009 broadened the scope of equity claims established by pre-amendment jurisprudence;
* This holding is consistent with the analysis in *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, 2011 ONSC 5018, 83 C.B.R. (5th) 123, which dealt with contractual indemnification claims of officers and

directors. Leave to appeal was denied by this court, 2012 ONCA 10, 90 C.B.R. (5th) 141; and

* "It would be totally inconsistent to arrive at a conclusion that would enable either the auditors or the underwriters, through a claim for indemnification, to be treated as creditors when the underlying actions of shareholders cannot achieve the same status" (para. 82). To hold otherwise would run counter to the scheme established by the CCAA and would permit an indirect remedy to the shareholders when a direct remedy is unavailable.

25 The supervising judge did not characterize the full amount of the claims of the auditors and underwriters as equity claims. He excluded the claims for defence costs on the basis that while it was arguable that they constituted claims for indemnity, they were not necessarily in respect of an equity claim. That determination is not appealed.

III INTERPRETATION OF "EQUITY CLAIM"

(a) Relevant Statutory Provisions

26 As part of a broad reform of Canadian insolvency legislation, various amendments to the CCAA were proclaimed in force as of September 18, 2009.

27 They included the addition of s. 6(8):

> No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1, which provides that creditors with equity claims may not vote at any meeting unless the court orders otherwise, was also added.

28 Related definitions of "claim", "equity claim", and "equity interest" were added to s. 2(1) of the CCAA:

> In this Act,
>
> ...
>
> "claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> ...

"equity claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,
(b) a return of capital,
(c) a redemption or retraction obligation,
(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or
(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d); [Emphasis added.]

"equity interest" means

(a) in the case of a company other than an income trust, a share in the company -- or a warrant or option or another right to acquire a share in the company -- other than one that is derived from a convertible debt, and
(b) in the case of an income trust, a unit in the income trust -- or a warrant or option or another right to acquire a unit in the income trust -- other than one that is derived from a convertible debt;

29 Section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("BIA") defines a "claim provable in bankruptcy". Section 121 of the BIA in turn specifies that claims provable in bankruptcy are those to which the bankrupt is subject.

2. "claim provable in bankruptcy", "provable claim" or "claim provable" includes any claim or liability provable in proceedings under this Act by a creditor;

121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act. [Emphasis added.]

(b) The Legal Framework Before the 2009 Amendments

30 Even before the 2009 amendments to the CCAA codified the treatment of equity claims, the courts subordinated shareholder equity claims to general creditors' claims in an insolvency. As the

supervising judge described:

> [23] Essentially, shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditor claims are not being paid in full. Simply put, shareholders have no economic interest in an insolvent enterprise.
>
> [24] The basis for the differentiation flows from the fundamentally different nature of debt and equity investments. Shareholders have unlimited upside potential when purchasing shares. Creditors have no corresponding upside potential.
>
> [25] As a result, courts subordinated equity claims and denied such claims a vote in plans of arrangement. [Citations omitted.][4]

(c) The Appellants' Submissions

31 The appellants essentially advance three arguments.

32 First, they argue that on a plain reading of s. 2(1), their claims are excluded. They focus on the opening words of the definition of "equity claim" and argue that their claims against Sino-Forest are not claims that are "in respect of an equity interest" because they do not have an equity interest in Sino-Forest. Their relationships with Sino-Forest were purely contractual and they were arm's-length creditors, not shareholders with the risks and rewards attendant to that position. The policy rationale behind ranking shareholders below creditors is not furthered by characterizing the appellants' claims as equity claims. They were service providers with a contractual right to an indemnity from Sino-Forest.

33 Second, the appellants focus on the term "claim" in paragraph (e) of the definition of "equity claim", and argue that the claims in respect of which they seek contribution and indemnity are the shareholders' claims against them in court proceedings for damages, which are not "claims" against Sino-Forest provable within the meaning of the BIA, and, therefore, not "claims" within s. 2(1). They submit that the supervising judge erred in focusing on the characterization of the underlying primary claims.

34 Third, the appellants submit that the definition of "equity claim" is not sufficiently clear to have changed the existing law. It is assumed that the legislature does not intend to change the common law without "expressing its intentions to do so with irresistible clearness": *District of Parry Sound Social Services Administration Board v. Ontario Public Service Employees Union, Local 324*, 2003 SCC 42, [2003] 2 S.C.R. 157, at para. 39, citing *Goodyear Tire & Rubber Co. of Canada Ltd. v. T. Eaton Co. Ltd.*, [1956] S.C.R. 610, at p. 614. The appellants argue that the

supervising judge's interpretation of "equity claim" dramatically alters the common law as reflected in *National Bank of Canada v. Merit Energy Ltd.*, 2001 ABQB 583, 294 A.R. 15, aff'd 2002 ABCA 5, 299 A.R. 200. There the court determined that in an insolvency, claims of auditors and underwriters for indemnification are not to be treated in the same manner as claims by shareholders. Furthermore, the Senate debates that preceded the enactment of the amendments did not specifically comment on the effect of the amendments on claims by auditors and underwriters. The amendments should be interpreted as codifying the pre-existing common law as reflected in *National Bank of Canada v. Merit Energy Ltd*.

35 The appellants argue that the decision of *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.* is distinguishable because it dealt with the characterization of claims for damages by an equity investor against officers and directors, and it predated the 2009 amendments. In any event, this court confirmed that its decision denying leave to appeal should not be read as a judicial precedent for the interpretation of the meaning of "equity claim" in s. 2(1) of the CCAA.

(d) Analysis

(i) Introduction

36 The exercise before this court is one of statutory interpretation. We are therefore guided by the following oft-cited principle from Elmer A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at p. 87:

> [T]he words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

37 We agree with the supervising judge that the definition of equity claim focuses on the nature of the claim, and not the identity of the claimant. In our view, the appellants' claims for contribution and indemnity are clearly equity claims.

38 The appellants' arguments do not give effect to the expansive language adopted by Parliament in defining "equity claim" and read in language not incorporated by Parliament. Their interpretation would render paragraph (e) of the definition meaningless and defies the logic of the section.

(ii) The expansive language used

39 The definition incorporates two expansive terms.

40 First, Parliament employed the phrase "*in respect of*" twice in defining equity claim: in the opening portion of the definition, it refers to an equity claim as a "claim that is *in respect of* an equity interest", and in paragraph (e) it refers to "contribution or indemnity *in respect of* a claim referred to in any of paragraphs (a) to (d)" (emphasis added).

41 The Supreme Court of Canada has repeatedly held that the words "in respect of" are "of the widest possible scope", conveying some link or connection between two related subjects. In *CanadianOxy Chemicals Ltd. v. Canada (Attorney General)*, [1999] 1 S.C.R. 743, at para. 16, citing *Nowegijick v. The Queen*, [1983] 1 S.C.R. 29, at p. 39, the Supreme Court held as follows:

> The words "in respect of" are, in my opinion, words of the widest possible scope. They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters. [Emphasis added in *CanadianOxy*.]

That court also stated as follows in *Markevich v. Canada*, 2003 SCC 9, [2003] 1 S.C.R. 94, at para. 26:

> The words "in respect of" have been held by this Court to be words of the broadest scope that convey some link between two subject matters. [Citations omitted.]

42 It is conceded that the Shareholder Claims against Sino-Forest are claims for "a monetary loss resulting from the ownership, purchase or sale of an equity interest", within the meaning of paragraph (d) of the definition of "equity claim". There is an obvious link between the appellants' claims against Sino-Forest for contribution and indemnity and the shareholders' claims against Sino-Forest. The legal proceedings brought by the shareholders asserted their claims against Sino-Forest together with their claims against the appellants, which gave rise to these claims for contribution and indemnity. The causes of action asserted depend largely on common facts and seek recovery of the same loss.

43 The appellants' claims for contribution or indemnity against Sino-Forest are therefore clearly connected to or "in respect of" a claim referred to in paragraph (d), namely the shareholders' claims against Sino-Forest. They are claims in respect of equity claims by shareholders and are provable in bankruptcy against Sino-Forest.

44 Second, Parliament also defined equity claim as "including a claim for, among others", the claims described in paragraphs (a) to (e). The Supreme Court has held that this phrase "including" indicates that the preceding words - "a claim that is in respect of an equity interest" - should be given an expansive interpretation, and include matters which might not otherwise be within the meaning of the term, as stated in *National Bank of Greece (Canada) v. Katsikonouris*, [1990] 2 S.C.R. 1029, at p. 1041:

> [T]hese words are terms of extension, designed to enlarge the meaning of preceding words, and not to limit them.

> ... [T]he natural inference is that the drafter will provide a specific illustration of a subset of a given category of things in order to make it clear that that category extends to things that might otherwise be expected to fall outside it.

45 Accordingly, the appellants' claims, which clearly fall within paragraph (e), are included within the meaning of the phrase a "claim that is in respect of an equity interest".

(iii) What Parliament did not say

46 "Equity claim" is not confined by its definition, or by the definition of "claim", to a claim advanced by the holder of an equity interest. Parliament could have, but did not, include language in paragraph (e) restricting claims for contribution or indemnity to those made by shareholders.

(iv) An interpretation that avoids surplusage

47 A claim for contribution arises when the claimant for contribution has been sued. Section 2 of the *Negligence Act* provides that a tortfeasor may recover contribution or indemnity from any other tortfeasor who is, or would if sued have been, liable in respect of the damage to any person suffering damage as a result of a tort. The securities legislation of the various provinces provides that an issuer, its underwriters, and, if they consented to the disclosure of information in the prospectus, its auditors, among others, are jointly and severally liable for a misrepresentation in the prospectus, and provides for rights of contribution.[5]

48 Counsel for the appellants were unable to provide a satisfactory example of when a holder of an equity interest in a debtor company would seek contribution under paragraph (e) against the debtor in respect of a claim referred to in any of paragraphs (a) to (d). In our view, this indicates that paragraph (e) was drafted with claims for contribution or indemnity by non-shareholders rather than shareholders in mind.

49 If the appellants' interpretation prevailed, and only a person with an equity interest could assert such a claim, paragraph (e) would be rendered meaningless, and as Lamer C.J. wrote in *R. v. Proulx*, 2000 SCC 5, [2000] 1 S.C.R. 61, at para. 28:

> It is a well accepted principle of statutory interpretation that no legislative provision should be interpreted so as to render it mere surplusage.

(v) The scheme and logic of the section

50 Moreover, looking at s. 2(1) as a whole, it would appear that the remedies available to shareholders are all addressed by ss. 2(1)(a) to (d). The logic of ss. 2(1)(a) to (e) therefore also supports the notion that paragraph (e) refers to claims for contribution or indemnity not by shareholders, but by others.

(vi) The legislative history of the 2009 amendments

51 The appellants and the respondents each argue that the legislative history of the amendments supports their respective interpretation of the term "equity claim". We have carefully considered the legislative history. The limited commentary is brief and imprecise. The clause by clause analysis of Bill C-12 comments that "[a]n equity claim is defined to include any claim that is related to an equity interest".[6] While, as the appellants submit, there was no specific reference to the position of auditors and underwriters, the desirability of greater conformity with United States insolvency law to avoid forum shopping by debtors was highlighted in 2003, some four years before the definition of "equity claim" was included in Bill C-12.

52 In this instance the legislative history ultimately provided very little insight into the intended meaning of the amendments. We have been guided by the plain words used by Parliament in reaching our conclusion.

(vii) Intent to change the common law

53 In our view the definition of "equity claim" is sufficiently clear to alter the pre-existing common law. *National Bank of Canada v. Merit Energy Ltd.,* an Alberta decision, was the single case referred to by the appellants that addressed the treatment of auditors' and underwriters' claims for contribution and indemnity in an insolvency before the definition was enacted. As the supervising judge noted, in a more recent decision, *Return on Innovation Capital Ltd. v. Gandi Innovations Ltd.*, the courts of this province adopted a more expansive approach, holding that contractual indemnification claims of directors and officers were equity claims.

54 We are not persuaded that the practical effect of the change to the law implemented by the enactment of the definition of "equity claim" is as dramatic as the appellants suggest. The operations of many auditors and underwriters extend to the United States, where contingent claims for reimbursement or contribution by entities "liable with the debtor" are disallowed pursuant to s. 502(e)(1)(B) of the U.S. Bankruptcy Code, 11 U.S.C.S.[7]

(viii) The purpose of the legislation

55 The supervising judge indicated that if the claims of auditors and underwriters for contribution and indemnity were not included within the meaning of "equity claim", the CCAA would permit an indirect remedy to the shareholders when a direct remedy is not available. We would express this concept differently.

56 In our view, in enacting s. 6(8) of the CCAA, Parliament intended that a monetary loss suffered by a shareholder (or other holder of an equity interest) in respect of his or her equity interest *not* diminish the assets of the debtor available to general creditors in a restructuring. If a shareholder sues auditors and underwriters in respect of his or her loss, in addition to the debtor, and the auditors or underwriters assert claims of contribution or indemnity against the debtor, the assets

of the debtor available to general creditors would be diminished by the amount of the claims for contribution and indemnity.

IV PREMATURITY

57 We are not persuaded that the supervising judge erred by determining that the appellants' claims were equity claims before the claims procedure established in Sino-Forest's CCAA proceeding had been completed.

58 The supervising judge noted at para. 7 of his endorsement that from the outset, Sino-Forest, supported by the Monitor, had taken the position that it was important that these proceedings be completed as soon as possible. The need to address the characterization of the appellants' claims had also been clear from the outset. The appellants have not identified any prejudice that arises from the determination of the issue at this stage. There was no additional information that the appellants have identified that was not before the supervising judge. The Monitor, a court-appointed officer, supported the motion procedure. The supervising judge was well positioned to determine whether the procedure proposed was premature and, in our view, there is no basis on which to interfere with the exercise of his discretion.

V SUMMARY

59 In conclusion, we agree with the supervising judge that the appellants' claims for contribution or indemnity are equity claims within s. 2(1)(e) of the CCAA.

60 We reach this conclusion because of what we have said about the expansive language used by Parliament, the language Parliament did not use, the avoidance of surplusage, the logic of the section, and what, from the foregoing, we conclude is the purpose of the 2009 amendments as they relate to these proceedings.

61 We see no basis to interfere with the supervising judge's decision to consider whether the appellants' claims were equity claims before the completion of the claims procedure.

VI DISPOSITION

62 This appeal is accordingly dismissed. As agreed, there will be no costs.

S.T. GOUDGE J.A.
A. HOY J.A.
S.E. PEPALL J.A.

cp/ln/e/qlmdl/qlpmg

1 Credit Suisse Securities (Canada) Inc., TD Securities Inc., Dundee Securities Corporation (now known as DWM Securities Inc.), RBC Dominion Securities Inc., Scotia Capital Inc., CIBC World Markets Inc., Merrill Lynch Canada Inc., Canaccord Financial Ltd. (now known as Canaccord Genuity Corp.), 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.

2 Noteholders holding in excess of $1.296 billion, or 72%, of Sino-Forest's approximately $1.8 billion in noteholders' debt have executed written support agreements in favour of the Sino-Forest CCAA plan as of March 30, 2012. These include noteholders represented by the Ad Hoc Committee of Noteholders.

3 None of the appellants are sued in Saskatchewan and all are sued in Ontario. E&Y is also sued in Quebec and New York and the appellant underwriters are also sued in New York.

4 The supervising judge cited the following cases as authority for these propositions: *Blue Range Resource Corp., Re*, 2000 ABQB 4, 259 A.R. 30; *Stelco Inc., Re* (2006), 17 C.B.R. (5th) 78 (Ont. S.C.); *Central Capital Corp. (Re)* (1996), 27 O.R. (3d) 494 (C.A.); *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229, 71 C.B.R. (5th) 153; *EarthFirst Canada Inc., Re*, 2009 ABQB 316, 56 C.B.R. (5th) 102.

5 *Securities Act*, R.S.O. 1990, c. S.5, s. 130(1), (8); *Securities Act*, R.S.A. 2000, c. S-4, s. 203(1), (10); *Securities Act*, R.S.B.C. 1996, c. 418, s. 131(1), (11); *The Securities Act*, C.C.S.M. c. S50, s. 141(1), (11); *Securities Act*, S.N.B. 2004, c. S-5.5, s. 149(1), (9); *Securities Act*, R.S.N.L. 1990, c. S-13, s. 130(1), (8); *Securities Act*, R.S.N.S. 1989, c. 418, s. 137(1), (8); *Securities Act*, S.Nu. 2009, c. 12, s. 111(1), (12); *Securities Act*, S.N.W.T. 2008, c. 10, s. 111(1), (12); *Securities Act*, R.S.P.E.I. 1988, c. S-3.1, s. 111(1), (12); *Securities Act*, R.S.Q. c. V-1.1, ss. 218, 219, 221; *The Securities Act, 1988*, S.S. 1988-89, c. S-42.2, s. 137(1), (9); *Securities Act*, S.Y. 2007, c. 16, s. 111(1), (13).

6 We understand that this analysis was before the Standing Senate Committee on Banking, Trade and Commerce in 2007.

7 The United States Bankruptcy Court for the District of Delaware in *In Re: Mid-American Waste Systems, Inc.*, 228 B.R. 816 (1999), indicated that this provision applies to underwriters' claims, and reflects the policy rationale that such stakeholders are in a better position to evaluate the risks associated with the issuance of stock than are general creditors.

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

[2012] O.J. No. 88

2012 ONSC 24

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

C. CARRIAGE ORDERS JURISPRUDENCE

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.

Labourers v. Sino-Forest

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.l 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.

Northwest v. Sino-Forest

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.

Labourers v. Sino-Forest

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.

Northwest v. Sino-Forest

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. Neutral or Non-Determinative Factors

(a) Attributes of Class Counsel

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) Attributes of the Proposed Representative Plaintiffs

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.

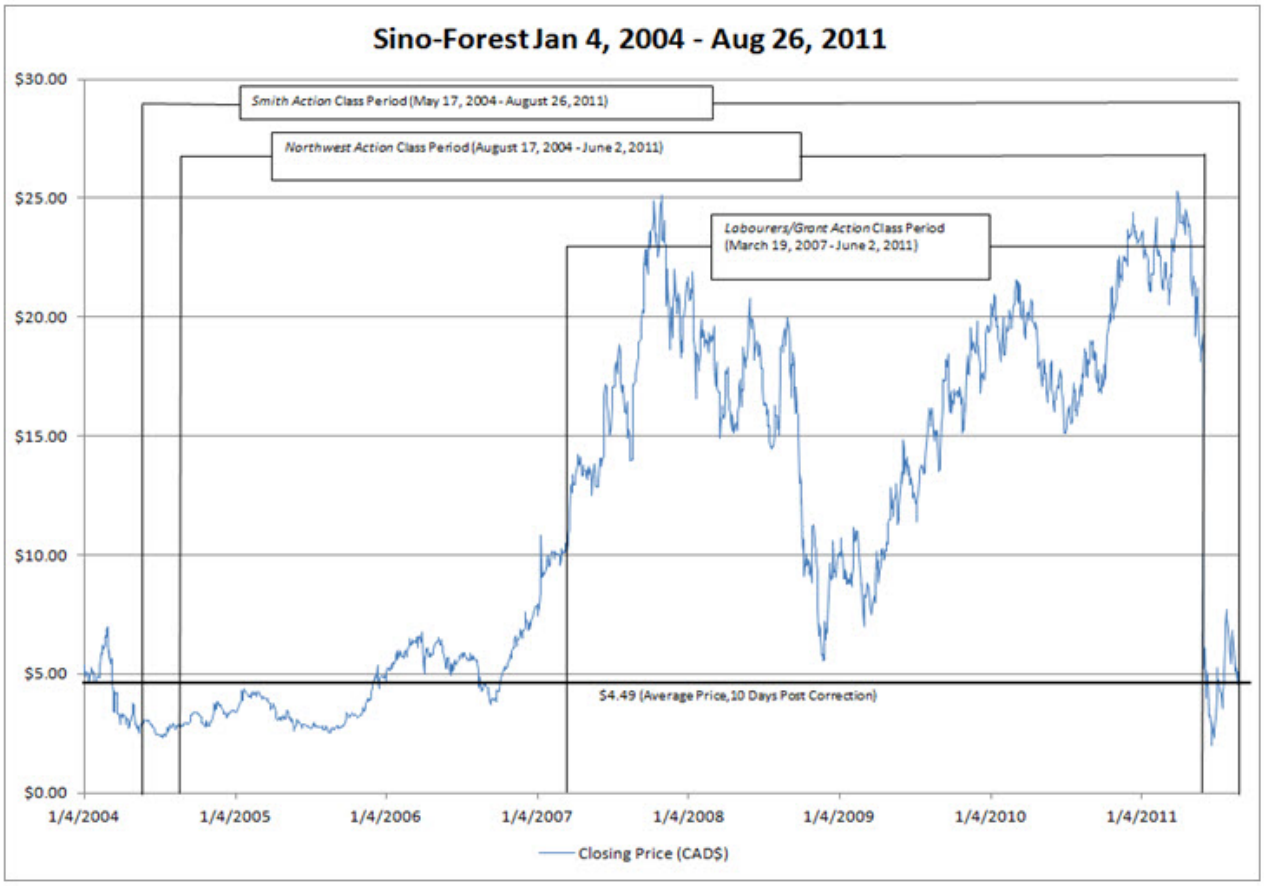
331 I repeat that a carriage motion is without prejudice to the defendants' rights to challenge the pleadings and whether any particular cause of action is legally tenable.

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

CITATION The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v. Sino Forest Corporation, 2012 ONSC 5398
COURT FILE NO.: CV-11-431153-00CP
DATE: September 25, 2012

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	*A. Dimitri Lascaris, Serge Kalloghlian, and S. Sajjad Nematollahi* for the 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	*Peter Osborne, Shara Roy, and Brendon Grey* for the Defendant Ernst & Young LLP *John Fabello* for the Defendants 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 Banc of America Securities LLC *Kenneth Dekker* for the Defendant BDO Limited *John J. Pirie and David Gadsden* for the Defendant Pöyry (Beijing) Consulting Company Limited

SUISSE SECURITIES (USA) LLC and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED (successor by merger to Banc of America Securities LLC) Defendants	)	*Emily Cole and Megan Mackey* for Allen Chan *Michael Eizenga* for Sino-Forest Corporation , W. Judson Martin, and Kai Kit Poon
Proceeding under the *Class Proceedings Act, 1992*	)	**HEARD:** September 21, 2012

PERELL, J.

REASONS FOR DECISION

A. INTRODUCTION

[1] This is a motion for approval of a partial settlement in a proposed class action under the *Class Proceedings Act, 1992*, S.O. 1992, c. C.6.

[2] The Plaintiffs are: Labourers' Pension Fund of Central and Eastern Canada ("Labourers'"), the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Operating Engineers"), Sjunde AP-Fonden ("AP7"), David Grant, and Robert Wong.

[3] The Defendants are: 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 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 Merril Lynch, Pierce, Fenner & Smith Incorporated (successor by merger to Banc of America Securities LLC).

[4] In this action, the Plaintiffs allege that Sino Forest misstated in its public filings its financial statements, misrepresented its timber rights, overstated the value of its assets, and concealed material information about its business operations from investors. There is a companion proposed class action in Québec. The Plaintiffs claim damages of $9.2 billion on behalf of resident and non-resident shareholders and noteholders of Sino-Forest.

[5] The Plaintiffs in Ontario and Québec have reached a settlement with one of the defendants, Pöyry (Beijing) Consulting Company Limited ("Pöyry (Beijing)"). The Settlement Agreement is subject to court approval in Ontario and Québec. The litigation is continuing against the other defendants.

[6] The Plaintiffs bring a motion for an order: (a) certifying the action for settlement purposes as against Pöyry (Beijing); (b) appointing the Plaintiffs as representative plaintiffs for the class; (c) approving the settlement as fair, reasonable, and in the best interests of the class; and (d) approving the form and method of dissemination of notice to the class of the certification and settlement of the action.

[7] The motion for settlement approval is not opposed by the Defendants.

[8] Up until the morning of the fairness hearing motion, three groups of Defendants objected to the settlement; namely: (a) Ernst & Young LLP; (b) BDO Limited; and (c) 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 Banc of America Securities LLC (collectively the "Underwriters").

[9] When the Plaintiffs and Pöyry (Beijing) and various other Pöyry entities agreed to amend their settlement arrangements to provide extensive discovery rights against the Pöyry entities, the opposition disappeared.

[10] While I originally I had misgivings, I have concluded that the court should approve the settlement as fair, reasonable, and in the best interests of the class members of the consent certification. Accordingly, I grant the Plaintiffs' motion.

B. FACTUAL BACKGROUND

[11] On July 20, 2011, the Plaintiffs commenced this action.

[12] Of the Plaintiffs, Labourers' and Operating Engineers are specified multi-employer pension plans. AP7 is a Swedish National Pension Fund and is part of Sweden's national pension system. David Grant is an individual residing in Calgary, Alberta. Robert Wong is an individual residing in Kincardine, Ontario.

[13] All the Plaintiffs purchased Sino Forest shares or Sino Forest Notes and lost a great deal of money.

[14] All of the Plaintiffs, especially the institutional investors, would appear to be sophisticated They are capable of understanding the issues and competent to give instructions to their lawyers about the tactics and strategies of this massive litigation.

[15] I mention this last point because their lawyers urged me that in weighing the fairness of the settlement to the class members, I should give considerable deference to the astuteness of the Plaintiffs and to the wisdom of their experienced lawyers about the advantages and disadvantages of the proposed settlement. See *Metzler Investment GmbH v Gildan Activewear Inc.*, 2011 ONSC 1146 at para. 31.

[16] In their action, the Plaintiffs allege that in its public filings, Sino Forest misstated its financial statements, misrepresented its timber rights, overstated the value of its assets, and concealed material information about its business and operations from

investors. As a result of these alleged misrepresentations, Sino Forest's securities allegedly traded at artificially inflated prices for many years.

[17] The Defendant Pöyry (Beijing) was one of several affiliated entities that appraised the value of Sino Forest's assets. Some of the Pöyry valuation reports were incorporated by reference into various offering documents. Some of the valuation reports were made publicly available through SEDAR and Pöyry valuation reports were posted on Sino Forest's website.

[18] In their statement of claim, the Plaintiffs allege that Pöyry (Beijing) is liable for: (a) negligence and under s. 130 of the Ontario *Securities Act*, R.S.O. 1990, c. S.5 to primary market purchasers of Sino-Forest shares and (b) is liable for negligence and under Part XXIII.1 of the *Act* to purchasers of Sino Forest's securities in the secondary markets.

[19] Only one Pöyry entity has been named as a defendant. The affiliated Pöyry entities have not been named as defendants.

[20] On January 26, 2012, the Plaintiffs filed an amended notice of action and a Statement of Claim. Around this time, The Plaintiffs and Pöyry (Beijing) began settlement discussions. Those discussions culminated in a Settlement Agreement made as of March 20, 2012.

[21] In its original form, the terms of the Settlement Agreement were as follows:

- Pöyry (Beijing) will provide information and cooperation to the Plaintiffs for the purpose of pursuing the claims against the other defendants.
- Pöyry (Beijing) is required to provide an evidentiary proffer relating to the allegations in this action. (This evidentiary proffer was made and apparently was very productive and the harbinger of useful information.).
- Pöyry (Beijing) is required to provide relevant documents within the possession, custody or control of Pöyry (Beijing) and its related entities, including: (a) documents relating to Sino-Forest, the Auditors or the Underwriters, or any of them, as well as the dates, locations, subject matter, and participants in any meetings with or about Sino-Forest, the Auditors, the Underwriters, or any of them; (b) documents provided by Pöyry (Beijing) or any of its related entities to any state, federal, or international government or administrative agency concerning the allegations raised in the proceedings; and (c) documents provided by Pöyry (Beijing) or any of its related entities to Sino Forest's Independent Committee or the ad hoc committee of noteholders.
- Pöyry (Beijing) is obliged to use reasonable efforts to make available directors, officers or employees of Pöyry (Beijing) and its related entities for interviews with Class Counsel, and to provide testimony at trial and affidavit evidence.
- The Plaintiffs will release their claims against Pöyry (Beijing) and its related entities.

- The Non-settling Defendants will be subject to a bar order that precludes any right to contribution or indemnity against Pöyry (Beijing) and its related entities, but preserves the non-settling defendants' rights of discovery as against Pöyry (Beijing) and Pöyry Management Consulting (Singapore) PTE. LTD. ("Pöyry (Singapore)").
- Pöyry (Beijing) will consent to certification for the purpose of settlement.
- Pöyry (Beijing) will pay the first $100,000 of the costs of providing the notice of certification and settlement, and half of any such costs over $100,000.

[22] The Settlement Agreement is subject to court approval in Ontario and Québec.

[23] As already noted above, Ernst & Young, BDO, and the Underwriters objected to the original version of the proposed settlement, but hard upon the hearing of the fairness motion, they withdrew their opposition because of a revised version of the settlement that preserved and extended their rights of discovery as against the Pöyry entities.

[24] The revised terms of the settlement agreement included, among other things, the following provisions:

- The Court shall retain jurisdiction over the Plaintiffs, the Pöyry Parties (Pöyry (Beijing), Pöyry Management Consulting (Singapore) Pte. Ltd., Pöyry Forest Industry Ltd., Pöyry Forest Industry Pte. Ltd, Pöyry Management Consulting (Australia) Pty. Ltd., Pöyry Management Consulting (NZ) Ltd., JP Management Consulting (Asia-Pacific) Ltd.), Pöyry PLC, and Pöyry Finland OY for all matters all of these parties are declared to have attorned to the jurisdiction of this Court.
- After all appeals or times to appeal from the certification of this action against the Non-Settling Defendants have been exhausted, any Non-Settling Defendant is entitled to the following:
    - documentary discovery and an affidavit of documents from any and all of Pöyry (Beijing), and the "Pöyry Parties";
    - oral discovery of a representative of any Pöyry Party, the transcript of which may be read in at trial solely by the Non-Settling Defendants as part of their respective cases in defending the Plaintiffs' allegations concerning the Proportionate Liability of the Releasees and in connection with any claim [described below] by a Non-Settling Defendant against a Pöyry Party for contribution and indemnity;
    - leave to serve a request to admit on any Pöyry Party in respect of factual matters and/or documents;
    - the production of a representative of any Pöyry Party to testify at trial, with such witness or witnesses to be subject to cross-examination by counsel for the Non-Settling Defendants;
    - leave to serve *Evidence Act* notices on any Pöyry Party; and

- discovery shall proceed pursuant to an agreement between the Non-Settling Defendants and the Pöyry Parties in respect of a discovery plan, or failing such agreement, by court order.

- The Pöyry Parties, Pöyry PLC, and Pöyry Finland OY shall, on a best efforts basis, take steps to collect and preserve all documents relevant to the matters at issue in the within proceeding.

- If any Pöyry Party fails to satisfy its reasonable obligations a Non-Settling Defendant may make a motion to this Court to compel reasonable compliance. If such an Order is made, and not adhered to by the Pöyry Party, a Non-Settling Defendant may then bring a motion to lift the Bar Order and to advance a claim for contribution, indemnity or other claims over against the Pöyry Party.

- If an Order is made permitting a claim to be advanced against a Pöyry Party by a Non-Settling Defendant any limitation period applicable to such a claim, whether in favour of a Pöyry Party or a Non-Settling Defendant, shall be deemed to have been tolled as of the date of the settlement approval order.

C. SUPPORT FOR THE SETTLEMENT AGREEMENT

[25] On May 17, 2012, the Plaintiffs distributed notice of the fairness hearing. No objections were filed by putative class members.

[26] The Plaintiffs' lawyers recommend the settlement for four reasons:

- (1) Although the Plaintiffs' central allegation against Pöyry (Beijing) is that its valuation reports on Sino Forest's assets contained misrepresentations, Pöyry (Beijing)'s, four reports (and one press release) contain exculpatory language that would pose significant challenges to establishing liability;

- (2) Pöyry (Beijing) is located in the People's Republic of China, and serious difficulties exist with respect to serving documents, compelling evidence, and enforcing any judgment, especially because compliance with the Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters ("Hague Convention") has already proven untimely;

- (3) The Plaintiffs' recourse against Pöyry (Beijing) may be limited to the collection of insurance proceeds (€2 million) from Pöyry (Beijing)'s insurer; and

- (4) Pöyry (Beijing is well-positioned to provide useful and valuable information and documents that would be helpful in the prosecution of the claims against the remaining defendants.

[27] As emerged from the argument at the fairness hearing, the last reason is by far the most significant reason that the Plaintiffs' lawyers recommend the settlement. They urged me that the direct claim against Pöyry (Beijing) is weak and not worth the effort, but the information available from the Pöyry entities and the swiftness of its availability

would be enormously valuable in the litigation battles for leave to assert an action under the Ontario *Securities Act,* to obtaining certification against the non-settling defendants, to succeeding on the merits, and to facilitating settlement overtures and negotiations.

[28] The Plaintiffs' lawyers urged me that the releases of the Pöyry entities and the risks of the bar order, which risks included the Plaintiffs having to take on the risk and task of contesting the non-settling defendants' efforts to attribute all or the greater proportion of responsibility onto the Pöyry entities was in the best interests of the class.

D. THE WITHDRAWN OPPOSITION OF BDO, ERNST & YOUNG AND THE UNDERWRITERS

[29] In connection with BDO's audits of the annual financial statements of Sino Forest for the years ended December 31, 2005 and December 31, 2006, BDO obtained and reviewed the Pöyry Asset Valuations and members of its audit team met with individuals from JP Management and Pöyry New Zealand and attended site visits at Sino Forest plantations with Pöyry staff.

[30] In its statement of defence, BDO will deny the allegations of negligence, and it will deliver a crossclaim against Pöyry (Beijing).

[31] BDO has already commenced an action against a Pöyry Beijing affiliate, Pöyry Management Consulting (Singapore) Pte. Ltd. ("Pöyry Singapore"), seeking contribution and indemnity in connection with the claims advanced against BDO in this action.

[32] The Pöyry valuations were relied upon by the Defendant Ernst &Young in its role as auditor of Sino Forest from 2007 to 2012. Ernst &Young submits that that the Plaintiffs' claims against it are inextricably linked to the claims the Plaintiffs advance against Pöyry (Beijing).

[33] Ernst & Young has commenced a separate action against Pöyry (Beijing) and the other Pöyry entities seeking contribution, indemnity and other relief emanating from the claim made by the plaintiffs against Ernst &Young.

[34] It was the position of the underwriters that the Pöyry entities and their valuation reports played significant roles in presenting Sino Forest's business to the market for ma many years and before the involvement of the Underwriters.

[35] The Underwriters have commenced an action seeking contribution and indemnity against seven Pöyry entities in respect of their involvement Sino Forest's disclosure and any liability that may be found after trial.

[36] Ernst & Young, BDO, and the Underwriters in their factums opposing the court approving the settlement disparaged the settlement as providing nothing of benefit to the class and as unfair to the non-settling defendants who had substantial claims of contribution and indemnity against the Pöyry entities whom they submit were at the centre of the events of this litigation.

E. CERTIFICATION FOR SETTLEMENT PURPOSES

[37] Pursuant to s. 5(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c.6, the court shall certify a proceeding as a class proceeding if: (a) the pleadings disclose a cause of action; (b) there is an identifiable class; (c) the claims of the class members raise common issues of fact or law; (d) a class proceeding would be the preferable procedure; and (e) there is a representative plaintiff who would adequately represent the interests of the class without conflict of interest and who has produced a workable litigation plan.

[38] Where certification is sought for the purposes of settlement, all the criteria for certification still must be met: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 22. However, compliance with the certification criteria is not as strictly required because of the different circumstances associated with settlements: *Bellaire v. Daya*, [2007] O.J. No. 4819 (S.C.J.) at para. 16; *National Trust Co. v. Smallhorn*, [2007] O.J. No. 3825 (S.C.J.) at para. 8; *Bonanno v. Maytag Corp.*, [2005] O.J. No. 3810 (S.C.J); *Bona Foods Ltd. v. Ajinomoto U.S.A. Inc.*, [2004] O.J. No. 908 (S.C.J.); *Gariepy v. Shell Oil Co.*, [2002] O.J. No. 4022 (S.C.J.) at para. 27; *Nutech Brands Inc. v. Air Canada*, [2008] O.J. No. 1065 (S.C.J.) at para. 9.

[39] Subject to approval of the settlement, in my opinion, the Plaintiffs' action satisfies the criterion for certification under the *Class Proceedings Act, 1992*. Their pleading discloses two causes of action against Pöyry (Beijing); namely: (1) misrepresentations in relation to the assets, business and transactions of Sino-Forest contrary to Part XXIII.1 and section 130 of the Ontario *Securities Act*; and (2) negligence in the preparation of its opinions and reports about the nature and value of Sino Forest's assets. Thus, the first criterion is satisfied.

[40] There is an identifiable class in which all class members have an interest in the resolution of the proposed common issue. Thus, the second criterion is satisfied. The proposed class is defined as:

> All persons and entities, wherever they may reside, who acquired Sino's Securities during the Class Period by distribution in Canada or on the Toronto Stock Exchange or other secondary market in Canada, which includes securities acquired over-the-counter, and all person and entities who acquired Sino's Securities during the Class Period* who are resident of Canada or were resident of Canada at the time of acquisition and who acquired Sino's Securities outside of Canada, except the Excluded Persons.*
>
> *Class Period is defined as the period from and including March 19, 2007 to and including June 2, 2011.
>
> *Excluded Persons is defined as 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 a member of the immediate family of an Individual Defendant.

[41] The Plaintiffs propose the following common issue, as agreed to between the parties to the Settlement Agreement:

> Did [Pöyry (Beijing)] make misrepresentations as alleged in this Proceeding during the Class Period concerning the assets, business or transactions of Sino-Forest? If so, what damages, if any, did Settlement Class Members suffer?

[42] I am satisfied that this question satisfies the third criterion.

[43] I am also satisfied that assuming that the settlement agreement is approved, a class proceeding is the preferable procedure and the Plaintiffs are suitable representative plaintiffs.

[44] Thus, I conclude that the action against Pöyry (Beijing) should be certified as a class action for settlement purposes.

F. SETTLEMENT APPROVAL

[45] 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 those affected by it: *Dabbs v. Sun Life Assurance*, [1998] O.J. No. 1598 (Gen. Div.) at para. 9, aff'd (1998), 41 O.R. (3d) 97 (C.A.); leave to appeal to the S.C.C. ref'd, [1998] S.C.C.A. No. 372; *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 68-73.

[46] In determining whether to approve a settlement, the court, without making findings of facts on the merits of the litigation, examines the fairness and reasonableness of the proposed settlement and whether it is in the best interests of the class as a whole having regard to the claims and defences in the litigation and any objections raised to the settlement: *Baxter v. Canada (Attorney General)* (2006), 83 O.R. (3d) 481 (S.C.J.) at para. 10.

[47] While a court has the jurisdiction to reject or approve a settlement, it does not have the jurisdiction to rewrite the settlement reached by the parties: *Dabbs v. Sun Life Assurance Co. of Canada*, *supra*, at para. 10.

[48] In determining whether a settlement is fair and reasonable and in the best interests of the class members, an objective and rational assessment of the pros and cons of the settlement is required: *Al-Harazi v. Quizno's Canada Restaurant Corp.*, [2007] O.J. No. 2819 (S.C.J.) at para. 23.

[49] A settlement must fall within a zone of reasonableness. Reasonableness allows for a range of possible resolutions and is an objective standard that allows for variation depending upon the subject matter of the litigation and the nature of the damages for which the settlement is to provide compensation: *Parsons v. The Canadian Red Cross Society*, *supra*, at para. 70; *Dabbs v. Sun Life Assurance*, *supra*.

[50] When considering the approval of negotiated settlements, the court may consider, among other things: likelihood of recovery or likelihood of success; amount and nature of discovery, evidence or investigation; settlement terms and conditions; recommendation and experience of counsel; future expense and likely duration of litigation and risk; recommendation of neutral parties, if any; number of objectors and

nature of objections; the presence of good faith, arms length bargaining and the absence of collusion; the degree and nature of communications by counsel and the representative plaintiffs with class members during the litigation; information conveying to the court the dynamics of and the positions taken by the parties during the negotiation: *Dabbs v. Sun Life Assurance Company of Canada, supra*; *Parsons v. The Canadian Red Cross Society*, [1999] O.J. No. 3572 (S.C.J.) at paras. 71-72; *Frohlinger v. Nortel Networks Corp.*, [2007] O.J. No. 148 (S.C.J.) at para. 8.

[51] There is an initial presumption of fairness when a settlement is negotiated arms-length: *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at paras. 113-114; *CSL Equity Investments Ltd. v. Valois*, [2007] O.J. No. 3932 (S.C.J.) at para. 5.

[52] The court may give considerable weight to the recommendations of experienced counsel who have been involved in the litigation and are in a better position than the court or the class members, to weigh the factors that bear on the reasonableness of a particular settlement: *Kranjcec v. Ontario*, [2006] O.J. No. 3671 (S.C.J.) at para. 11; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 142.

[53] In assessing the reasonableness of a settlement agreement, the court is entitled to consider the non-monetary benefits, including the provision of cooperation: *Nutech Brands Inc. v. Air Canada*, [2009] O.J. No. 709 (SCJ) at paras 29-30, 36-37; *Osmun v Cadbury Adams Canada Inc.*, [2010] O.J. No. 1877 (S.C.J.), aff'd 2010 ONCA 841, leave to appeal to S.C.C. refd [2011] S.C.C.A. No. 55.

[54] The court may approve a settlement with a "bar order" in which the plaintiff settles with some defendants and agrees only to pursue claims of several liability against the remaining defendants: *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130 (S.C.J.); *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at paras. 134-39; *Millard v. North George Capital Management Ltd.*, [2000] O.J. No. 1535 (S.C.J.); *Garlepy v. Shell Oil Co.*, [2002] O.J. No. 4022 (S.C.J.); *McCarthy v. Canadian Red Cross Society*, [2001] O.J. No. 2474 (S.C.J.); *Bona Foods Ltd. v. Ajinomoto U.S.A. Inc.*, [2004] O.J. No. 908 (S.C.J.); *Attis v. Canada (Minister of Health)*, [2003] O.J. No. 344 (S.C.J.), aff'd [2003] O.J. No. 4708 (C.A.); *Osmun v. Cadbury Adams Canada Inc., supra.*

[55] In the case at bar, before the settlement agreement between the Plaintiffs and Pöyry (Beijing) was revised at the eleventh hour, I had serious misgivings about approving the proposed settlement. I was concerned about whether the non-settling Defendants were being fairly treated, and I was concerned about whether the Plaintiffs should take on the risk and burden of contesting the apportionment of liability in crossclaims and third party claims that normally would not be their concern.

[56] Subject to what the Plaintiffs might submit during the oral argument, the Defendants' arguments in their factums appeared to me to make a strong case that the non-settling Defendants' ability to defend themselves by shifting the blame exclusively on the Pöyry entities and the non-settling Defendants' ability to advance their

substantive claims for contribution and indemnity were unfairly compromised by the release of all the Pöyry entities and the protection afforded all of them by a bar order.

[57] Subject to what the Plaintiffs might submit during the oral argument, I was concerned whether the release and bar order was in the class members' best interests in the circumstances of this case, where it is early days in assessing the extent to which the non-settling Defendants could succeed in establishing their claims of contribution and indemnity.

[58] However, with the non-settling Defendants, apparently being content with the revised settlement arrangement, and with the assertive and confident recommendation of the Plaintiffs and their lawyers made during oral argument that the proposed settlement is in the best interests of the class members and will increase the likelihood of success in obtaining leave under the *Securities Act* and certification under the *Class Proceedings Act, 1992* and perhaps success in encouraging a settlement, my conclusion is that the court should approve the settlement.

[59] I know from the carriage motion that the lawyers for the Plaintiffs have expended a great deal of forensic energy investigating and advancing this litigation and it is true that they are in a better position than the court to weigh the factors that bear on the reasonableness of a particular settlement, particularly a tactically and strategically motivated settlement in ongoing litigation.

G. CONCLUSION

[60] For the above reasons, I grant the Plaintiffs' motion without costs.

Perell, J.

Released: September 25, 2012

The Trustees of the Labourers' Pension Fund of Central and Eastern Canada v. Sino Forest Corporation, 2012 ONSC 5398

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

Plaintiff

- 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

REASONS FOR DECISION

Perell, J.

Released: September 25, 2012.

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE MR.	)	MONDAY, THE 14th
	)	
JUSTICE MORAWETZ	)	DAY OF MAY, 2012

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 AND ARRANGEMENT OF SINO-FOREST CORPORATION

CLAIMS PROCEDURE ORDER

THIS MOTION, made by Sino-Forest Corporation (the "Applicant") for an order establishing a claims procedure for the identification and determination of certain claims was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Applicant's Notice of Motion, the affidavit of W. Judson Martin sworn on May 2, 2012, the Second Report of FTI Consulting Canada Inc. (the "Monitor") dated April 30, 2012 (the "Monitor's Second Report") and the Supplemental Report to the Monitor's Second Report dated May 12, 2012 (the "Supplemental Report"), and on hearing the submissions of counsel for the Applicant, the Applicant's directors, the Monitor, the *ad hoc* committee of Noteholders (the "Ad Hoc Noteholders"), and those other parties present, no one appearing for the other parties served with the Applicant's Motion Record, although duly served as appears from the affidavit of service, filed:

SERVICE

1. THIS COURT ORDERS that the time for service of the Notice of Motion, the Motion Record, the Monitor's Second Report and the Supplemental Report is hereby abridged and

validated such that this Motion is properly returnable today and hereby dispenses with further service thereof.

DEFINITIONS AND INTERPRETATION

2. The following terms shall have the following meanings ascribed thereto:

(a) "2013 and 2016 Trustee" means The Bank of New York Mellon, in its capacity as trustee for the 2013 Notes and the 2016 Notes;

(b) "2014 and 2017 Trustee" means Law Debenture Trust Company of New York, in its capacity as trustee for the 2014 Notes and the 2017 Notes;

(c) "2013 Note Indenture" means the indenture dated as of July 23, 2008, by and between the Applicant, the entities listed as subsidiary guarantors thereto, and The Bank of New York Mellon, as trustee, as amended, modified or supplemented;

(d) "2014 Note Indenture" means the indenture dated as of July 27, 2009 entered into by and between the Applicant, the entities listed as subsidiary guarantors thereto, and Law Debenture Trust Company of New York, as trustee, as amended, modified or supplemented;

(e) "2016 Note Indenture" means the indenture dated as of December 17, 2009, by and between the Applicant, the entities listed as subsidiary guarantors thereto, and The Bank of New York Mellon, as trustee, as amended, modified or supplemented;

(f) "2017 Note Indenture" means the indenture dated as of October 21, 2010, by and between the Applicant, the entities listed as subsidiary guarantors thereto, and Law Debenture Trust Company of New York, as trustee, as amended, modified or supplemented;

(g) "2013 Notes" means the US$345,000,000 of 5.00% Convertible Senior Notes Due 2013 issued pursuant to the 2013 Note Indenture;

(h) "2014 Notes" means the US$399,517,000 of 10.25% Guaranteed Senior Notes Due 2014 issued pursuant to the 2014 Note Indenture;

(i) "2016 Notes" means the US$460,000,000 of 4.25% Convertible Senior Notes Due 2016 issued pursuant to the 2016 Note Indenture;

(j) "2017 Notes" means the US$600,000,000 of 6.25% Guaranteed Senior Notes Due 2017 issued pursuant to the 2017 Note Indenture;

(k) "Administration Charge" has the meaning given to that term in paragraph 37 of the Initial Order;

(l) "BIA" means the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended;

(m) "Business Day" means a day, other than a Saturday or a Sunday, on which banks are generally open for business in Toronto, Ontario;

(n) "CCAA" means the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended;

(o) "CCAA Proceedings" means the proceedings commenced by the Applicant in the Court under Court File No. CV-12-9667-00CL;

(p) "CCAA Service List" means the service list in the CCAA Proceedings posted on the Monitor's Website, as amended from time to time;

(q) "Claim" means:

(i) any right or claim of any Person that may be asserted or made in whole or in part against the Applicant, whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, including by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement

(oral or written), by reason of any breach of duty (including any legal, statutory, equitable or fiduciary duty) or by reason of any right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present or future, known or unknown, by guarantee, surety or otherwise, and whether or not any right or claim is executory or anticipatory in nature, including any right or ability of any Person (including Directors and Officers) to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action, whether existing at present or commenced in the future, which indebtedness, liability or obligation, and any interest accrued thereon or costs payable in respect thereof (A) is based in whole or in part on facts prior to the Filing Date, (B) relates to a time period prior to the Filing Date, or (C) is a right or claim of any kind that would be a claim provable in bankruptcy within the meaning of the BIA had the Applicant become bankrupt on the Filing Date, or an Equity Claim (each a "Prefiling Claim", and collectively, the "Prefiling Claims");

(ii) a Restructuring Claim; and

(iii) a Secured Claim;

provided, however, that "Claim" shall not include an Excluded Claim, a D&O Claim or a D&O Indemnity Claim;

(r) "Claimant" means any Person having a Claim, a D&O Claim or a D&O Indemnity Claim and includes the transferee or assignee of a Claim, a D&O Claim or a D&O Indemnity Claim transferred and recognized as a Claimant in accordance with paragraphs 46 and 47 hereof or a trustee, executor, liquidator, receiver, receiver and manager, or other Person acting on behalf of or through such Person;

(s) "Claimants' Guide to Completing the D&O Proof of Claim" means the guide to completing the D&O Proof of Claim form, in substantially the form attached as Schedule "E-2" hereto;

(t) "Claimants' Guide to Completing the Proof of Claim" means the guide to completing the Proof of Claim form, in substantially the form attached as Schedule "E" hereto;

(u) "Claims Bar Date" means June 20, 2012;

(v) "Class" means the National Class and the Quebec Class;

(w) "Court" means the Ontario Superior Court of Justice (Commercial List);

(x) "Creditors' Meeting" means any meeting of creditors called for the purpose of considering and voting in respect of the Plan, if one is filed, to be scheduled pursuant to further order of the Court;

(y) "D&O Claim" means, other than an Excluded Claim, (i) any right or claim of any Person that may be asserted or made in whole or in part against one or more Directors or Officers that relates to a Claim for which such Directors or Officers are by law liable to pay in their capacity as Directors or Officers, or (ii) any right or claim of any Person that may be asserted or made in whole or in part against one or more Directors or Officers, in that capacity, whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, including by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement (oral or written), by reason of any breach of duty (including any legal, statutory, equitable or fiduciary duty) or by reason of any right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and whether or not any indebtedness, liability or obligation, and any interest accrued thereon or costs payable in respect thereof, is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured,

disputed, undisputed, legal, equitable, secured, unsecured, present or future, known or unknown, by guarantee, surety or otherwise, and whether or not any right or claim is executory or anticipatory in nature, including any right or ability of any Person to advance a claim for contribution or indemnity from any such Directors or Officers or otherwise with respect to any matter, action, cause or chose in action, whether existing at present or commenced in the future, which indebtedness, liability or obligation, and any interest accrued thereon or costs payable in respect thereof (A) is based in whole or in part on facts prior to the Filing Date, or (B) relates to a time period prior to the Filing Date;

(z) "D&O Indemnity Claim" means any existing or future right of any Director or Officer against the Applicant which arose or arises as a result of any Person filing a D&O Proof of Claim in respect of such Director or Officer for which such Director or Officer is entitled to be indemnified by the Applicant;

(aa) "D&O Indemnity Claims Bar Date" has the meaning set forth in paragraph 19 of this Order;

(bb) "D&O Indemnity Proof of Claim" means the indemnity proof of claim in substantially the form attached as Schedule "F" hereto to be completed and filed by a Director or Officer setting forth its purported D&O Indemnity Claim;

(cc) "D&O Proof of Claim" means the proof of claim in substantially the form attached as Schedule "D-2" hereto to be completed and filed by a Person setting forth its purported D&O Claim and which shall include all supporting documentation in respect of such purported D&O Claim;

(dd) "Directors" means anyone who is or was, or may be deemed to be or have been, whether by statute, operation of law or otherwise, a director or *de facto* director of the Applicant;

(ee) "Directors' Charge" has the meaning given to that term in paragraph 26 of the Initial Order;

(ff) "Dispute Notice" means a written notice to the Monitor, in substantially the form attached as Schedule "B" hereto, delivered to the Monitor by a Person who has received a Notice of Revision or Disallowance, of its intention to dispute such Notice of Revision or Disallowance;

(gg) "Employee Amounts" means all outstanding wages, salaries and employee benefits (including, employee medical, dental, disability, life insurance and similar benefit plans or arrangements, incentive plans, share compensation plans and employee assistance programs and employee or employer contributions in respect of pension and other benefits), vacation pay, commissions, bonuses and other incentive payments, termination and severance payments, and employee expenses and reimbursements, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements;

(hh) "Equity Claim" has the meaning set forth in Section 2(1) of the CCAA;

(ii) "Excluded Claim" means:

(i) any Claims entitled to the benefit of the Administration Charge or the Directors' Charge, or any further charge as may be ordered by the Court;

(ii) any Claims of the Subsidiaries against the Applicant;

(iii) any Claims of employees of the Applicant as at the Filing Date in respect of Employee Amounts;

(iv) any Post-Filing Claims;

(v) any Claims of the Ontario Securities Commission; and

(vi) any D&O Claims in respect of (i) though (v) above;

(jj) "Filing Date" means March 30, 2012;

(kk) "Government Authority" means a federal, provincial, territorial, municipal or other government or government department, agency or authority (including a court of law) having jurisdiction over the Applicant;

(ll) "Initial Order" means the Initial order of the Honourable Mr. Justice Morawetz made March 30, 2012 in the CCAA Proceedings, as amended, restated or varied from time to time;

(mm) "Known Claimants" means:

(i) any Persons which, based upon the books and records of the Applicant, was owed monies by the Applicant as of the Filing Date and which monies remain unpaid in whole or in part;

(ii) any Person who has commenced a legal proceeding in respect of a Claim or D&O Claim or given the Applicant written notice of an intention to commence a legal proceeding or a demand for payment in respect of a Claim or D&O Claim, provided that where a lawyer of record has been listed in connection with any such proceedings, the "Known Claimant" for the purposes of any notice required herein or to be given hereunder shall be, in addition to that Person, its lawyer of record; and

(iii) any Person who is a party to a lease, contract, or other agreement or obligation of the Applicant which was restructured, terminated, repudiated or disclaimed by the Applicant between the Filing Date and the date of this Order;

(nn) "Monitor's Website" has the meaning set forth in paragraph 12(a) of this Order;

(oo) "National Class" has the meaning given to it in the Fresh As Amended Statement of Claim in the Ontario Class Action;

(pp) "Note Indenture Trustees" means, collectively, the 2013 and 2016 Trustee and the 2014 and 2017 Trustee;

(qq) "Notes" means, collectively, the 2013 Notes, the 2014 Notes, the 2016 Notes, and the 2017 Notes;

(rr) "Noteholder" means a registered or beneficial holder on or after the Filing Date of a Note in that capacity, and, for greater certainty, does not include former registered or beneficial holders of Notes;

(ss) "Notice of Revision or Disallowance" means a notice, in substantially the form attached as Schedule "A" hereto, advising a Person that the Monitor has revised or disallowed all or part of such Person's purported Claim, D&O Claim or D&O Indemnity Claim set out in such Person's Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim;

(tt) "Notice to Claimants" means the notice to Claimants for publication in substantially the form attached as Schedule "C" hereto;

(uu) "Officers" means anyone who is or was, or may be deemed to be or have been, whether by statute, operation of law or otherwise, an officer or *de facto* officer of the Applicant;

(vv) "Ontario Class Action: means the action commenced against the Applicant and others in the Ontario Superior Court of Justice, bearing (Toronto) Court File No. CV-11-431153-00CP;

(ww) "Ontario Plaintiffs" means the Trustees of the Labourers' Pension Fund of Central and Eastern Canada and the other named Plaintiffs in the Ontario Class Action;

(xx) "Person" is to be broadly interpreted and includes any individual, firm, corporation, limited or unlimited liability company, general or limited partnership, association, trust, unincorporated organization, joint venture, Government Authority or any agency, regulatory body, officer or instrumentality thereof or any other entity, wherever situate or domiciled, and whether or not having legal status, and whether acting on their own or in a representative capacity;

(yy) "Plan" means any proposed plan of compromise or arrangement filed in respect of the Applicant pursuant to the CCAA as the same may be amended, supplemented or restated from time to time in accordance with its terms;

(zz) "Post-Filing Claims" means any claims against the Applicant that arose from the provision of authorized goods and services provided or otherwise incurred on or after the Filing Date in the ordinary course of business, but specifically excluding any Restructuring Claim;

(aaa) "Proof of Claim" means the proof of claim in substantially the form attached as Schedule "D" hereto to be completed and filed by a Person setting forth its purported Claim and which shall include all supporting documentation in respect of such purported Claim;

(bbb) "Proof of Claim Document Package" means a document package that includes a copy of the Notice to Claimants, the Proof of Claim form, the D&O Proof of Claim form, the Claimants' Guide to Completing the Proof of Claim form, the Claimants' Guide to Completing the D&O Proof of Claim form, and such other materials as the Monitor, in consultation with the Applicant, may consider appropriate or desirable;

(ccc) "Proven Claim" means the amount and Status of a Claim, D&O Claim or D&O Indemnity Claim of a Claimant as determined in accordance with this Order;

(ddd) "Quebec Class" has the meaning given to it in the statement of claim in the Quebec Class Action;

(eee) "Quebec Class Action" means the action commenced against the Applicant and others in the Quebec Superior Court, bearing Court File No. 200-06-000132-111 ;

(fff) "Quebec Plaintiffs" means Guining Liu and the other named plaintiffs in the Quebec Class Action;

(ggg) "Restructuring Claim" means any right or claim of any Person that may be asserted or made in whole or in part against the Applicant, whether or not asserted

or made, in connection with any indebtedness, liability or obligation of any kind arising out of the restructuring, termination, repudiation or disclaimer of any lease, contract, or other agreement or obligation on or after the Filing Date and whether such restructuring, termination, repudiation or disclaimer took place or takes place before or after the date of this Order;

(hhh) "Restructuring Claims Bar Date" means, in respect of a Restructuring Claim, the later of (i) the Claims Bar Date, and (ii) 30 days after a Person is deemed to receive a Proof of Claim Document Package pursuant to paragraph 12(e) hereof.

(iii) "Secured Claim" means that portion of a Claim that is (i) secured by security validly charging or encumbering property or assets of the Applicant (including statutory and possessor liens that create security interests) up to the value of such collateral, and (ii) duly and properly perfected in accordance with the relevant legislation in the appropriate jurisdiction as of the Filing Date;

(jjj) "Status" means, with respect to a Claim, D&O Claim or D&O Indemnity Claim, or a purported Claim, D&O Claim or D&O Indemnity Claim, whether such claim is secured or unsecured; and

(kkk) "Subsidiaries" means all direct and indirect subsidiaries of the Applicant other than Greenheart Group Limited (Bermuda) and its direct and indirect subsidiaries, and "Subsidiary" means any one of the Subsidiaries.

3. THIS COURT ORDERS that all references as to time herein shall mean local time in Toronto, Ontario, Canada, and any reference to an event occurring on a Business Day shall mean prior to 5:00 p.m. on such Business Day unless otherwise indicated herein.

4. THIS COURT ORDERS that all references to the word "including" shall mean "including without limitation".

5. THIS COURT ORDERS that all references to the singular herein include the plural, the plural include the singular, and any gender includes the other gender.

GENERAL PROVISIONS

6. THIS COURT ORDERS that the Monitor, in consultation with the Applicant, is hereby authorized to use reasonable discretion as to the adequacy of compliance with respect to the manner in which forms delivered hereunder are completed and executed, and may, where it is satisfied that a Claim, a D&O Claim or a D&O Indemnity Claim has been adequately proven, waive strict compliance with the requirements of this Order as to completion and execution of such forms and to request any further documentation from a Person that the Monitor, in consultation with the Applicant, may require in order to enable it to determine the validity of a Claim, a D&O Claim or a D&O Indemnity Claim.

7. THIS COURT ORDERS that if any purported Claim, D&O Claim or D&O Indemnity Claim arose in a currency other than Canadian dollars, then the Person making the purported Claim, D&O Claim or D&O Indemnity Claim shall complete its Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim, as applicable, indicating the amount of the purported Claim, D&O Claim or D&O Indemnity Claim in such currency, rather than in Canadian dollars or any other currency. The Monitor shall subsequently calculate the amount of such purported Claim, D&O Claim or D&O Indemnity Claim in Canadian Dollars, using the Reuters closing rate on the Filing Date (as found at http://www.reuters.com/finance/currencies), without prejudice to a different exchange rate being proposed in any Plan.

8. THIS COURT ORDERS that a Person making a purported Claim, D&O Claim or D&O Indemnity Claim shall complete its Proof of Claim, D&O Proof of Claim or Indemnity Proof of Claim, as applicable, indicating the amount of the purported Claim, D&O Claim or D&O Indemnity Claim without including any interest and penalties that would otherwise accrue after the Filing Date.

9. THIS COURT ORDERS that the form and substance of each of the Notice of Revision or Disallowance, Dispute Notice, Notice to Claimants, the Proof of Claim, the D&O Proof of Claim, the Claimants' Guide to Completing the Proof of Claim, the Claimants' Guide to Completing the D&O Proof of Claim, and D&O Indemnity Proof of Claim substantially in the forms attached as Schedules "A", "B", "C", "D", "D-2", "E", "E-2" and "F" respectively to this Order are hereby approved. Notwithstanding the foregoing, the Monitor, in consultation with the

Applicant, may from time to time make minor non-substantive changes to such forms as the Monitor, in consultation with the Applicant, considers necessary or advisable.

MONITOR'S ROLE

10. THIS COURT ORDERS that the Monitor, in addition to its prescribed rights, duties, responsibilities and obligations under the CCAA and under the Initial Order, is hereby directed and empowered to take such other actions and fulfill such other roles as are authorized by this Order or incidental thereto.

11. THIS COURT ORDERS that (i) in carrying out the terms of this Order, the Monitor shall have all of the protections given to it by the CCAA, the Initial Order, and this Order, or as an officer of the Court, including the stay of proceedings in its favour, (ii) the Monitor shall incur no liability or obligation as a result of the carrying out of the provisions of this Order, (iii) the Monitor shall be entitled to rely on the books and records of the Applicant and any information provided by the Applicant, all without independent investigation, and (iv) the Monitor shall not be liable for any claims or damages resulting from any errors or omissions in such books, records or information.

NOTICE TO CLAIMANTS, DIRECTORS AND OFFICERS

12. THIS COURT ORDERS that:

(a) the Monitor shall no later than five (5) Business Days following the making of this Order, post a copy of the Proof of Claim Document Package on its website at http://cfcanada.fticonsulting.com/sfc ("Monitor's Website");

(b) the Monitor shall no later than five (5) Business Days following the making of this Order, send on behalf of the Applicant to the Note Indenture Trustees (or to counsel for the Note Indenture Trustees as appears on the CCAA Service List if applicable) a copy of the Proof of Claim Document Package;

(c) the Monitor shall no later than five (5) Business Days following the making of this Order, send on behalf of the Applicant to each of the Known Claimants a copy of the Proof of Claim Document Package, provided however that the

Monitor is not required to send Proof of Claim Document Packages to Noteholders;

(d) the Monitor shall no later than five (5) Business Days following the making of this Order, cause the Notice to Claimants to be published in (i) The Globe and Mail newspaper (National Edition) on one such day, and (ii) the Wall Street Journal (Global Edition) on one such day;

(e) with respect to Restructuring Claims arising from the restructuring, termination, repudiation or disclaimer of any lease, contract, or other agreement or obligation, the Monitor shall send to the counterparty(ies) to such lease, contract, or other agreement or obligation a Proof of Claim Document Package no later than five (5) Business Days following the time the Monitor becomes aware of the restructuring, termination, repudiation or disclaimer of any such lease, contract, or other agreement or obligation;

(f) the Monitor shall, provided such request is received by the Monitor prior to the Claims Bar Date, deliver as soon as reasonably possible following receipt of a request therefor a copy of the Proof of Claim Document Package to any Person requesting such material; and

(g) the Monitor shall send to any Director of Officer named in a D&O Proof of Claim received by the Claims Bar Date a copy of such D&O Proof of Claim as soon as practicable along with an D&O Indemnity Proof of Claim form, with a copy to counsel for such Directors or Officers.

13. THIS COURT ORDERS that the Applicant shall (i) inform the Monitor of all Known Claimants by providing the Monitor with a list of all Known Claimants and their last known addresses according to the books and records of the Applicant and (ii) provide the Monitor with a list of all Directors and Officers and their last known addresses according to the books and records of the Applicant.

14. THIS COURT ORDERS that, except as otherwise set out in this Order or other orders of the Court, neither the Monitor nor the Applicant is under any obligation to send notice to any

Person holding a Claim, a D&O Claim or a D&O Indemnity Claim, and without limitation, neither the Monitor nor the Applicant shall have any obligation to send notice to any Person having a security interest in a Claim, D&O Claim or D&O Indemnity Claim (including the holder of a security interest created by way of a pledge or a security interest created by way of an assignment of a Claim, D&O Claim or D&O Indemnity Claim), and all Persons (including Known Claimants) shall be bound by any notices published pursuant to paragraphs 12(a) and 12(d) of this Order regardless of whether or not they received actual notice, and any steps taken in respect of any Claim, D&O Claim or D&O Indemnity Claim in accordance with this Order.

15. THIS COURT ORDERS that the delivery of a Proof of Claim, D&O Proof of Claim, or D&O Indemnity Proof of Claim by the Monitor to a Person shall not constitute an admission by the Applicant or the Monitor of any liability of the Applicant or any Director of Officer to any Person.

CLAIMS BAR DATES

Claims and D&O Claims

16. THIS COURT ORDERS that (i) Proofs of Claim (but not in respect of any Restructuring Claims) and D&O Proofs of Claim shall be filed with the Monitor on or before the Claims Bar Date, and (ii) Proofs of Claim in respect of Restructuring Claims shall be filed with the Monitor on or before the Restructuring Claims Bar Date. For the avoidance of doubt, a Proof of Claim or D&O Proof of Claim, as applicable, must be filed in respect of every Claim or D&O Claim, regardless of whether or not a legal proceeding in respect of a Claim or D&O Claim was commenced prior to the Filing Date.

17. THIS COURT ORDERS that any Person that does not file a Proof of Claim as provided for herein such that the Proof of Claim is received by the Monitor on or before the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, (a) shall be and is hereby forever barred from making or enforcing such Claim against the Applicant and all such Claims shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such Claim as against any other Person who could claim contribution or indemnity from the Applicant; (c) shall not be entitled to vote such Claim at the Creditors' Meeting in respect of the

Plan or to receive any distribution thereunder in respect of such Claim; and (d) shall not be entitled to any further notice in, and shall not be entitled to participate as a Claimant or creditor in, the CCAA Proceedings in respect of such Claim.

18. THIS COURT ORDERS that any Person that does not file a D&O Proof of Claim as provided for herein such that the D&O Proof of Claim is received by the Monitor on or before the Claims Bar Date (a) shall be and is hereby forever barred from making or enforcing such D&O Claim against any Directors or Officers, and all such D&O Claims shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such D&O Claim as against any other Person who could claim contribution or indemnity from any Directors or Officers; (c) shall not be entitled to vote such D&O Claim at the Creditors' Meeting or to receive any distribution in respect of such D&O Claim; and (d) shall not be entitled to any further notice in, and shall not be entitled to participate as a Claimant or creditor in, the CCAA Proceedings in respect of such D&O Claim.

D&O Indemnity Claims

19. THIS COURT ORDERS that any Director of Officer wishing to assert a D&O Indemnity Claim shall deliver a D&O Indemnity Proof of Claim to the Monitor so that it is received by no later than fifteen (15) Business Days after the date of receipt of the D&O Proof of Claim by such Director or Officer pursuant to paragraph 12(g) hereof (with respect to each D&O Indemnity Claim, the "D&O Indemnity Claims Bar Date").

20. THIS COURT ORDERS that any Director of Officer that does not file a D&O Indemnity Proof of Claim as provided for herein such that the D&O Indemnity Proof of Claim is received by the Monitor on or before the D&O Indemnity Claims Bar Date (a) shall be and is hereby forever barred from making or enforcing such D&O Indemnity Claim against the Applicant, and such D&O Indemnity Claim shall be forever extinguished; (b) shall be and is hereby forever barred from making or enforcing such D&O Indemnity Claim as against any other Person who could claim contribution or indemnity from the Applicant; and (c) shall not be entitled to vote such D&O Indemnity Claim at the Creditors' Meeting or to receive any distribution in respect of such D&O Indemnity Claim.

Excluded Claims

21. THIS COURT ORDERS that Persons with Excluded Claims shall not be required to file a Proof of Claim in this process in respect of such Excluded Claims, unless required to do so by further order of the Court.

PROOFS OF CLAIM

22. THIS COURT ORDERS that (i) each Person shall include any and all Claims it asserts against the Applicant in a single Proof of Claim, provided however that where a Person has taken assignment or transfer of a purported Claim after the Filing Date, that Person shall file a separate Proof of Claim for each such assigned or transferred purported Claim, and (ii) each Person that has or intends to assert a right or claim against one or more Subsidiaries which is based in whole or in part on facts, underlying transactions, causes of action or events relating to a purported Claim made against the Applicant shall so indicate on such Claimant's Proof of Claim.

23. THIS COURT ORDERS that each Person shall include any and all D&O Claims it asserts against one or more Directors or Officers in a single D&O Proof of Claim, provided however that where a Person has taken assignment or transfer of a purported D&O Claim after the Filing Date, that Person shall file a separate D&O Proof of Claim for each such assigned or transferred purported D&O Claim.

24. THIS COURT ORDERS that the 2013 and 2016 Trustee is authorized and directed to file one Proof of Claim on or before the Claims Bar Date in respect of each of the 2013 Notes and the 2016 Notes, indicating the amount owing on an aggregate basis as at the Filing Date under each of the 2013 Note Indenture and the 2016 Note Indenture.

25. THIS COURT ORDERS that the 2014 and 2017 Trustee is authorized and directed to file one Proof of Claim on or before the Claims Bar Date in respect of each of the 2014 Notes and the 2017 Notes, indicating the amount owing on an aggregate basis as at the Filing Date under each of the 2014 Note Indenture and the 2017 Note Indenture.

26. Notwithstanding any other provisions of this Order, Noteholders are not required to file individual Proofs of Claim in respect of Claims relating solely to the debt evidenced by their

Notes. The Monitor may disregard any Proofs of Claim filed by any individual Noteholder claiming the debt evidenced by the Notes, and such Proofs of Claim shall be ineffective for all purposes. The process for determining each individual Noteholder's Claim for voting and distribution purposes with respect to the Plan and the process for voting on the Plan by Noteholders will be established by further order of the Court.

27. THIS COURT ORDERS that the Ontario Plaintiffs are, collectively, authorized to file, on or before the Claims Bar Date, one Proof of Claim and, if applicable, one D&O Proof of Claim, in respect of the substance of the matters set out in the Ontario Class Action, notwithstanding that leave to make a secondary market liability claim has not be granted and that the National Class has not yet been certified, and that members of the National Class may rely on the one Proof of Claim and/or one D&O Proof of Claim filed by the counsel for the Ontario Plaintiffs and are not required to file individual Proofs of Claim or D&O Proofs of Claim in respect of the Claims forming the subject matter of the Ontario Class Action.

28. THIS COURT ORDERS that the Quebec Plaintiffs are, collectively, authorized to file, on or before the Claims Bar Date, one Proof of Claim and, if applicable, one D&O Proof of Claim, in respect of the substance of the matters set out in the Quebec Class Action, notwithstanding that leave to make a secondary market liability claim has not be granted and that the Quebec Class has not yet been certified, and that members of the Quebec Class may rely on the one Proof of Claim and/or one D&O Proof of Claim filed by the counsel for the Quebec Plaintiffs and are not required to file individual Proofs of Claim or D&O Proofs of Claim in respect of the Claims forming the subject matter of the Quebec Class Action.

REVIEW OF PROOFS OF CLAIM

29. THIS COURT ORDERS that any Claimant filing a Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim shall clearly mark as "Confidential" any documents or portions thereof that that Person believes should be treated as confidential.

30. THIS COURT ORDERS that with respect to documents or portions thereof that are marked "Confidential", the following shall apply:

(a) any information that is otherwise publicly available shall not be treated as "Confidential" regardless of whether it is marked as such;

(b) subject to the following, such information will be accessible to and may be reviewed only by the Monitor, the Applicant, any Director or Officer named in the applicable D&O Proof of Claim or D&O Indemnity Proof of Claim and each of their respective counsel, or as otherwise ordered by the Court ("**Designated Persons**") or consented to by the Claimant, acting reasonably; and

(c) any Designated Person may provide Confidential Information to other interested stakeholders (who shall have provided non-disclosure undertakings or agreements) on not less than 3 Business Days' notice to the Claimant. If such Claimant objects to such disclosure, the Claimant and the relevant Designated Person shall attempt to settle any objection, failing which, either party may seek direction from the Court.

31. THIS COURT ORDERS that the Monitor (in consultation with the Applicant and the Directors and Officers named in the D&O Proof of Claim, as applicable), subject to the terms of this Order, shall review all Proofs of Claim and D&O Proofs of Claim filed, and at any time:

(a) may request additional information from a purported Claimant;

(b) may request that a purported Claimant file a revised Proof of Claim or D&O Proof of Claim, as applicable;

(c) may, with the consent of the Applicant and any Person whose liability may be affected or further order of the Court, attempt to resolve and settle any issue arising in a Proof of Claim or D&O Proof of Claim or in respect of a purported Claim or D&O Claim, provided that if a Director or Officer disputes all or any portion of a purported D&O Claim, then the disputed portion of such purported D&O Claim may not be resolved or settled without such Director or Officer's consent or further order of the Court;

(d) may, with the consent of the Applicant and any Person whose liability may be affected or further order of the Court, accept (in whole or in part) the amount and/or Status of any Claim or D&O Claim, provided that if a Director or Officer disputes all or any portion of a purported D&O Claim against such Director or Officer, then the disputed portion of such purported D&O Claim may not be accepted without such Director or Officer's consent or further order of the Court; and

(e) may by notice in writing revise or disallow (in whole or in part) the amount and/or Status of any purported Claim or D&O Claim.

32. THIS COURT ORDERS that where a Claim or D&O Claim has been accepted by the Monitor in accordance with this Order, such Claim or D&O Claim shall constitute such Claimant's Proven Claim. The acceptance of any Claim or D&O Claim or other determination of same in accordance with this Order, in full or in part, shall not constitute an admission of any fact, thing, liability, or quantum or status of any claim by any Person, save and except in the context of the CCAA Proceedings, and, for greater certainty, shall not constitute an admission of any fact, thing, liability, or quantum or status of any claim by any Person as against any Subsidiary.

33. THIS COURT ORDERS that where a purported Claim or D&O Claim is revised or disallowed (in whole or in part, and whether as to amount and/or Status), the Monitor shall deliver to the purported Claimant a Notice of Revision or Disallowance, attaching the form of Dispute Notice.

34. THIS COURT ORDERS that where a purported Claim or D&O Claim has been revised or disallowed (in whole or in part, and whether as to amount and/or as to Status), the revised or disallowed purported Claim or D&O Claim (or revised or disallowed portion thereof) shall not be a Proven Claim until determined otherwise in accordance with the procedures set out in paragraphs 42 to 45 hereof or as otherwise ordered by the Court.

REVIEW OF D&O INDEMNITY PROOFS OF CLAIM

35. THIS COURT ORDERS that the Monitor, subject to the terms of this Order, shall review all D&O Indemnity Proofs of Claim filed, and at any time:

(a) may request additional information from a Director of Officer;

(b) may request that a Director or Officer file a revised D&O Indemnity Proof of Claim;

(c) may attempt to resolve and settle any issue arising in a D&O Indemnity Proof of Claim or in respect of a purported D&O Indemnity Claim;

(d) may accept (in whole or in part) the amount and/or Status of any D&O Indemnity Claim; and

(e) may by notice in writing revise or disallow (in whole or in part) the amount and/or Status of any purported D&O Indemnity Claim.

36. THIS COURT ORDERS that where a D&O Indemnity Claim has been accepted by the Monitor in accordance with this Order, such D&O Indemnity Claim shall constitute such Director or Officer's Proven Claim. The acceptance of any D&O Indemnity Claim or other determination of same in accordance with this Order, in full or in part, shall not constitute an admission of any fact, thing, liability, or quantum or Status of any claim by any Person, save and except in the context of the CCAA Proceedings, and, for greater certainty, shall not constitute an admission of any fact, thing, liability, or quantum or Status of any claim by any Person as against any Subsidiary.

37. THIS COURT ORDERS that where a purported D&O Indemnity Claim is revised or disallowed (in whole or in part, and whether as to amount and/or Status), the Monitor shall deliver to the Director or Officer a Notice of Revision or Disallowance, attaching the form of Dispute Notice.

38. THIS COURT ORDERS that where a purported D&O Indemnity Claim has been revised or disallowed (in whole or in part, and whether as to amount and/or as to Status), the revised or

disallowed purported D&O Indemnity Claim (or revised or disallowed portion thereof) shall not be a Proven Claim until determined otherwise in accordance with the procedures set out in paragraphs 42 to 45 hereof or as otherwise ordered by the Court.

39. THIS COURT ORDERS that, notwithstanding anything to the contrary in this Order, in respect of any Claim, D&O Claim or D&O Indemnity Claim that exceeds $1 million, the Monitor and the Applicant shall not accept, admit, settle, resolve, value (for any purpose), revise or reject such Claim, D&O Claim or D&O Indemnity Claim ~~without the consent of the Ad Hoc Noteholders or~~ without Order of the Court.

DISPUTE NOTICE

40. THIS COURT ORDERS that a purported Claimant who intends to dispute a Notice of Revision or Disallowance shall file a Dispute Notice with the Monitor as soon as reasonably possible but in any event such that such Dispute Notice shall be received by the Monitor on the day that is fourteen (14) days after such purported Claimant is deemed to have received the Notice of Revision or Disallowance in accordance with paragraph 50 of this Order. The filing of a Dispute Notice with the Monitor within the fourteen (14) day period specified in this paragraph shall constitute an application to have the amount or Status of such claim determined as set out in paragraphs 42 to 45 of this Order.

41. THIS COURT ORDERS that where a purported Claimant that receives a Notice of Revision or Disallowance fails to file a Dispute Notice with the Monitor within the time period provided therefor in this Order, the amount and Status of such purported Claimant's purported Claim, D&O Claim or D&O Indemnity Claim, as applicable, shall be deemed to be as set out in the Notice of Revision or Disallowance and such amount and Status, if any, shall constitute such purported Claimant's Proven Claim, and the balance of such purported Claimant's purported Claim, D&O Claim, or D&O Indemnity Claim, if any, shall be forever barred and extinguished.

RESOLUTION OF CLAIMS, D&O CLAIMS AND D&O INDEMNITY CLAIMS

42. THIS COURT ORDERS that as soon as practicable after the delivery of the Dispute Notice to the Monitor, the Monitor, in accordance with paragraph 31(c), shall attempt to resolve and settle the purported Claim or D&O Claim with the purported Claimant.

43. THIS COURT ORDERS that as soon as practicable after the delivery of the Dispute Notice in respect of a D&O Indemnity Claim to the Monitor, the Monitor, in accordance with paragraph 35(c), shall attempt to resolve and settle the purported D&O Indemnity Claim with the Director or Officer.

44. THIS COURT ORDERS that in the event that a dispute raised in a Dispute Notice is not settled within a time period or in a manner satisfactory to the Monitor, the Applicant and the applicable Claimant, the Monitor shall seek direction from the Court, on the correct process for resolution of the dispute. Without limitation, the foregoing includes any dispute arising as to whether a Claim is or is not an "equity claim" as defined in the CCAA.

45. THIS COURT ORDERS that any Claims and related D&O Claims and/or D&O Indemnity Claims shall be determined at the same time and in the same proceeding.

NOTICE OF TRANSFEREES

46. THIS COURT ORDERS that neither the Monitor nor the Applicant shall be obligated to send notice to or otherwise deal with a transferee or assignee of a Claim, D&O Claim or D&O Indemnity Claim as the Claimant in respect thereof unless and until (i) actual written notice of transfer or assignment, together with satisfactory evidence of such transfer or assignment, shall have been received by the Monitor and the Applicant, and (ii) the Monitor shall have acknowledged in writing such transfer or assignment, and thereafter such transferee or assignee shall for all purposes hereof constitute the "Claimant" in respect of such Claim, D&O Claim or D&O Indemnity Claim. Any such transferee or assignee of a Claim, D&O Claim or D&O Indemnity Claim, and such Claim, D&O Claim or D&O Indemnity Claim shall be bound by all notices given or steps taken in respect of such Claim, D&O Claim or D&O Indemnity Claim in accordance with this Order prior to the written acknowledgement by the Monitor of such transfer or assignment.

47. THIS COURT ORDERS that if the holder of a Claim, D&O Claim or D&O Indemnity Claim has transferred or assigned the whole of such Claim, D&O Claim or D&O Indemnity Claim to more than one Person or part of such Claim, D&O Claim or D&O Indemnity Claim to another Person or Persons, such transfer or assignment shall not create a separate Claim, D&O

Claim or D&O Indemnity Claim and such Claim, D&O Claim or D&O Indemnity Claim shall continue to constitute and be dealt with as a single Claim, D&O Claim or D&O Indemnity Claim notwithstanding such transfer or assignment, and the Monitor and the Applicant shall in each such case not be bound to acknowledge or recognize any such transfer or assignment and shall be entitled to send notice to and to otherwise deal with such Claim, D&O Claim or D&O Indemnity Claim only as a whole and then only to and with the Person last holding such Claim, D&O Claim or D&O Indemnity Claim in whole as the Claimant in respect of such Claim, D&O Claim or D&O Indemnity Claim. Provided that a transfer or assignment of the Claim, D&O Claim or D&O Indemnity Claim has taken place in accordance with paragraph 46 of this Order and the Monitor has acknowledged in writing such transfer or assignment, the Person last holding such Claim, D&O Claim or D&O Indemnity Claim in whole as the Claimant in respect of such Claim, D&O Claim or D&O Indemnity Claim may by notice in writing to the Monitor direct that subsequent dealings in respect of such Claim, D&O Claim or D&O Indemnity Claim, but only as a whole, shall be with a specified Person and, in such event, such Claimant, transferee or assignee of the Claim, D&O Claim or D&O Indemnity Claim shall be bound by any notices given or steps taken in respect of such Claim, D&O Claim or D&O Indemnity Claim by or with respect to such Person in accordance with this Order.

48. THIS COURT ORDERS that the transferee or assignee of any Claim, D&O Claim or D&O Indemnity Claim (i) shall take the Claim, D&O Claim or D&O Indemnity Claim subject to the rights and obligations of the transferor/assignor of the Claim, D&O Claim or D&O Indemnity Claim, and subject to the rights of the Applicant or Director or Officer against any such transferor or assignor, including any rights of set-off which the Applicant, Director or Officers had against such transferor or assignor, and (ii) cannot use any transferred or assigned Claim, D&O Claim or D&O Indemnity Claim to reduce any amount owing by the transferee or assignee to the Applicant, Director or Officer, whether by way of set off, application, merger, consolidation or otherwise.

DIRECTIONS

49. THIS COURT ORDERS that the Monitor, the Applicant and any Person (but only to the extent such Person may be affected with respect to the issue on which directions are sought) may, at any time, and with such notice as the Court may require, seek directions from the Court with respect to this Order and the claims process set out herein, including the forms attached as Schedules hereto.

SERVICE AND NOTICE

50. THIS COURT ORDERS that the Monitor and the Applicant may, unless otherwise specified by this Order, serve and deliver the Proof of Claim Document Package, and any letters, notices or other documents to Claimants, purported Claimants, Directors or Officers, or other interested Persons, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or electronic or digital transmission to such Persons (with copies to their counsel as appears on the CCAA Service List if applicable) at the address as last shown on the records of the Applicant or set out in such Person's Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim. Any such service or notice by courier, personal delivery or electronic or digital transmission shall be deemed to have been received: (i) if sent by ordinary mail, on the third Business Day after mailing within Ontario, the fifth Business Day after mailing within Canada (other than within Ontario), and the tenth Business Day after mailing internationally; (ii) if sent by courier or personal delivery, on the next Business Day following dispatch; and (iii) if delivered by electronic or digital transmission by 6:00 p.m. on a Business Day, on such Business Day, and if delivered after 6:00 p.m. or other than on a Business Day, on the following Business Day. Notwithstanding anything to the contrary in this paragraph 50, Notices of Revision or Disallowance shall be sent only by (i) facsimile to a number that has been provided in writing by the purported Claimant, Director or Officer, or (ii) courier.

51. THIS COURT ORDERS that any notice or other communication (including Proofs of Claim, D&O Proofs of Claims, D&O Indemnity Proofs of Claim and Notices of Dispute) to be given under this Order by any Person to the Monitor shall be in writing in substantially the form, if any, provided for in this Order and will be sufficiently given only if delivered by prepaid registered mail, courier, personal delivery or electronic or digital transmission addressed to:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

Any such notice or other communication by a Person shall be deemed received only upon actual receipt thereof during normal business hours on a Business Day, or if delivered outside of a normal business hours, the next Business Day.

52. THIS COURT ORDERS that if during any period during which notices or other communications are being given pursuant to this Order a postal strike or postal work stoppage of general application should occur, such notices or other communications sent by ordinary mail and then not received shall not, absent further Order of the Court, be effective and notices and other communications given hereunder during the course of any such postal strike or work stoppage of general application shall only be effective if given by courier, personal delivery or electronic or digital transmission in accordance with this Order.

53. THIS COURT ORDERS that in the event that this Order is later amended by further order of the Court, the Monitor shall post such further order on the Monitor's Website and such posting shall constitute adequate notice of such amended claims procedure.

MISCELLANEOUS

54. THIS COURT ORDERS that notwithstanding any other provision of this Order, the solicitation of Proofs of Claim, D&O Proofs of Claim and D&O Indemnity Proofs of Claim and the filing by a Person of any Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim shall not, for that reason only, grant any Person any standing in the CCAA Proceedings or rights under the Plan.

55. THIS COURT ORDERS that the rights of the Ontario Plaintiffs and the Quebec Plaintiffs granted pursuant to paragraphs 27 and 28 of this Order are limited to filing a single Proof of

Claim and, if applicable, a single D&O Proof in respect of each of the National Class and the Quebec Class in these proceedings, and not for any other purpose. Without limiting the generality of the foregoing, the filing of any Proof of Claim or D&O Proof of Claim by the Ontario Plaintiffs or the Quebec Plaintiffs pursuant to this Order:

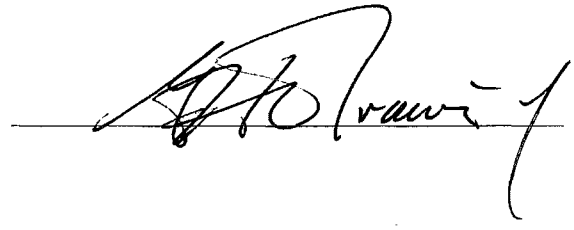
(a) is not an admission or recognition of their right to represent the Class for any other purpose, including with respect to settlement or voting in these proceedings, the Ontario Class Action or the Quebec Class Action; and

(b) is without prejudice to the right of the Ontario Plaintiffs and the Quebec Plaintiffs or their counsel to seek an order granting them rights of representation in these proceedings, the Ontario Class Action or the Quebec Class Action.

56. THIS COURT ORDERS that nothing in this Order shall constitute or be deemed to constitute an allocation or assignment of Claims, D&O Claims, D&O Indemnity Claims, or Excluded Claims into particular affected or unaffected classes for the purpose of a Plan and, for greater certainty, the treatment of Claims, D&O Claims, D&O Indemnity Claims, Excluded Claims or any other claims are to be subject to a Plan and the class or classes of creditors for voting and distribution purposes shall be subject to the terms of any proposed Plan or further Order of the Court.

57. THIS COURT ORDERS that nothing in this Order shall prejudice the rights and remedies of any Directors or Officers or other persons under any existing Director and Officers or other insurance policy or prevent or bar any Person from seeking recourse against or payment from the Applicant's insurance and any Director's and/or Officer's liability insurance policy or policies that exist to protect or indemnify the Directors and/or Officers or other persons, whether such recourse or payment is sought directly by the Person asserting a Claim or a D&O Claim from the insurer or derivatively through the Director or Officer or Applicant; provided, however, that nothing in this Order shall create any rights in favour of such Person under any policies of insurance nor shall anything in this Order limit, remove, modify or alter any defence to such claim available to the insurer pursuant to the provisions of any insurance policy or at law.

58. THIS COURT HEREBY REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada, the United States, Barbados, the British Virgin Islands, Cayman Islands, Hong Kong, the People's Republic of China or in any other foreign jurisdiction, to give effect to this Order and to assist the Applicant, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Applicant and to the Monitor, as an officer of the Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Applicant and the Monitor and their respective agents in carrying out the terms of this Order.



SCHEDULE "A"

NOTICE OF REVISION OR DISALLOWANCE

For Persons that have asserted Claims against Sino-Forest Corporation, D&O Claims against the Directors or Officers of Sino-Forest Corporation or D&O Indemnity Claims against Sino-Forest Corporation

Claim Reference Number: _____

TO: _____
(Name of purported claimant)

Defined terms not defined in this Notice of Revision or Disallowance have the meaning ascribed in the Order of the Ontario Superior Court of Justice dated May 8, 2012 (the "Claims Procedure Order"). **All dollar values contained herein are in Canadian dollars unless otherwise noted.**

Pursuant to 31 of the Claims Procedure Order, the Monitor hereby gives you notice that it has reviewed your Proof of Claim, D&O Proof of Claim or D&O Indemnity Proof of Claim and has revised or disallowed all or part of your purported Claim, D&O Claim or D&O Indemnity Claim, as the case may be. Subject to further dispute by you in accordance with the Claims Procedure Order, your Proven Claim will be as follows:

	Amount as submitted		**Amount allowed by Monitor**
	(original currency amount)	**(in Canadian dollars)**	**(in Canadian dollars)**
A. Prefiling Claim	$	$	$
B. Restructuring Claim	$	$	$
C. Secured Claim	$	$	$
D. D&O Claim	$	$	$
E. D&O Indemnity Claim	$	$	$
F. Total Claim	$	$	$

Reasons for Revision or Disallowance:

_____

_____

_____

SERVICE OF DISPUTE NOTICES

If you intend to dispute this Notice of Revision or Disallowance, you must, no later than 5:00 p.m. (prevailing time in Toronto) on the day that is fourteen (14) days after this Notice of Revision or Disallowance is deemed to have been received by you (in accordance with paragraph 50 of the Claims Procedure Order), deliver a Dispute Notice to the Monitor by registered mail, courier, personal delivery or electronic or digital transmission to the address below. In accordance with the Claims Procedure Order, notices shall be deemed to be received upon actual receipt thereof by the Monitor during normal business hours on a Business Day, or if delivered outside of normal business hours, on the next Business Day. The form of Dispute Notice is enclosed and can also be accessed on the Monitor's website at http://cfcanada.fticonsulting.com/sfc.

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

IF YOU FAIL TO FILE A DISPUTE NOTICE WITHIN THE PRESCRIBED TIME PERIOD, THIS NOTICE OF REVISION OR DISALLOWANCE WILL BE BINDING UPON YOU.

DATED at Toronto, this day of , 2012.

FTI Consulting Canada Inc., solely in its capacity as Court-appointed Monitor of Sino-Forest Corporation and not in its personal or corporate capacity

Per: Greg Watson / Jodi Porepa

SCHEDULE "B"

DISPUTE NOTICE

With respect to Sino-Forest Corporation

Claim Reference Number: _____

1. **Particulars of Claimant:**

Full Legal Name of claimant (include trade name, if different):

_____

_____

(the "Claimant")

Full Mailing Address of the Claimant:

_____

_____

Other Contract Information of the Claimant:

Telephone Number: _____

Email Address: _____

Facsimile Number: _____

Attention (Contact Person): _____

2. **Particulars of original Claimant from whom you acquired the Claim, D&O Claim or D&O Indemnity Claim:**

Have you acquired this purported Claim, D&O Claim or D&O Indemnity Claim by assignment?

Yes: ☐ No: ☐

If yes and if not already provided, attach documents evidencing assignment.

Full Legal Name of original Claimant(s): _____

3. **Dispute of Revision or Disallowance of Claim, D&O Claim or D&O Indemnity Claim, as the case may be:**

For the purposes of the Claims Procedure Order only (and without prejudice to the terms of any plan of arrangement or compromise), claims in a foreign currency will be converted to Canadian dollars at the exchange rates set out in the Claims Procedure Order.

The Claimant hereby disagrees with the value of its Claim, D&O Claim or D&O Indemnity Claim, as the case may be, as set out in the Notice of Revision or Disallowance and asserts a Claim, D&O Claim or D&O Indemnity Claim, as the case may be, as follows:

	Amount allowed by Monitor: (Notice of Revision or Disallowance) (in Canadian dollars)	**Amount claimed by Claimant: (in Canadian Dollars)**
A. Prefiling Claim	$	$
B. Restructuring Claim	$	$
C. Secured Claim	$	$
D. D&O Claim	$	$
E. D&O Indemnity Claim	$	$
F. Total Claim	$	$

REASON(S) FOR THE DISPUTE:

_____

_____

_____

_____

SERVICE OF DISPUTE NOTICES

If you intend to dispute a Notice of Revision or Disallowance, you must, by no later than the date that is fourteen (14) days after the Notice of Revision or Disallowance is deemed to have been received by you (in accordance with paragraph 50 of the Claims Procedure Order), deliver to the Monitor this Dispute Notice by registered mail, courier, personal delivery or electronic or digital transmission to the address below. In accordance with the Claims Procedure Order, notices shall be deemed to be received upon actual receipt thereof by the Monitor during normal business hours on a Business Day, or if delivered outside of normal business hours, on the next Business Day.

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

DATED this _____ day of _____, 2012.

Name of Claimant: _____

_____
Witness

Per: _____
Name:
Title:
(please print)

SCHEDULE "C"

NOTICE TO CLAIMANTS
AGAINST SINO-FOREST CORPORATION
(hereinafter referred to as the "Applicant")

RE: NOTICE OF CLAIMS PROCEDURE FOR THE APPLICANT PURSUANT TO THE *COMPANIES' CREDITORS ARRANGEMENT ACT* (the "CCAA")

PLEASE TAKE NOTICE that this notice is being published pursuant to an Order of the Superior Court of Justice of Ontario made on May 8, 2012 (the "Claims Procedure Order"). Pursuant to the Claims Procedure Order, Proof of Claim Document Packages will be sent to claimants by mail, on or before May 15, 2012, if those claimants are known to the Applicant. Claimants may also obtain the Claims Procedure Order and a Proof of Claim Document Package from the website of the Monitor at http://cfcanada.fticonsulting.com/sfc, or by contacting the Monitor by telephone (416-649-8094).

Proofs of Claim (including D&O Proofs of Claim) must be submitted to the Monitor for any claim against the Applicant, whether unliquidated, contingent or otherwise, or a claim against any current or former officer or director of the Applicant, in each case where the claim (i) arose prior to March 30, 2012, or (ii) arose on or after March 30, 2012 as a result of the restructuring, termination, repudiation or disclaimer of any lease, contract, or other agreement or obligation. Please consult the Proof of Claim Document Package for more details.

Completed Proofs of Claim must be received by the Monitor by 5:00 p.m. (prevailing Eastern Time) on the applicable claims bar date, as set out in the Claims Procedure Order. It is your responsibility to ensure that the Monitor receives your Proof of Claim or D&O Proof of Claim by the applicable claims bar date.

Certain Claimants are exempted from the requirement to file a Proof of Claim. Among those claimants who do not need to file a Proof of Claim are individual noteholders in respect of Claims relating solely to the debt evidenced by their notes and persons whose Claims form the subject matter of the Ontario Class Action or the Quebec Class Action. Please consult the Claims Procedure Order for additional details.

CLAIMS AND D&O CLAIMS WHICH ARE NOT RECEIVED BY THE APPLICABLE CLAIMS BAR DATE WILL BE BARRED AND EXTINGUISHED FOREVER.

DATED at Toronto this • day of •, 2012.

SCHEDULE "D"

PROOF OF CLAIM AGAINST SINO-FOREST CORPORATION

1. Original Claimant Identification (the "Claimant")

Legal Name of Claimant _____ Name of Contact _____

Address _____ Title _____

_____ Phone # _____

_____ Fax # _____

City _____ Prov / State ____ e-mail _____

Postal/Zip code _____

2. Assignee, if claim has been assigned

Full Legal Name of Assignee _____ Name of Contact _____

Address _____ Phone # _____

_____ Fax # _____

City _____ Prov / State ____ e-mail _____

Postal/Zip code _____

3a. Amount of Claim

The Applicant or Director or Officer was and still is indebted to the Claimant as follows:

Currency	Original Currency Amount	Unsecured Prefiling Claim	Restructuring Claim	Secured Claim
_____	_____	☐	☐	☐
_____	_____	☐	☐	☐
_____	_____	☐	☐	☐
_____	_____	☐	☐	☐
_____	_____	☐	☐	☐

3b. Claim against Subsidiaries

If you have or intend to make a claim against one or more Subsidiaries which is based in whole or in part on facts, underlying transactions, causes of action or events relating to a claim made against the Applicant above, check the box below, list the Subsidiaries against whom you assert your claim, and provide particulars of your claim against such Subsidiaries.

☐ I/we have a claim against one or more Subsidiary

Name(s) of Subsidiaries	Currency	Original Currency Amount	Amount of Claim
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

4. Documentation

Provide all particulars of the Claim and supporting documentation, including amount, and description of transaction(s) or agreement(s), or legal breach(es) giving rise to the Claim.

5. Certification

I hereby certify that:

1. I am the Claimant, or authorized representative of the Claimant.
2. I have knowledge of all the circumstances connected with this Claim.
3. Complete documentation in support of this claim is attached.

Name _____

Title _____

Dated at _____

Signature _____

this _____ day of _____2012

Witness _____

6. Filing of Claim

This Proof of Claim **must be received by the Monitor by no later than 5:00 p.m. (prevailing Eastern Time) on June 20, 2012,** by registered mail, courier, personal delivery or electronic or digital transmission at the following address:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

SCHEDULE "D-2"

PROOF OF CLAIM AGAINST DIRECTORS OR OFFICERS OF SINO-FOREST CORPORATION

This form is to be used only by Claimants asserting a claim against any director and/or officers of Sino-Forest Corporation, and NOT for claims against Sino-Forest Corporation itself. For claims against Sino-Forest Corporation, please use the form titled "Proof of Claim Against Sino-Forest Corporation", which is available on the Monitor's website at http://cfcanada.fticonsulting.com/sfc.

1. Original Claimant Identification (the "Claimant")

Legal Name of Claimant _____

Address _____

_____

_____

City_____ Prov / State____

Postal/Zip code_____

Name of Contact _____

Title _____

Phone # _____

Fax # _____

e-mail _____

2. Assignee, if D&O Claim has been assigned

Full Legal Name of Assignee _____

Address_____

_____

City_____ Prov / State___

Postal/Zip code _____

Name of Contact_____

Phone #_____

Fax #_____

e-mail_____

3. Amount of D&O Claim

The Director or Officer was and still is indebted to the Claimant as follows:

☐ I/we have a claim against a Director(s) and/or Officer(s)

Name(s) of Director(s) and/or Officer(s)	Currency	Original Currency Amount	Amount of Claim

4. Documentation

Provide all particulars of the D&O Claim and supporting documentation, including amount, and description of transaction(s) or agreement(s), or legal breach(es) giving rise to the D&O Claim.

5. Certification

I hereby certify that:

1. I am the Claimant, or authorized representative of the Claimant.

2. I have knowledge of all the circumstances connected with this D&O Claim.
3. Complete documentation in support of this D&O Claim is attached.

Name _____

Title _____

Dated at _____

Signature _____

this _____ day of _____2012

Witness _____

6. Filing of D&O Claim

This Proof of Claim **must be received by the Monitor by no later than 5:00 p.m. (prevailing Eastern Time) on June 20, 2012,** by registered mail, courier, personal delivery or electronic or digital transmission at the following address:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

SCHEDULE "E"

GUIDE TO COMPLETING THE PROOF OF CLAIM FOR CLAIMS AGAINST SINO-FOREST CORPORATION

This Guide has been prepared to assist Claimants in filling out the Proof of Claim with respect to Sino-Forest Corporation (the "Applicant"). If you have any additional questions regarding completion of the Proof of Claim, please consult the Monitor's website at http://cfcanada.fticonsulting.com/sfc or contact the Monitor, whose contact information is shown below.

Additional copies of the Proof of Claim may be found at the Monitor's website address noted above.

Please note that this is a guide only, and that in the event of any inconsistency between the terms of this guide and the terms of the Claims Procedure Order made on May 8, 2012 (the "Claims Procedure Order"), the terms of the Claims Procedure Order will govern.

SECTION 1 - ORIGINAL CLAIMANT

4. A separate Proof of Claim must be filed by each legal entity or person asserting a claim against the Applicant.

5. The Claimant shall include any and all Claims it asserts against the Applicant in a single Proof of Claim.

6. The full legal name of the Claimant must be provided.

7. If the Claimant operates under a different name, or names, please indicate this in a separate schedule in the supporting documentation.

8. If the Claim has been assigned or transferred to another party, Section 2 must also be completed.

9. Unless the Claim is assigned or transferred, all future correspondence, notices, etc. regarding the Claim will be directed to the address and contact indicated in this section.

10. Certain Claimants are exempted from the requirement to file a Proof of Claim. Among those claimants who do not need to file a Proof of Claim are individual noteholders in respect of Claims relating solely to the debt evidenced by their notes. Please consult the Claims Procedure Order for details with respect to these and other exemptions.

SECTION 2 - ASSIGNEE

11. If the Claimant has assigned or otherwise transferred its Claim, then Section 2 must be completed.

12. The full legal name of the Assignee must be provided.

13. If the Assignee operates under a different name, or names, please indicate this in a separate schedule in the supporting documentation.

14. If the Monitor in consultation with the Applicant is satisfied that an assignment or transfer has occurred, all future correspondence, notices, etc. regarding the Claim will be directed to the Assignee at the address and contact indicated in this section.

SECTION 3A - AMOUNT OF CLAIM OF CLAIMANT AGAINST DEBTOR

15. Indicate the amount the Applicant was and still is indebted to the Claimant.

Currency, Original Currency Amount

16. The amount of the Claim must be provided in the currency in which it arose.

17. Indicate the appropriate currency in the Currency column.

18. If the Claim is denominated in multiple currencies, use a separate line to indicate the Claim amount in each such currency. If there are insufficient lines to record these amounts, attach a separate schedule indicating the required information.

19. Claims denominated in a currency other than Canadian dollars will be converted into Canadian dollars in accordance with the Claims Procedure Order.

Unsecured Prefiling Claim

20. Check this box ONLY if the Claim recorded on that line is an unsecured prefiling claim.

Restructuring Claim

21. Check this box ONLY if the amount of the Claim against the Applicant arose out of the restructuring, termination, repudiation or disclaimer of a lease, contract, or other agreement or obligation on or after March 30, 2012.

Secured Claim

Check this box ONLY if the Claim recorded on that line is a secured claim.

SECTION 3B - CLAIM AGAINST SUBSIDIARIES

22. Check this box ONLY if you have or intend to make a claim against one or more Subsidiaries which is based in whole or in part on facts, underlying transactions, causes of action or events relating to a claim made against the Applicant above, and list the Subsidiaries against whom you assert your claim.

SECTION 4 - DOCUMENTATION

23. Attach to the claim form all particulars of the Claim and supporting documentation, including amount, description of transaction(s) or agreement(s) or breach(es) giving rise to the Claim.

SECTION 5 - CERTIFICATION

24. The person signing the Proof of Claim should:

(a) be the Claimant, or authorized representative of the Claimant.

(b) have knowledge of all the circumstances connected with this Claim.

(c) have a witness to its certification.

25. By signing and submitting the Proof of Claim, the Claimant is asserting the claim against the Applicant.

SECTION 6 - FILING OF CLAIM

26. This Proof of Claim must be received by the Monitor by no later than 5:00 p.m. (prevailing Eastern Time) on June 20, 2012. Proofs of Claim should be sent by prepaid ordinary mail, courier, personal delivery or electronic or digital transmission to the following address:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

Failure to file your Proof of Claim so that it is received by the Monitor by 5:00 p.m., on the applicable claims bar date will result in your claim being barred and you will be prevented from making or enforcing a Claim against the Applicant. In addition, you shall not be entitled to further notice in and shall not be entitled to participate as a creditor in these proceedings.

SCHEDULE "E-2"

GUIDE TO COMPLETING THE PROOF OF CLAIM FOR CLAIMS AGAINST DIRECTORS OR OFFICERS OF SINO-FOREST CORPORATION

This Guide has been prepared to assist Claimants in filling out the D&O Proof of Claim against any Directors or Officers of Sino-Forest Corporation (the "Applicant"). If you have any additional questions regarding completion of the Proof of Claim, please consult the Monitor's website at http://cfcanada.fticonsulting.com/sfc or contact the Monitor, whose contact information is shown below.

The D&O Proof of Claim is to be used only by Claimants asserting a claim against a director and/or officer of Sino-Forest Corporation, and NOT for claims against Sino-Forest Corporation itself. For claims against Sino-Forest Corporation, please use the form titled "Proof of Claim Against Sino-Forest Corporation", which is available on the Monitor's website at http://cfcanada.fticonsulting.com/sfc.

Additional copies of the D&O Proof of Claim may be found at the Monitor's website address noted above.

Please note that this is a guide only, and that in the event of any inconsistency between the terms of this guide and the terms of the Claims Procedure Order made on May 8, 2012 (the "Claims Procedure Order"), the terms of the Claims Procedure Order will govern.

SECTION 1 - ORIGINAL CLAIMANT

27. A separate D&O Proof of Claim must be filed by each legal entity or person asserting a claim against any Directors or Officers of the Applicant.

28. The Claimant shall include any and all D&O Claims it asserts in a single D&O Proof of Claim.

29. The full legal name of the Claimant must be provided.

30. If the Claimant operates under a different name, or names, please indicate this in a separate schedule in the supporting documentation.

31. If the D&O Claim has been assigned or transferred to another party, Section 2 must also be completed.

32. Unless the D&O Claim is assigned or transferred, all future correspondence, notices, etc. regarding the D&O Claim will be directed to the address and contact indicated in this section.

SECTION 2 - ASSIGNEE

33. If the Claimant has assigned or otherwise transferred its D&O Claim, then Section 2 must be completed.

34. The full legal name of the Assignee must be provided.

35. If the Assignee operates under a different name, or names, please indicate this in a separate schedule in the supporting documentation.

36. If the Monitor in consultation with the Applicant is satisfied that an assignment or transfer has occurred, all future correspondence, notices, etc. regarding the D&O Claim will be directed to the Assignee at the address and contact indicated in this section.

SECTION 3 - AMOUNT OF CLAIM OF CLAIMANT AGAINST DIRECTOR OR OFFICER

37. Indicate the amount the Director or Officer is claimed to be indebted to the Claimant and provide all other request details.

Currency, Original Currency Amount

38. The amount of the D&O Claim must be provided in the currency in which it arose.

39. Indicate the appropriate currency in the Currency column.

40. If the D&O Claim is denominated in multiple currencies, use a separate line to indicate the Claim amount in each such currency. If there are insufficient lines to record these amounts, attach a separate schedule indicating the required information.

41. D&O Claims denominated in a currency other than Canadian dollars will be converted into Canadian dollars in accordance with the Claims Procedure Order.

SECTION 4 - DOCUMENTATION

42. Attach to the claim form all particulars of the D&O Claim and supporting documentation, including amount, description of transaction(s) or agreement(s) or breach(es) giving rise to the D&O Claim.

SECTION 5 - CERTIFICATION

43. The person signing the D&O Proof of Claim should:

(a) be the Claimant, or authorized representative of the Claimant.

(b) have knowledge of all the circumstances connected with this D&O Claim.

(c) have a witness to its certification.

44. By signing and submitting the D&O Proof of Claim, the Claimant is asserting the claim against the Directors and Officers identified therein.

SECTION 6 - FILING OF CLAIM

45. The D&O Proof of Claim must be received by the Monitor by no later than 5:00 p.m. (prevailing Eastern Time) on June 20, 2012. D&O Proofs of Claim should be sent by prepaid ordinary mail, courier, personal delivery or electronic or digital transmission to the following address:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8
Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

Failure to file your D&O Proof of Claim so that it is received by the Monitor by 5:00 p.m., on the applicable claims bar date will result in your claim being barred and you will be prevented from making or enforcing a D&O Claim against the any directors or officers of the Applicant. In addition, you shall not be entitled to further notice in and shall not be entitled to participate as a D&O claimant in these proceedings.

SCHEDULE "F"

D&O INDEMNITY PROOF OF CLAIM
SINO-FOREST CORPORATION

1. Director and /or Officer Particulars (the "Indemnitee")

Legal Name of Indemnitee _____

Address _____ Phone # _____

_____ Fax # _____

_____

City_____ Prov / State____ e-mail _____

Postal/Zip code_____

2. Indemnification Claim

Position(s) Held_____

Dates Position(s) Held: From _____ to _____

Reference Number of Proof of Claim with respect to which this D&O Indemnity Claim is made _____

Particulars of and basis for D&O Indemnity Claim_____

_____

_____

_____

(Provide all particulars of the D&O Indemnity Claim, including all supporting documentation)

3 Filing of Claim

This D&O Indemnity Proof of Claim and supporting documentation are to be returned to the Monitor within ten Business Days of the date of deemed receipt by the Director or Officer of the Proof of Claim by registered mail, courier, personal delivery or electronic or digital transmission at the following address:

FTI Consulting Canada Inc.
Court-appointed Monitor of Sino-Forest Corporation
TD Waterhouse Tower
79 Wellington Street West
Suite 2010, P.O. Box 104
Toronto, Ontario M5K 1G8

Attention: Jodi Porepa
Telephone: (416) 649-8094
E-mail: sfc@fticonsulting.com

Failure to file your D&O Indemnity Proof of Claim in accordance with the Claims Procedure Order will result in your D&O Indemnity Claim being barred and forever extinguished and you will be prohibited from making or enforcing such D&O Indemnity Claim against the Applicant.

Dated at _____, this _____ day of _____, 2012.

Per: _____
Name

Signature: _____ (Former Director and/or Officer)

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 OR COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

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

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced in Toronto

ORDER

BENNETT JONES LLP
One First Canadian Place
Suite 3400, P.O. Box 130
Toronto, Ontario
M5X 1A4

Robert W. Staley (LSUC #27115J)
Kevin Zych (LSUC #33129T)
Derek J. Bell (LSUC #43420J)
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Tel: 416-863-1200
Fax: 416-863-1716

Lawyers for the Applicant

CITATION: Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corporation, 2012 ONSC 1924
COURT FILE NO. 11-CV-431153CP
DATE: 20120326

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, Sjuunde 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 Banc of America Securities LLC

Defendants

Proceeding under the *Class Proceedings Act, 1992*

COUNSEL:

- Kirk M. Baert and Michael Robb for the Plaintiffs
- Michael Eizenga for Sino-Forest Corporation, Simon Murray, Edmund Mak, W. Judson Martin, Kai Kit Poon and Peter Wang
- Emily Cole and Megan Mackey for Allan T.Y. Chan
- Peter Wardle and Simon Bieber for David J. Horsley
- Laura Fric and Geoffrey Grove for William E. Ardell, James P. Bowland, James M.E. Hyde and Garry J. West
- John Fabello and Andrew Gray for 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 Banc of America Securities LLC
- Peter H. Griffin and Shara Roy for Ernst & Young LLP
- Kenneth Dekker and Michelle Booth for BDO Limited

- John Pirie and David Gadsden for Pöyry (Beijing) Consulting Company Limited

HEARING DATES: March 22, 2012

PERELL, J.

REASONS FOR DECISION

A. INTRODUCTION

[1] A motion for an order requiring a defendant to deliver a statement of defence or for an order setting a timetable for a motion should not be a momentous matter. But scheduling is a very big deal in this very big case under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

[2] The Defendants strenuously resist delivering a statement of defence before the certification motion, and they submit that it would both contrary to law and a denial of due process to require them to plead in the normal course of an action.

[3] The Defendants submit that having to plead their statement of defence is contrary to law because the Plaintiffs' statement of claim can be commenced only with leave pursuant to s. 138.8 of the *Securities Act,* R.S.O. 199O, c. S.5 and in *Sharma v. Timminco,* 2012 ONCA 107, the Court of Appeal ruled that the statement of claim does not exist until leave is granted. The Defendants submit that having to plead their statement of defence is a denial of due process because the Plaintiffs' statement of claim includes causes of action that might not survive a challenge under Rule 21 of the *Rules of Civil Procedure*. One of the Defendants, BDO Limited, also argues that claims against it are statute-barred, and, therefore, it should not be required to deliver a statement of defence but should be permitted to bring a Rule 21 motion before the certification hearing.

[4] The position of the Defendants is set out in paragraph 2 of the Defendant Sino-Forest Corporation's factum as follows:

> 2. The Responding Parties oppose the relief relating to the delivery of a statement of defence because, as a result of the Ontario Court of Appeal's decision in *Sharma v. Timminco*, the secondary market action has yet to be commenced and will not have been commenced unless and until leave has been granted by this Honourable Court. Accordingly, the Defendants cannot be required to deliver a statement of defence to a proceeding that has yet to be commenced. Moreover, the secondary market claims are intertwined with the balance of the allegations in the statement of claim, such that it would not be realistic to provide a partial or bifurcated defence. In addition, the Responding Parties expect to be bringing a motion to strike the Statement of claim, at least in respect of the portion of the claim that purports to be brought on behalf of Noteholders, who are prohibited from commencing such a claim by virtue of the no suits by holder clause.

[5] In response, the Plaintiffs submit that just as defendants are entitled to know the case they must meet, plaintiffs are entitled to know the defence they confront. The Plaintiffs submit that the law and the dictates of due process do not preclude ordering

the delivery of a statement of defence in accordance with the *Rules of Civil Procedure*, and the Plaintiffs' rely on the court's power under s. 12 of the *Class Proceedings Act, 1992* and on what I said in *Pennyfeather v. Timminco*, 2011 ONSC 4257 about the desirability of the pleadings being closed before the certification motion.

[6] In the immediate case, the Defendants also strenuously resist the Plaintiffs' request that the leave motion under s. 138.8 the *Securities Act* and the certification motion under the *Class Proceedings Act, 1992* be heard together. Instead of a combined leave and certification motion, the Defendants submit that a series of motions be scheduled, beginning with the leave motion, followed by Rule 21 motions, followed by the certification motion. Some Defendants would begin with the Rule 21 motions before the leave motion, but all wish a sequence of separate motions.

[7] The Defendants submit that a combined leave and certification motion would be both inappropriate and also unfair, and particularly so, if they are also required to plead their defences. The Defendants submit that fairness dictates that leave be determined in advance of certification, and that their right to attack all or part of whatever pleading emerges from the leave motion be preserved. They submit that it would be inefficient to deliver a statement of defence when the statement of claim is likely to be amended in a substantial manner depending on the outcome of the Plaintiffs' leave motion and the Rule 21 motions.

[8] The Plaintiffs regard the Defendants' proposal of a sequence of motions as something akin to having their action being sentenced to a life of imprisonment on Devil's Island.

[9] For the reasons that follow, I adjourn the motion as it concerns BDO Limited, and I order that there shall be a combined leave and certification motion on November 21-30, 2012 (10 days).

[10] I order that the "Proposed Fresh as Amended Statement of Claim" be the statement of claim for the purposes of the leave and certification motion and that this pleading shall not be amended without leave of the court. Further, I order that with the exception of the Plaintiffs' funding motion, there shall be no other motions before the leave and certification motion without leave of the court first being obtained.

[11] I do not agree that it would be contrary to law or a denial of due process to order the pre-certification delivery of a statement of defence; nevertheless, I shall not order all the Defendants to deliver their statements of defence before the combined leave and certification.

[12] Rather, I shall order that a statement of defence be delivered by any Defendant that delivers an affidavit pursuant to s. 138.8 (2) of the *Securities Act*. I order that any other Defendant may, if so advised, deliver a statement of defence. Further, I order that if a Defendant delivers a statement of defence, then the delivery of the statement of defence is not a fresh step and the Defendant is not precluded from bringing a Rule 21 motion at the leave and certification motion or from contesting that the Plaintiffs have shown a cause of action under s. 5 (1)(a) of the *Class Proceedings Act, 1992*.

[13] In my reasons, I will explain why it may be advantageous to a defendant to deliver a statement of defence although it may not be obliged to do so.

[14] Finally, in my reasons, I will establish a timetable for the funding motion and for the leave and certification motion, which timetable may be adjusted, if necessary, by directions made at a case conference.

B. FACTUAL AND PROCEDURAL BACKGROUND

[15] Sino-Forest is a Canadian public company whose shares formerly traded on the Toronto Stock Exchange. At the moment, trading is suspended because on June 2, 2011, Muddy Waters Research released a research report alleging fraud by Sino-Forest. The release of the report had a catastrophic effect on Sino-Forest's share price.

[16] On June 20, 2011, The Trustees of the Labourers' Pension Fund of Central and Eastern Canada ("Labourers") retained Koskie Minsky LLP to sue Sino-Forest. Koskie Minsky issued a notice of action in a proposed class action with Labourers as the proposed representative plaintiff.

[17] The June action, however, was not pursued, and in July 2011, Labourers and another pension fund, the Trustees of the International Union of Operating Engineers Local 793 Pension Plan for Operating Engineers in Ontario ("Engineers") retained Koskie Minsky and Siskinds LLP to commence a new action, which followed on July 20, 2011, by notice of action. The statement of claim in *Labourers v. Sino-Forest*, which is the action now before the court, was served in August, 2011.

[18] On November 4, 2011, Labourers 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.l of the *Ontario Securities Act.*

[19] At this time, there were rival class actions. Douglas Smith had retained Rochon Genova, LLP. Rochon Genova issued a notice of action on June 8, 2011. The statement of claim in *Smith v. Sino-Forest* followed on July 8, 2011. Northwest & Ethical Investments L.P. and Comité Syndical National de Retraite Bâtirente Inc. retained Kim Orr Barristers P.C., and on September 26, 2011, Kim Orr commenced *Northwest v. Sino-Forest*.

[20] On December 20 and 21, 2011, there was a carriage motion, and on January 6, 2012, I released my judgment awarding carriage to Class Counsel in *Labourers v. Sino-Forest*. I granted leave to the Plaintiffs 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.

[21] On January 26, 2012, the plaintiffs delivered an Amended Statement of Claim.

[22] On March 2, 2012, the Plaintiffs initiated a motion seeking leave to assert causes of action pursuant to ss. 138.3 and 138.8 under Part XXIII.1 of the *Securities Act*

[23] Plaintiffs' motion materials included a draft Fresh as Amended Statement of Claim for the eventuality that leave is granted ("Proposed Fresh as Amended Statement

of Claim"). The Proposed Fresh as Amended Statement of Claim substantially amends and extends the allegations contained in the pleading delivered in January 2012.

[24] In their various pleadings, the Plaintiffs allege that Sino-Forest and the other Defendants made misrepresentations in the primary and secondary markets. The Plaintiffs claims include: $0.8 billion for primary market claims; $1.8 billion (U.S.) for noteholders; and $6.5 billion for secondary market claims. There are also claims against some of the Defendants for a corporate oppression remedy, negligence, negligent misrepresentation, conspiracy, and unjust enrichment. The following chart describes the claims against each Defendant:

	S.A. s. 130 (prospectus)	S.A. s. 130.1 (offering memorandum)	S.A. s. 138.3 (secondary market)	Negligent misrepresentation (secondary market)	Negligent misrepresentation (prospectus / o-memo)	Negligence (prospectus, offering memorandum)	Unjust Enrichment	CBCA Oppression	Conspiracy
Sino Forest	X	X	X	X	X	X	X	X	X
Chan	X		X	X	X	X	X	X	X
Horsley	X		X	X	X	X	X	X	X
Poon	X		X	X	X	X	X	X	X
Wang	X		X	X	X	X		X	
Martin	X		X	X	X	X	X	X	
Mak	X		X		X	X	X	X	
Murray	X		X	X	X	X	X	X	
Hyde	X		X	X	X	X		X	
Ardell			X	X				X	
Bowland			X	X				X	
West			X	X				X	
Ernst & Young	X		X	X	X	X			
BDO Ltd.	X		X	X	X	X			
Böyry (Beijing)	X		X			X			
Credit Suisse	X				X	X	X		
TD Securities	X				X	X	X		
Dundee Securities	X				X	X	X		
RBC Dominion	X				X	X	X		
Scotia Capital	X				X	X	X		
CIBC World	X				X	X	X		
Merrill Lynch	X				X	X	X		
Canaccord	X				X	X	X		
Maison	X				X	X	X		
Credit Suisse (USA)						X	X		
Banc of America						X	X		

[25] On March 6, 2012, there was a case conference, and I scheduled 10 days of hearings from November 21 to November 30, 2012. Apart from deciding that the leave motion must be heard, I did not decide what would be the subject matter of those hearing dates.

[26] None of the Defendants has served a statement of defence. None has advised which, if any, statutory or common law defences they will advance in response to the Plaintiffs' claims. In this regard, it may be noted that the Plaintiffs advance claims under s. 130 of the *Securities Act* with respect to misrepresentations in the primary market.

These claims raises at least eight possible statutory defences, which are set out in subsections 130(3), (4) and (5) of the *Securities Act*. If leave is granted, the Plaintiffs also advance claims under Part XXIII.1 of the *Securities Act.* As noted in Sino-Forest's factum for this motion, there are at least 11 defences to secondary market claims.

C. DISCUSSION

1. Introduction

[27] In this introductory section, I will address the one relatively easy issue; i.e., the problem of the "moving target" statement of claim.

[28] In the sections that follow, I will address the more difficult issues of: (a) whether the Defendants can and should be ordered to deliver statements of defence; (b) whether the leave motion should be combined with the certification motion or instead there should be a sequence of motions; (c) what other motions, if any, should be permitted before the certification motion; and (d) what should the timetable be for the motions.

[29] Beginning with the relatively easy problem, at the argument of this motion, the Defendants vociferously complained that the Plaintiffs keep changing their statement of claim. The Defendants pointed to substantial differences among the statement of claim delivered before the carriage motion, the statement of claim delivered after the carriage motion, and the Proposed Fresh as Amended Statement of Claim offered up for the purposes of the leave motion.

[30] This complaint about a "moving target" statement of claim was advanced as part of the Defendants' arguments that they cannot legally be ordered to deliver a statement of defence. I, however, do not see how this complaint supports that particular argument.

[31] I rather regard the "moving target" complaint as a proper objection that if the Defendants are to be ordered to deliver a statement of defence, the content of the statement of claim needs first to be finalized.

[32] I agree that for the purposes of a leave or a certification motion, the content of the statement of claim needs to be finalized, and thus the approach should be to order a pleading to be finalized and to order that this pleading not be amended without leave of the court. I so order.

[33] The problem then becomes one of selecting which pleading to finalize for the purposes of the leave and certification motion. It makes common sense to select the pleading for which leave is being sought under the *Securities Act*; i.e. the Proposed Fresh as Amended Statement of Claim, and that indeed is my selection.

2. The Delivery of the Statement of Defence in Class Actions

[34] I turn now to the difficult issues of whether the Defendants can be ordered to deliver statements of defence, and if they can be ordered to plead, whether they should be ordered to plead.

[35] As will be seen shortly, the Defendants submit that they cannot be ordered to plead to a secondary market claim that does not exist unless and until leave is granted under s. 138.8 of the *Securities Act*. For present purposes, I will accept the correctness of this submission, but it does not follow that the Defendants cannot plead to that portion of the Proposed Fresh as Amended Statement of Claim that is not exclusively referable to the secondary market claims. Assuming that the Defendants are correct that there is a portion of the Proposed Fresh as Amended Statement of Claim to which they cannot be obliged to plead does not negate that there are portions of the Proposed Fresh as Amended Statement of Claim that can and should be answered by a statement of defence.

[36] The Defendants' submission rather means that rule 25.07 of the *Rules of Civil Procedure*, which provides the rules of pleading applicable to defences, needs to be amended for the purpose of the leave and certification motion so that defendants do not have to plead to a pregnant action under Part XXIII.1 of the *Securities Act* that may never be born.

[37] Rule 25.07 states:

> Admissions
>
> 25.07 (1) In a defence, a party shall admit every allegation of fact in the opposite party's pleading that the party does not dispute.
>
> Denials
>
> (2) Subject to subrule (6), all allegations of fact that are not denied in a party's defence shall be deemed to be admitted unless the party pleads having no knowledge in respect of the fact.
>
> Different Version of Facts
>
> (3) Where a party intends to prove a version of the facts different from that pleaded by the opposite party, a denial of the version so pleaded is not sufficient, but the party shall plead the party's own version of the facts in the defence.
>
> Affirmative Defences
>
> (4) In a defence, a party shall plead any matter on which the party intends to rely to defeat the claim of the opposite party and which, if not specifically pleaded, might take the opposite party by surprise or raise an issue that has not been raised in the opposite party's pleading.
>
> Effect of Denial of Agreement
>
> (5) Where an agreement is alleged in a pleading, a denial of the agreement by the opposite party shall be construed only as a denial of the making of the agreement or of the facts from which the agreement may be implied by law, and not as a denial of the legality or sufficiency in law of the agreement.
>
> Damages
>
> (6) In an action for damages, the amount of damages shall be deemed to be in issue unless specifically admitted.

[38] To repeat, for the purposes of the leave motion where a party cannot be obliged to plead and for the combined certification motion, rule 25.07 needs to be revised to accommodate s. 138.8 of the *Securities Act*.

[39] Pursuant to the authority provided by s. 12 of the *Class Proceedings Act, 1992*, which authorizes the court to make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination, I have the jurisdiction to revise the procedure for a class proceeding to accommodate s. 138.8 of the *Securities Act*, and I do so by notionally adding a new subrule 25.07 (7) as follows:

> (7) In an action under the *Class Proceedings Act, 1992* for which leave is also being sought to commence an action under section 138.3 of the *Securities Act* (liability for secondary market disclosure), in a defence, a party who does not file an affidavit pursuant to rule 138.8 (2) and who delivers a statement of defence shall decline to either admit or deny the allegations of fact referable solely to his or her liability for secondary market disclosure and not referable to any other pleaded cause of action.

[40] Practically speaking, notional subrule 25.07 (7) divides the Defendants into three classes.

[41] First, there are those Defendants who deliver a s. 138.8 (2) affidavit under the *Securities Act*. These Defendants must deliver a statement of defence for the reasons expressed below.

[42] Second, there are those Defendants against whom there are no allegations of fact referable to liability for secondary market disclosure, who thus have no right or need to deliver a s. 138.8 (2) affidavit under the *Securities Act* and who choose to deliver a statement of defence. These plaintiffs may, if so advised, simply plead in the normal course.

[43] Third, there are those Defendants against whom there are allegations of fact referable to liability for secondary market disclosure and who do not deliver a s. 138.8 (2) affidavit but who deliver a statement of defence.

[44] Under notional rule 25.07 (7), these Defendants shall decline to either admit or deny the allegations of fact referable solely to his or her liability for secondary market liability and not referable to any other pleaded cause of action. These defendants must state that they neither admit nor deny the allegations contained in those paragraphs (*identify paragraph numbers)* of the statement of claim referable solely to liability for secondary market liability and not referable to any other pleaded cause of action. As will become clearer after the discussion below, by being required to neither admit nor deny allegations referable solely to secondary market liability, these Defendants cannot circumvent the requirements of s.138.8 (2) of the *Securities Act* that they must file an affidavit in order to set forth the material facts upon which they intend to rely for the leave motion.

[45] This brings the discussion and the analysis to whether there might be other reasons not to order the Defendants to deliver a statement of defence. The convention in class actions, which existed from 1996 to 2011, was that a defendant not be required to deliver a statement of defence pre-certification because of the likelihood that the statement of claim would be reformulated as a result of the certification decision and

based on the view that the statement of defence had little utility before certification. See *Mangan v. Inco Ltd.* (1996), 30 O.R. (3d) 90 at pp. 94-95 (Gen. Div.); *Glover v. Toronto (City)* [2008] O.J. No. 604 at para. 8 (S.C.J.).

[46] In *Pennyfeather*, I suggested that the convention should be revisited and that it was desirable that the pleadings be closed before the certification motion. See also *Kang v. Sun Life Assurance Company of Canada*, 2011 ONSC 6335.

[47] In *Pennyfeather* at paras. 37-38, 84-92, I stated:

> 37. Class actions are subject to the *Rules of Civil Procedure*, and there is nothing in the *Class Proceedings Act, 1992* that precludes defendants from pleading before the certification motion. It is informative that the convention of not closing the pleadings is not a statutory rule, and if the Plaintiff insists on the delivery of a pleading, a defendant may need to seek the permission of the court to delay the delivery of the pleading.
>
> 38. Moreover, the provisions of the *Class Proceedings Act, 1992* indicate that it was the Legislature's intention that the general rule is that the statement of defence should be delivered before the certification motion. Section 2 (3) of the Act indicates that the timing of the certification motion is measured by the delivery of the statement of defence. ….
>
> 84. … it would be advantageous for the immediate case and for other cases, if the current convention ended and defendants were required in the normal course to deliver a statement of defence before the certification motion. As I will illustrate, there would be several advantages to this approach, and as I mentioned above, the Legislature intended that the general rule should be that the pleadings should be completed before the certification motion.
>
> 85. Before I provide some examples of the advantages of closing the pleadings before certification, it is helpful to recall that under s. 5 (1) of the *Class Proceedings Act, 1992*, a plaintiff must satisfy five interdependent criteria for his or her action or application to be certified as a class proceeding. The Plaintiff must: (1) show a cause of action; (2) identify a class; (3) define common issues; (4) show that a class proceeding would be the preferable procedure; and (5) qualify as a representative plaintiff with a litigation plan and adequate Class Counsel.
>
> 86. A major advantage of closing the pleadings is that controversies about the first of the five criteria for certification might be resolved or at least narrowed or confined before the certification motion.
>
> 87. The delivery of a statement of defence could be a fresh step that could foreclose any subsequent attack by the defendant for any pleadings irregularities and, more to the point, typically defendants do not deliver a statement of defence if there is a substantive challenge to the statement of claim. Rather, they bundle all their challenges to the statement of claim and bring a motion to have the statement of claim or portions of it struck out on both technical and substantive grounds. …
>
> 88. In other words, the requirement of delivering a statement of defence will call out the defendant to make its challenges to the statement of claim and, thus, the s. 5 (1)(a) criterion might be removed as an issue as would any challenge to the pleading for wanting in particulars or for breaching the technical rules for pleading. The s. 5 (1)(a) criterion for certification might be decided before the certification motion.
>
> 89. If the defendant brings a comprehensive pleadings challenge before the certification motion, then, the s. 5 (1)(a) criterion would be resolved before the certification hearing one

> way or the other. It would be particularly useful to resolve a s. 5 (1)(a) challenge before the certification motion when the challenge is based on the court not having subject-matter jurisdiction over the plaintiff's claim. If that challenge is upheld, then the class action would be dismissed or stayed and the enormous costs of a comprehensive certification motion is avoided.
>
> 90. Further, hearing an interlocutory motion about the sufficiency of the pleading might be preferable to having the challenge heard at the certification motion as an aspect of the s. 5 (1)(a) analysis because a common outcome of this analysis is to grant the plaintiff leave to amend his or her statement of claim, which outcome, at a minimum, exacerbates the complexities of determining the certification motion because of the interdependency of the certification criteria.
>
> 91. In many cases, the technical or substantive adequacy of a plaintiff's statement of claim is not an issue and, therefore, requiring the completion of the pleadings will involve no interlocutory steps and the analysis of the other four certification criteria would be facilitated by a completed set of pleadings.
>
> 92. For instance, having the Statement of defence before the certification motion would provide useful information for analyzing the preferable procedure criterion and the plaintiff's litigation plan. Moreover, it may emerge that there are issues worthy of certification in the defendant's statement of defence.

[48] For present purposes, I do not retreat from what I said in *Pennyfeather*, and I shall emphasize several points and add a few more. In this regard, I emphasize that it was the clear intention of the Legislature that the pleadings be closed before certification. I add that this makes sense because the certification criteria of class definition, common issues, preferable procedure, and litigation plan are best adjudicated in the context of the parameters of the action and it may emerge that the defendant has pleaded issues that may usefully be added to the list of common issues.

[49] Further, I add that the Legislature also indicated by s. 35 of the *Class Proceedings Act, 1992*,that the *Rules of Civil Procedure* apply to class proceedings, reserving the courts' authority to make adjustments to that procedure under s. 12 of the *Act*. Generally speaking, it is desirable to normalize class actions with the procedure under the *Rules of Civil Procedure*. The *Rules* are the norm for a fair procedure, and the norm of civil procedure is that both sides must disclose the case that their opponent must meet. Defendants are not like an accused in a criminal proceeding with a right to remain silent. It is not regarded as unfair or abnormal to compel a defendant to plead a statement of defence in response to a statement of claim.

[50] Further still, I add that having a complete set of pleadings recognizes the maturity of the class action jurisprudence. There already have been many Rule 21 and s.5 (1)(a) challenges, and the viability of many causes of action or types of claim as being suitable for class actions has been informed by twenty years of cases. Recognition of the maturity of the case law in and of itself calls for a rethinking of the convention of not delivering a statement of defence, because assisted by precedents of what has been certified in the past, plaintiffs are better able to exit the certification hearing with their pleadings intact.

[51] In other words, in contemporary times the Defendants' concern that they will have wasted time and effort pleading to a statement of claim that may be different after certification will not be borne out. In any event, the complaint of a wasted effort is overblown. Unless pleadings are to be regarded as a work of fictional literature, claims and defences are based on the material facts that existed, and competent counsel will take instructions about all the possible claims and defences that emerge from those set of facts before the certification motion.

[52] I find it hard to believe that the accomplished lawyers in the case at bar are waiting for the outcome of the leave motion and the certification motion before investigating the material facts and researching the applicable law and advising the Defendants about what defences are available to them. The truth of the matter is that the Defendants and their lawyers are not concerned about wasted time and effort but rather they do not wish to plead because they believe it is tactically better to avoid the disclosure of their case that the *Rules of Civil Procedure* would normally mandate.

[53] I see no unfairness of denying defendants a tactical maneuver that may be inconsistent with general principle of rule 1.04 that the rules "shall be liberally construed to secure, the just, most expeditious and least expensive determination of every civil proceeding on its merits."

[54] I also see no unfairness in denying defendants the tactical maneuver of not delivering a statement of defence before certification when the exchange of pleadings may be tactically and substantively beneficial to defendants. The defendants arguments that class membership is over-inclusive or under-inclusive, that the proposed common issues want for commonality, that the action is not manageable as a class action, that a class proceeding is not the preferable procedure, and that the litigation plan is deficient are best made when the defendants shows the colour of his or her eyes by pleading a defence and these arguments will be stronger than the "is! – is not! – is too!" sandbox arguments of many a certification motion. For whatever it is worth, my own observation from recent certification motions where defendants have pleaded before certification is that both sides and the administration of justice are better for it.

[55] Finally, from a public relations point of view - and class actions are by their nature of considerable interest to the public - I would have thought that many defendants would like to seize the opportunity by pleading the material facts of their defence to take the sting out of the plaintiff's argument that the defendants need behaviour management and to level the playing field about the certification criteria.

[56] Thus, generally speaking, I persist in my view that the pleadings issues should be completed before the certification motion. The Defendants' argue, however, that whatever may be the situation for class actions generally, the Court of Appeal's decision in *Sharma v. Timminco, supra*, has overtaken *Pennyfeather*, and *Sharma* means that in a proposed secondary market class action, a statement of defence cannot be demanded or delivered before leave is granted under s. 138.3 of the *Securities Act*. A defendant cannot be asked to plead to a pregnant statement of claim.

[57] The Defendants take the *Sharma* decision to be authority that a class proceeding is not an action commenced under s. 138.3 until leave is granted and leave is required to

add the s. 138.3 cause of action to the class proceeding. The Defendants submit that without leave, a s. 138.3 action cannot be enforced. As Sino-Forest put it in its factum: "Until leave has been granted, the plaintiff has nothing: no limitation periods are tolled, and no steps in the proceeding – including the filing of a defence – can be taken."

[58] This hyperbolic submission by Sino-Forest and by the rest of the Defendants is not true. Whatever the effect of *Sharma*, it did not take away s. 138.8 of the *Securities Act*, under which subsection (2) requires for the leave motion that the plaintiff and each defendant swear under oath the "material facts upon which each intends to rely."

[59] Section 138.8 of the *Securities Act*, which provides the test for leave and which governs the procedure for the leave motion, states:

> 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.
>
> Same
>
> (2) Upon an application under this section, the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely.
>
> Same
>
> (3) The maker of such an affidavit may be examined on it in accordance with the rules of court. ….

[60] Subsection 138.8 (2) may be usefully compared and contrasted with rule 25.06 (1) of the *Rules of Civil Procedure*, which is the predominant rule about pleading in an action. Rule 25.06 (1) states:

> 25.06 (1) Every pleading shall contain a concise statement of the material facts on which the party relies for the claim or defence, but not the evidence by which those facts are to be proved.

Both the subsection and the rule require the party to disclose to their opponent the "material facts" on which the party "relies." The pleadings rule, however, does not require that the disclosure of material facts be under oath. Assuming that a defendant does file an affidavit under s. 138.8 (2), then the affidavit is, in effect, an under oath version of 25.06 (1)'s requirement that a defendant disclose the material facts upon which he or she relies.

[61] I concede that filing an affidavit under s. 138 (8) is not mandatory and that it cannot be assumed that a defendant will deliver an affidavit for a leave motion under the *Securities Act*, and that he or she cannot be compelled to do so. In *Ainslie v. CV*

Technologies Inc. 93 O.R. (3d) 200 at paras. 14-20, 24-25 (S.C.J.), Justice Lax interpreted s. 138.8 (2), and she stated:

> 14. Section 138.8(1) sets out a two-part test for obtaining leave to bring an action under Part XXIII.1 of the OSA and places the onus on the plaintiffs to demonstrate that (1) their proposed action is brought in good faith and (2) has a reasonable prospect for success at trial. As s. 138.8(1) requires an examination of the merits, the plaintiffs submit that the section is supplemented with s. 138.8(2) and (3). They rely on the mandatory language in s. 138.8(2) ("and each defendant shall") and submit that without the benefit of this requirement and the ability to cross-examine, a plaintiff would be deprived of the tools necessary to meet the standard the legislature created in s. 138.8(1).
>
> 15. This submission ignores the legislative purpose of s. 138.8. The section was not enacted to benefit plaintiffs or to level the playing field for them in prosecuting an action under Part XXIII.1 of the Act. Rather, it was enacted to protect defendants from coercive litigation and to reduce their exposure to costly proceedings. No onus is placed upon proposed defendants by s. 138.8. Nor are they required to assist plaintiffs in securing evidence upon which to base an action under Part XXIII.1. The essence of the leave motion is that putative plaintiffs are required to demonstrate the propriety of their proposed secondary market liability claim before a defendant is required to respond. Section 138.8(2) must be interpreted to reflect this underlying policy rationale and the legislature's intention in imposing a "gatekeeper mechanism".
>
> 16. The plaintiffs appear to be interpreting s. 138.8(2) as if it read: "Upon an application under this section, the plaintiff and each defendant shall serve and file one or more affidavits." But, the subsection continues: "setting forth the material facts upon which each intends to rely". If there are no material facts upon which a defendant intends to rely in responding to a leave motion, how can it be that a defendant is required to file an affidavit? Similarly, if a defendant files one or more affidavits, how can a plaintiff require that defendant to file other affidavits? By discounting this language, the plaintiffs are proposing an interpretation which relieves them of their obligation to demonstrate that their proposed action meets the pre-conditions for granting leave under the Act.
>
> 17. The plaintiffs' interpretation also fails to address the language used in subsections (3) and (4). Section 138.8(3) reads: "The maker of such an affidavit may be examined on it in accordance with the rules of court." Section 138.8(4) reads: "A copy of the application for leave to proceed and any affidavits filed with the court shall be sent to the Commission when filed" (emphasis added). Had it been the intention of the legislature to require the parties to file affidavits, irrespective of the onus placed upon the moving party, the legislature would have substituted the word "the" for "any" in s. 138.8(4) and the words "the plaintiff and each defendant" for "maker" in s. 138.8(3). I also note that the legislature attached no consequences to the failure of "each defendant" to file an affidavit.
>
> 18. In terms of onus, a useful analogy can be found in the summary judgment rule, Rule 20, of the Rules of Civil Procedure. Rule 20.04 provides:
>
> > 20.04(1) In response to affidavit material or other evidence supporting a motion for summary judgment, a responding party may not rest on the mere allegations or denials of the party's pleadings but must set out, in affidavit material or other evidence, specific facts showing that there is a genuine issue for trial.
>
> 19. Similar to s. 138.8(2), rule 20.04 utilizes language suggesting that a responding party "must" or "shall" file affidavit material. Notwithstanding the use of such language, under Rule 20, a responding party retains the option to counter the motion by simply cross-examining the moving party, rather than by leading any direct evidence on the motion. In

> this regard, rule 20.04 has been interpreted as requiring the respondent to a summary judgment motion to "lead trump or risk losing". Notably, however, the onus to establish that there is no genuine issue for trial remains with the moving party. The onus does not shift to the respondent to show that a genuine issue for trial does in fact exist.8
>
> 20. Similarly, in a motion under s. 138.8 of the Act, the onus to demonstrate that the proposed claim meets the required threshold remains with the plaintiffs. The onus does not shift to the defendants. A defendant that does not "lead trump" by filing affidavit evidence in response to a motion under s. 138.8 may well take the risk that leave will be granted to the plaintiffs. It does not follow, however, that a defendant is obligated to file evidence or produce an affidavit from each named defendant. It is a well-established principle that, as a general proposition, it is counsel who decides on the witnesses whose evidence will be put forward. ….
>
> 24. In my view, the "gatekeeper provision" was intended to set a bar. That bar would be considerably lowered if the plaintiffs' view is correct. As I have already indicated, a defendant who does not file affidavit material accepts the risk that it may be impairing its ability to successfully defeat the motion for leave and is probably foregoing the right to assert the statutory defences under Part XXIII.1 of the Act. However, parties are entitled to present their case as they see fit and this includes the right to oppose the leave motion on the basis of the record put forward by the plaintiffs as GT intends, or on the basis of the affidavits of experts as CV intends. [page209]
>
> 25. To accept the plaintiffs' submissions would require each defendant to produce evidence that may not be necessary for the leave motion and would serve no purpose other than to expose those defendants to a time-consuming and costly discovery process. It would sanction "fishing expeditions" prior to the plaintiffs obtaining leave to proceed with their proposed action. This is an unreasonable interpretation of s. 138.8(2). It is inconsistent with the scheme and object of the Act. Properly interpreted, the ordinary meaning of s. 138.8(2) is that a proposed defendant must file an affidavit only where it intends to lead evidence of material facts in response to the motion for leave.

[62] In *Ainslie*, leave to appeal was granted [2009] O.J. No. 730 (Div. Ct.), but it appears that the appeal was never argued. In *Sharma v. Timminco Ltd.*, 2010 ONSC 790 at para. 32, I agreed with Justice Lax's interpretation of s. 138.8 (2).

[63] In the case at bar, I do not know whether any of the Defendants will deliver affidavits under s. 138.8 (2), but I do know that if a Defendant does deliver an affidavit, then its protest that it would be unfair to require a statement of defence loses its potency as does the urgency of the Plaintiffs' request that the Defendants be ordered to deliver their statements of defence. Delivering an affidavit under s. 138.8 is essentially the same as delivering a statement of claim or defence. As Justice Lax notes, a defendant who does not file affidavit material accepts the risk that it may be impairing its ability to successfully defeat the motion for leave. Justice Lax also notes that the defendant is probably foregoing the right to assert the statutory defences under Part XXIII.1 of the Act, but I would not necessarily go that far.

[64] Where this analysis takes me is that it while it would be inappropriate to order all the Defendants to deliver a statement of defence to a secondary market claim under the *Securities Act*, it would be proper to order that any Defendant who delivers an affidavit pursuant to s. 138.8 (2) of the *Act* shall also deliver a statement of defence. I so order.

[65] Although I am ordering only Defendants who deliver s. 138.8 (2) affidavits to deliver a statement of defence, I order that any other Defendant may, if so advised, deliver a statement of defence. I leave them to make the tactical decision whether or not to deliver a pleading. As I discussed above, there are advantages for a defendant to plead in a class action.

[66] For reasons that I will come to next, if a Defendant does deliver a statement of defence, the delivery is without prejudice to the Defendant's right to bring a Rule 21 motion or to challenge whether the Plaintiffs have shown a cause of action as required by s. 5 (1)(a) of the *Class Proceedings Act, 1992*.

[67] Here it should be note that the "plain and obvious" test for disclosing a cause of action from *Hunt v. Carey Canada*, [1990] 2 S.C.R. 959, which is used for a Rule 21 motion, is used to determine whether the proposed class proceedings discloses a cause of action; thus, a claim will be satisfactory under s. 5 (1)(a) unless it has a radical defect or it is plain and obvious that it could not succeed: *Anderson v. Wilson* (1999), 44 O.R. (3rd) 673 (C.A.) at p. 679, leave to appeal to S.C.C. ref'd, [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 (S.C.J.), 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.

[68] In this last regard, the Defendants submitted that a defendant has a right to challenge whether the plaintiff has pleaded a reasonable cause of action by bringing a Rule 21 motion and a defendant would lose this procedural right if he or she delivered a statement of defence. Pleading over is a fresh step that deprives a defendant of the right to subsequently challenge the substantive adequacy of a pleading: *Bell v. Booth Centennial Healthcare Linen Services,* [2006] O.J. No. 4646 at paras. 5-7 (S.C.J.); *Cetinalp v. Casino,* [2009] O.J. No. 5015 (S.C.J.). From this true premise, the Defendants submit that since some or all of them wish to bring a Rule 21 motion or some or all will be challenging the reasonableness of the plaintiffs' statement of claim as an aspect of the s. 5 (1)(a) criterion of the of test for certification, they should not be required to deliver a statement of defence before the certification motion.

[69] The court's typical but not inevitable response to a Defendant's request to bring a Rule 21 motion before certification is to direct the motion to be heard at the certification hearing because the test for granting a Rule 21 motion is the same test that is applied for the s. 5 (1)(a) criterion for certification. Typically, when this direction is made the defendant is not required to deliver a statement of defence.

[70] As already noted, in the case at bar, several defendants have indicated that they wish to bring Rule 21 motions on the basis that several of the Plaintiffs' claims do not disclose a reasonable cause of action or on the basis that the bonds contain a "no suits" clause, and BDO Limited wishes to bring a Rule 21motion based on the argument that it is plain and obvious that claims against it are statute-barred.

[71] I agree that the right of Defendants to challenge the reasonableness of the Plaintiffs' statement of claim should be preserved and protected and I also believe that

this objective can be accomplished while still permitting defendants to deliver a statement of defence.

[72] Once again, using the authority of s. 12 of the *Class Proceedings Act, 1992*, I order that if a Defendant delivers a statement of defence, then the delivery of the statement of defence is not a fresh step and the Defendant is not precluded from bringing a Rule 21 motion at the leave and certification motion or the Defendant is not precluded from disputing that the Plaintiffs have shown a cause of action under s. 5 (1)(a) of the *Class Proceedings Act, 1992*.

3. Leave and Certification

[73] The above discussion addresses the matter of the Plaintiffs' request that the Defendants be ordered to deliver statements of defence and the discussion also lays the foundation for the discussion of the Plaintiffs' request that the leave motion under s.138.8 the *Securities Act* and the certification motion under the *Class Proceedings Act, 1992* be heard together and the Defendants' counter-submission that the motions should be sequenced leave motion, Rule 21 motions, and certification motion.

[74] In the case at bar, there is a general consensus that the leave motion should go first, and, in any event, because of the Court of Appeal's ruling in *Sharma* that s. 28 of the *Class Proceedings Act, 1992* is useless in protecting claims under Part XXIII.1 of the *Securities Act* from limitation periods, the leave motion must go first, and I have scheduled ten days of hearing commencing November 21, 2012.

[75] The question then is whether the certification motion should be combined with the leave motion.

[76] The Plaintiffs submit that hearing the two matters together is consistent with the direction from the Ontario Court of Appeal and that Supreme Court of Canada that litigation by installments should be avoided wherever possible because it does little service to the parties or to the efficient administration of justice." *Garland v. Consumers' Gas Company Limited* (2001), 57 O.R. (3d) 127 at para. 76 (C.A.), aff'd [2004] 1 S.C.R. 629 at para. 90. The Plaintiffs note that leave and certification were dealt with together in *Silver v. Imax Corp.*, [2009] O.J. No. 5585 (S.C.J.), leave to appeal refused [2011] O.J. No. 656 (Div. Ct.) and in *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25.

[77] An admonition is different from a prohibition, and while the Court of Appeal and the Supreme Court may frown on litigation in installments, they did not prohibit it. Whether to permit motions before the certification motion is a matter of discretion. In exercising its discretion whether to permit a motion before the certification motion, relevant factors include : (a) whether the motion will dispose of the entire proceeding or will substantially narrow the issues to be determined; (b) the likelihood of delays and costs associated with the motion; (c) whether the outcome of the motion will promote settlement; (d) whether the motion could give rise to interlocutory appeals and delays that would affect certification; (e) the interests of economy and judicial efficiency; and (f) generally, whether scheduling the motion in advance of certification would promote

the fair and efficient determination of the proceeding: *Cannon v. Funds for Canada Foundation*, [2010] O.J. No. 314 (S.C.J.) at paras. 14-15

[78] Thus, in my opinion, the question to be decided in the immediate case is whether it is fair (the most important factor) and efficient to hear the certification motion and the leave motion together.

[79] Provided that any Defendants who deliver s. 138.8 (2) affidavits or any Defendants who deliver statements of defence may bring Rule 21 motions or otherwise challenge all of the certification criteria as they may be advised, I see no unfairness in having the certification motion heard along with the leave motion. Because of the orders that I shall make, already discussed above, a Defendant may challenge all of the certification criteria regardless of whether the Defendant has pleaded or not. Pursuant to notional rule 25.07 (7), Defendants who do not file a s. 138.8 (2) affidavit and who deliver a statement of defence "shall decline to admit or deny the allegations referable solely to liability for secondary market disclosure and not referable to any other pleaded cause of action." I see no unfairness to the Defendants who may resist both the certification motion and the leave motion as they may be advised.

[80] In contrast, the sequential approach being advocated by the Defendants is unfair to the Plaintiffs and to the proposed class and will impede fulfilling the purposes of the class proceedings legislation, which are first and foremost, access to justice, secondarily, judicial economy, and thirdly, behaviour modification, all the while providing due process and fairness to all parties. Unfortunately, the suffocating expense of motions in class actions along with the excruciating delays and the additional costs of the inevitable leave to appeal motions and appeals that follow class action orders is a serious barrier to achieving the purposes of the legislation for both plaintiffs and defendants and a substantial disincentive to class counsel employing the legislation for other than the huge cases that would justify the litigation risks.

[81] As night follows day, if I agreed to schedule sequentially, there would be a ten-day leave motion, followed by the unsuccessful party launching the appeal process which will take several years to resolve. Whatever the outcome of the appeal, the action will return to the Superior Court for the certification motion of the claims not referable solely to liability for secondary market disclosure.

[82] In the case at bar, if Rule 21 motions were permitted before the certification hearing although work that could be done at the certification hearing will be accomplished, this will come at the cost of another round of appeals that will take several years to resolve only for the action to return again to the Superior Court for the determination of whether the balance of the certification criteria have been satisfied. That determination will also be appealed.

[83] In contrast, if I combine the leave motion, the Rule 21 motions, and the certification motion into one hearing, as night follows day, the determination will be appealed but the superior court and the appellate courts including the Supreme Court of Canada will be denied the pleasure of three visits from one or two generations of Class and Defence Counsel.

[84] The Defendants argue that there will be no efficiencies in a sequential ordering of the motions because the criteria for leave differs from the certification criteria, as does the burden of proof for these motions. However, courts are obliged to have the perspicacity to be able to deal with different criteria and different onuses of proof, but, more to the point, the evidentiary footprint for the leave and certification motions are the same, and it makes for little efficiency for the parties and little judicial economy to have the evidence and argument for leave and for certification heard more than once.

[85] Putting aside the somewhat unique circumstances of BDO Limited, I conclude that the certification hearing should be combined with the leave motion and that with the exception of the Plaintiffs' funding motion, which has already been scheduled, there shall be no other motions before the leave and certification motion without leave of the court first being obtained.

4. BDO Limited's Request for a Rule 21 Motion

[86] As noted at the outset of these reasons, I am adjourning the motion as it concerns BDO Limited, whose circumstances may be unique.

[87] BDO was a party to the *Smith v. Sino-Forest* and the *Northwest v. Sino-Forest* rival class actions and it was added to the case at bar after the carriage motion. It submits that all of the statutory claims against it are statute-barred as in one of the main common law misrepresentation claims. It submits that it can diminish its involvement in this expensive litigation by a Rule 21 motion based on the pleadings and without evidence.

[88] The Plaintiffs' response was that if BDO wished to assert a limitation period defence it should be a pleaded defence to which the Plaintiffs would file a reply demonstrating that it was not plain and obvious that the claims were statute-barred or demonstrating that there were defences to the running of the limitation period, presumably based on fraudulent concealment or estoppel or waiver. The Plaintiffs also asserted that there were other common claims against BDO that were not statute-barred and thus there was no utility in permitting a Rule 21 motion that would see BDO only partially out of the action.

[89] BDO's response was that there were no defences that could withstand the ultimate limitation periods of the *Securities Act* and fairness dictated that it should be permitted to substantially reduce being embroiled in this litigation.

[90] My own assessment was that the Plaintiffs were correct in submitting that in the circumstances of this case, BDO should plead its limitation defence and the Plaintiffs should have an opportunity to deliver a reply.

[91] Once BDO has pleaded, I will be in a better position in determining whether to permit a Rule 21 motion or perhaps a Rule 20 partial summary judgment motion.

[92] Accordingly, I am adjourning the motion as it concerns BDO Limited to be brought on again, if at all, after BDO has pleaded its statement of defence and the Plaintiffs their Reply.

5. The Timetable

[93] In light of the discussion above, it is ordered that subject to adjustments, if necessary, made at a case conference, the timetable for the Plaintiff's Funding Approval Motion and for the Leave and Certification Motion is as follows:

Funding Approval Motion

March 9, 2012: Plaintiffs to deliver motion record (completed)

March 30, 2012: Defendants to deliver responding records, if any

April 6, 2012: Plaintiffs to deliver factum

April 13, 2012: Defendants to delivery factum

April, 17, 2012: Hearing of the motion

Leave and Certification Motion

April 10, 2012: Plaintiffs to deliver motion record

June 11, 2012: Defendants to deliver responding records

July 3, 2012: Plaintiffs to delivery reply records, if any

September 14, 2012: Cross-examinations to be completed

October 19, 2012: Plaintiffs to deliver factum

November 9, 2012: Defendants to deliver factum

November 21-30, 2012: Hearing of the motion

D. CONCLUSION

[94] An order shall issue in accordance with these Reasons with costs in the cause.

_____

Perell, J.

Released: March 26, 2012

CITATION**:** Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corporation, 2012 ONSC 1924
COURT FILE NO. 11-CV-431153CP
DATE**:** 20120326

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

The Trustees of the Labourers' Pension Fund of Central and Eastern Canada, et al.

Plaintiffs

- and -

Sino-Forest Corporation et al**.**

Defendants

REASONS FOR DECISION

Perell, J.

Released: March 26, 2012.

CITATION: Sharma v. Timminco Limited 2011 ONSC 8024
COURT FILE NO.: 09-CV-378701CP
DATE: March 31, 2011

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

Ravinder Kumar Sharma

Plaintiff

- and -

Timminco Limited, Photon Consulting LLC, Rogol Energy Consulting LLC, Michael Rogol, Dr. Heinz Schimmerlbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, Mickey M. Yaksich, and John P. Walsh

Defendants

Proceeding under the *Class Proceedings Act, 1992*

COUNSEL:
Won J. Kim, Victoria Paris, and Norman Mizobuchi for the Plaintiff
Alan L. W. D'Silva and John Finnigan for the Defendants Timminco Limited, Dr. Heinz Schimmerlbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, and Mickey M. Yaksich
Paul Le Vay for the Defendants Photon Consulting LLC, Rogol Energy Consulting LLC and Michael Rogol
Robert W. Staley for the Defendant John P. Walsh

HEARING DATE: March 25, 2011

PERELL, J.

REASONS FOR DECISION

A. Introduction and Overview

[1] On May 14, 2009, Ravinder Sharma commenced a proposed class action about alleged misrepresentations affecting the secondary market value in shares of Timminco Limited. The action was against Timminco Limited, Photon Consulting LLC, Rogol Energy Consulting LLC, Michael Rogol, Dr. Heinz Schimmerlbusch, Robert Dietrich,

René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, Mickey M. Yaksich, and John P. Walsh.

[2] Mr. Sharma retained the Kim Orr P.C. law firm as his lawyers of record.

[3] Mr. Sharma now brings a motion for: (1) an order that he be removed as plaintiff and St. Clair Pennyfeather be substituted; (2) an order declaring that the limitation period in s. 138.14 of the *Securities Act*, R.S.O. 1990, s. S.5 is suspended pursuant to s. 28 of the *Class Proceedings Act, 1992*, S.O. 1992, c. C.6; or (3) "conditional leave" to commence an action under section 138.3 of the *Securities Act*.

[4] At the hearing, Mr. Sharma abandoned his request for "conditional leave" and at the hearing, the Defendants did not oppose an order substituting Mr. Pennyfeather for Mr. Sharma, subject to certain terms that, in turn, were unopposed by Mr. Sharma.

[5] The motion narrowed and the argument at the hearing focused on Mr. Sharma's request for an order declaring that the limitation period in s. 138.14 of the *Securities Act* is suspended pursuant to s. 28 of the *Class Proceedings Act, 1992.*

[6] The recasting of the motion at the hearing reduced the need of the parties to discuss the particular factual background of the case at bar and elevated the debate to the plane of interpreting the operation of s. 28 of the *Class Proceedings Act, 1992* generally. The general issue became, how does s. 28 of the *Class Proceedings Act, 1992* operate in a case where an action requires leave under s. 138.8 of the *Securities Act*?

[7] For the reasons set out below, my answer to that question is that if a statement of claim in a proposed class action mentions an action provided for under Part XXIII.1 of the *Securities Act*, which includes an action for which leave is required under s.138.8 of the *Act*, then s. 28 of the *Class Proceedings Act, 1992* becomes operative and s. 28 suspends the operation of the limitation period found in s. 138.14 of the *Securities Act*.

[8] To explain my order and my reasons, I will next discuss the factual background that gives rise to the order to replace Mr. Sharma and the reasons why Mr. Sharma, before his departure as plaintiff, seeks a declaration about the operation of s. 28 of the *Class Proceedings Act, 1992*. Then, I will address the terms of the order that will provide for Mr. Sharma's departure and for the introduction of Mr. Pennyfeather as Plaintiff. The Reasons will then turn to the parties' arguments and my own analysis of the operation of s. 28 of the *Class Proceedings Act, 1992* as it intersects with the operation of the *Securities Act.* I will include with some directions about costs and about the further carriage of this action.

B. Factual Background

[9] In the action, Mr. Sharma alleged that the Defendants made misrepresentations in Timminco's public documents, in public oral statements, and in expert opinions. These misrepresentations are alleged to have been made beginning on or about March 17, 2008 and continuing until November 11, 2008.

[10] Mr. Sharma's Statement of Claim alleges common law negligence and negligent misrepresentation. The claim is for more than $500 million plus punitive damages. The pleading indicates that claims will be made pursuant to the statutory cause of action provided by Part XXIII.1 (secondary market disclosure) of the *Securities Act*. To be more precise, in paragraph 2 (e) of his Statement of Claim, Mr. Sharma pleads:

> 2. The Plaintiff claims on his own behalf and on behalf of other Class Members: …
>
> > (e) an order allowing the Plaintiff to amend this Statement of Claim to assert the right of action provided for in Part XXIII.1 of the *Securities Act*, R.S.O. 1990, c. S.5.

[11] Mr. Sharma then mentions Part XXIII.1 of the *Securities Act* in para. 117 of his Statement of Claim, which states:

> 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.

[12] Mr. Sharma defined the class for his proposed class proceedings as "all persons, other than the Excluded Persons" who acquired securities of Timminco between March 17, 2008 through November 11, 2008.

[13] Mr. St. Clair Pennyfeather is a member of the class defined in Mr. Sharma's Statement of Claim. Mr. Pennyfeather bought 10 shares of Timminco on May 9, 2008, 12 shares on May 21, 2008, and 35 shares on September 3, 2008. He still holds the shares, which are now penny stocks.

[14] The Defendants have some questions about whether Mr. Sharma was a class member, but for present purposes I need not decide this factual point, and whether this point needs to be determined will also await another day.

[15] On June 11, 2009, Robert Gowan commenced a similar proposed class action. In that action, Siskinds LLP was the lawyer of record. With two rival class proceedings, a motion to determine who should have carriage was commenced. Between June and October 2009, Kim Orr and Siskinds were preoccupied with this carriage fight

[16] In mid-July 2009, before the carriage motion was heard, Mr. Sharma advised his lawyers of record that he was concerned that his work on the Ontario Judicial Council would interfere with his ability to serve as an adequate representative plaintiff and he requested that he eventually be removed.

[17] Mr. Pennyfeather swore an affidavit for the carriage motion in anticipation of eventually becoming a representative plaintiff.

[18] On October 29, 2009, I granted carriage of the proposed class proceedings to Mr. Sharma and stayed Mr. Gowan's action. See *Sharma v. Timminco Ltd.* (2009), 99 O.R. (3d) 260 (S.C.J.).

[19] On January 22, 2010, Mr. Sharma brought a motion at a date to be determined for his withdrawal as representative plaintiff and for the substitution of Messrs. Pennyfeather and Gowan as plaintiffs. The motion record did not contain affidavits from Messrs. Sharma, Pennyfeather, or Gowan, but it did contain a proposed Amended Statement of Claim in which Mr. Pennyfeather was a plaintiff.

[20] On January 28, 2010, Mr. Sharma brought a motion for disclosure from the Timminco Defendants of their insurance policies.

[21] On February 3, 2010, I granted Mr. Sharma's motion; see: *Sharma v. Timminco Ltd.*, [2010] O.J. No. 469 (S.C.J.), and the Timminco Defendants shortly moved for leave to appeal.

[22] On April 22, 2010, Justice McCombs refused leave. See *Sharma v. Timminco Ltd.*, [2010] O.J. No. 2161 (Div. Ct.).

[23] Between April 2010 and March 2011 depending on their differing perspectives, Mr. Sharma's action was perceived as active or it was perceived as inactive and inexcusably dormant.

[24] From Mr. Sharma's perspective during this period, he was energetically engaged in settlement discussions with the Timminco Defendants, who are Timminco Limited, Dr. Heinz Schimmerlbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, and Mickey M. Yaksich with much less attention been given to the Photon Defendants, who are Photon Consulting LLC, Rogol Energy Consulting LLC and Michael Rogol, and to the Defendant Mr. Walsh.

[25] From the perspective of the Timminco Defendants, during the 12 months between April 2010 and March 2011, they were willing to entertain settlement negotiations but without relieving Mr. Sharma from the risks of not promptly advancing his proposed class proceeding or the risks of not promptly seeking the leave required by the *Securities Act*.

[26] From the perspectives of the Photon Defendants and Mr. Walsh, the proposed class action has been dormant or inactive since the carriage motion in the fall of 2009.

[27] For present purposes, because of how the issues have narrowed, it is not necessary for me to resolve whose perspective is correct, nor is it necessary to resolve the merits of the finger pointing and the barbs of the competing lawyers about the proper carriage of the proceedings.

[28] For present purposes, what is important is that for whatever reasons, after the carriage motion in the fall of 2009, Mr. Sharma: (a) did not set down his motion to substitute Mr. Pennyfeather; (2) did not deliver his motion material for leave under the

Securities Act; and (3) did not deliver his motion material for certification under the *Class Proceedings Act, 1992*.

[29] For present purposes, what is also important is that around the end of February 2011, Mr. Sharma and his lawyers recalled that his action involved alleged misrepresentations made on March 17, 2008. The third anniversary of those alleged misrepresentations was shortly to be celebrated and this prompted Mr. Sharma and his lawyers to request a case conference to deal with the prospect that there might be a limitation period problem in advancing Class Members' claims.

[30] On March 10, 2011, there was a case conference, and I made the following direction:

> This is a case conference to respond to the plaintiff's request to accelerate the leave motion under the *Securities Act* and the certification motion because of the possibility of a limitation period defence becoming available, which may or may not be the case. It would not be procedurally fair to agree to this request. However, certain steps can be taken in the short term that may address the risk and that need to be done in any event. I, therefore, direct the plaintiff to bring a motion to join new plaintiffs and to seek conditional leave of the court to commence an action under the *Securities Act.* The plaintiff's material shall be delivered before noon on March 14, 2011. Responding materials shall be delivered before noon on March 18, 2011. No factums are required. Cross-examinations to take place between March 18 and March 23, 2011.

[31] The parties followed the direction and also delivered factums, for which I am grateful, and the motion was argued on March 25, 2011.

[32] The factums had the effect of narrowing the issues, and as I noted at the outset of these reasons, the parties focused their attention on the operation of s. 28 of the *Class Proceedings Act, 1992*.

C. The Motion to Substitute Mr. Pennyfeather for Mr. Sharma

[33] As I noted at the outset, the Timminco Defendants and the Photon Defendants do not oppose the substitution of Mr. Pennyfeather effective March 25, 2011, provided that the substitution is without prejudice to their respective rights to assert that both Mr. Sharma and also Mr. Pennyfeather are not or never have been an appropriate representative plaintiff. The Defendant Mr. Walsh takes no position with respect to the request that Mr. Pennyfeather be substituted for Mr. Sharma.

[34] Accordingly, I make the following order: (1) Mr. Sharma shall be removed as plaintiff effective March 25, 2011; (2) Mr. Pennyfeather shall be added as plaintiff effective March 25, 2011; (3) the style of cause and statement of claim shall be amended accordingly; and (4) this order is without prejudice to the rights of the parties to assert or challenge respectively whether Mr. Sharma and Mr. Pennyfeather qualify as plaintiffs or representative plaintiffs under the *Class Proceedings Act, 1992*.

D. Discussion

a. The Relevant Statutory Provisions

[35] I turn now to the major issue that preoccupied this motion and which concerns the interaction of s. 28 of *Class Proceedings* Act, *1992* with the limitation period found in Part XXIII.1, s. 138.8 of the *Securities Act* and the leave requirement found in s.138.14 of that Act.

[36] In order to discuss that major issue, it is also necessary to discuss the interaction of s. 28 of the *Class Proceedings Act, 1992* with the limitation period found in Part XXIII.1, s. 138 of the *Securities Act*, which bars a statutory cause of action for which no leave requirement is imposed.

[37] Section 28 of the *Class Proceedings Act, 1992* states:

> *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;
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> (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.
>
> *Idem*
>
> (2) Where there is a right of appeal in respect of an event described in clauses (1) (a) to (f), the limitation period resumes running as soon as the time for appeal has expired without an appeal being commenced or as soon as any appeal has been finally disposed of.

[38] Section 138.8 of the *Securities Act* states:

> *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.

Same

(2) Upon an application under this section, the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely.

Same

(3) The maker of such an affidavit may be examined on it in accordance with the rules of court.

[39] Section 138.14 of the *Securities Act* states:

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.

[40] Section 138 of the *Securities Act*, which is applicable to the cause of action set out in s. 130 of the Act states:

Limitation periods

138. Unless otherwise provided in this Act, no action shall be commenced to enforce a right created by this Part more than,

> (a) in the case of an action for rescission, 180 days after the date of the transaction that gave rise to the cause of action; or
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> (b) in the case of any action, other than an action for rescission, the earlier of,
>
> > (i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or
> >
> > (ii) three years after the date of the transaction that gave rise to the cause of action.

b. The Competing Arguments about the Application of s. 28 of the Class Proceedings Act, 1992

[41] Relying on my decision in *Coulson v. Citigroup Global Markets Canada Inc.*, 2010 ONSC 1596 and of Justice Winkler and of the Court of Appeal in *Logan v. Canada (Minister of Health),* [2003] O.J. No. 418 (S.C.J.), aff'd (2004), 71 O.R. (3d) 451 (C.A.), which judgments, I will discuss later, Mr. Sharma argues that the limitation period in s. 138.14 of the *Securities Act* was suspended by s. 28 of the *Class Proceedings Act, 1992.*

[42] Mr. Sharma's argument is that: (a) s.28 (1) of the *Class Proceedings Act, 1992* suspends any limitation period applicable to a cause of action asserted in a class proceeding; (b) s.138.3 of the *Securities Act* is a cause of action; (c) s.138.8 of the *Securities Act* is a limitation period applicable to the s. 138.3 cause of action; (c) the s.138.3 cause of action has been asserted with the commencement of Mr. Sharma's class proceeding because the action is mentioned in the statement of claim; therefore, since s.138.8 is a limitation period applicable to a cause of action asserted in a class proceeding, the limitation period was suspended on May 14, 2009 when Mr. Sharma commenced his proposed class action. (The suspension will end and the limitation period will resume running when one of the events listed in s. 29 (1) (a) to (f) is satisfied.)

[43] The Defendants counter-argument is that s. 28 (1) of the *Class Proceedings Act, 1992* does not apply to protect Mr. Sharma's s. 138.3 cause of action from the operation of the s. 138.14 limitation period, because the s. 138.3 cause of action has not and cannot be asserted in the class proceeding until leave is granted under s. 138.14 of the Act, which has not yet occurred. The Defendants submit that the Part XXIII.1 claim cannot be asserted because it has not been commenced.

[44] During the course of the argument, I asked the lawyers for the various Defendants if there was any way that a plaintiff in a proposed class action who wished to assert a claim under Part XXIII.1 of the *Securities Act* could stop the running of the limitation period short of obtaining leave under s. 138.14 of the *Securities Act*. The answer was a categorical no.

[45] It was the Defendants' categorical submission of the Defendants that a Part XXIII.1 cause of action cannot be asserted in a proposed class action without leave having being granted under s. 138.14 of the *Securities Act*.

[46] I asked this question about the manner of pleading because I wanted to determine whether the Defendants were making a technical argument that Mr. Sharma had not asserted his Part XXIII.1 cause of action because of the particular manner in which his pleading refers to or mentions the Part XXIII.1 cause of action. Thus, I asked whether s. 28 of the *Class Proceedings Act, 1992* would have been triggered and the limitation period suspended, if para. 2 (e) of Mr. Sharma's Statement of Claim read:

> 2. The Plaintiff claims on his own behalf and on behalf of other Class Members: …
>
> (e) the right of action provided for in Part XXIII.1 of the *Securities Act*, R.S.O. 1990, c. S.5.

[47] The answer I received was that there was no way that a plaintiff can assert a Part XXIII.1 cause of action without leave having been first granted under 138.14 of the *Securities Act*.

c. Analysis and Discussion

[48] I begin my analysis and discussion by saying that I agree with Mr. Sharma's argument and I disagree with the Defendants' argument.

[49] To explain why I disagree with the Defendants' argument, I begin by noting two problematic consequences of their argument.

[50] First, it follows from the Defendants' argument that the interpretation and operation of s. 28 of the *Class Proceedings Act, 1992* becomes inconsistent. On the one hand, by its express terms, s. 28 applies to "any limitation period applicable to a cause of action" but on the other hand, under the Defendants' interpretation, s. 28 does not apply to a cause of action under Part XXIII.1 of the *Securities Act.*

[51] Under the Defendants' interpretation, s. 28 does not have any meaningful operation for causes of action that have a leave requirement under Part XXIII.1. Visualize, the Defendants argue that before leave is obtained, there is nothing that can be pleaded that would trigger the operation of s. 28, but after leave is obtained, whatever is pleaded will either be timely and toll the limitation period without triggering s. 28 or the pleading will come too late because the limitation period will not have been suspended. Under the Defendants' argument, despite its express language applying to any cause of action, s. 28 does not apply to causes of action that require leave.

[52] A second problematic consequence of the Defendants' argument and interpretation of s. 28 is that s.28 can apply to suspend the three-year absolute limitation period for causes of action under Part XXIII (for the primary market), but s. 28 does not apply to suspend the three-year absolute limitation period for causes of action under Part XXIII.1 (for the secondary market). I see no sense or justification for interpreting s. 28 to operate for Part XXIII causes of action but not Part XXIII.1 causes of action, and, in my opinion, the Defendants did not offer an explanation.

[53] The Legislature intended both Part XXIII and also Part XXIII.1 causes of action to be advanced in a timely way, and an absolute limitation period applies to both, and the Legislature added a leave requirement for Part XXIII.1 causes of action. The leave requirement, however, serves a different purpose than the temporal purposes of a limitation period.

[54] The leave requirement serves the gatekeeper, qualitative, or substantive purpose of barring frivolous and abusive claims (so-called strike suits), and the leave requirement is never suspended. In other words, there is no reason to remove Part XXIII.1 causes of action from the operation of s.28 of the *Class Proceedings Act, 1992* because of the leave requirement that will remain operative in any event.

[55] In still other words, s. 28 applies to suspend the temporal filter of "any limitation period" and the existence of additional substantive filters, which will be applied in any event is not a reason to diminish the operation of s. 28 of the *Class Proceedings Act, 1992*.

[56] The existence of a leave requirement is a distinction without a difference to the operation of s. 28 of the *Class Proceedings Act*. Had Mr. Sharma sought leave for his Part XXIII.1 cause of action before he commenced his class proceeding, he would have had to satisfy the filter of s. 138.8 of the *Securities Act*. And, in the case at bar, having commenced his class proceeding, he still must subject his Part XXIII.1 cause of action to the filter of s. 138.8 of the *Securities Act.*

[57] It escapes me why the existence of a leave requirement that will be unaffected by s. 28 of the *Class Proceedings Act, 1992* should be a distinction that would differentiate the operation of s. 28 as the Defendants would have it. The Defendants pointed out that the leave requirement was a distinctive feature of some causes of action, but they never explained why this distinction should made a difference to the operation of s. 28 of the *Class Proceedings Act, 1992*.

[58] Returning to the language of s. 28 and other weaknesses or problems with the Defendants' argument, it is important to always keep in mind that s. 28 of the *Class Proceeding Act, 1992* speaks about "a cause of action asserted in a class proceeding" while, in contrast, the leave requirement of s. 138.8 of the *Securities Act* does not speak about "asserting a cause of action" but rather speaks about the commencement of the cause of action; that is, under s. 138.8, "no action may be commenced … without leave".

[59] The important point to keep in mind is that the legal problem is that of interpreting s. 28, which applies to suspend temporal bars to causes of action, and the legal problem is not how s. 138.8 should be interpreted to apply to a different substantive qualitative bar to a cause of action.

[60] Given that a cause of action exists before litigation is commenced and given that limitation periods begin to operate with the existence of the cause of action precisely to require the timely commencement of litigation, the "assertion of a cause of action" does

not depend upon the commencement of litigation as the Defendants' argument would have it. The Defendants' argument is that a Part XXIII.1 action cannot be asserted in a class proceeding until after leave is granted. This argument conflates the assertion of a cause of action with the litigation (the action or application) that enforces the cause of action.

[61] To make this last point, I return to the Defendants' categorical assertion that there is no Part XXIII.1 cause of action that could be asserted in a statement of claim of a class proceeding before leave was granted under s. 138.8 of the *Securities Act.* Thus, under the Defendants' argument without leave having been first granted under s. 138.8 of the *Securities Act*, the pleading "The Plaintiff claims the right of action provided for in Part XXIII.1 of the *Securities Act"* would not be the assertion of a cause of action. However, in my opinion, claiming the right of action provided by Part XXIII.1 is to assert a cause of action in a class proceeding regardless whether leave has been granted or not under the provisions of the *Securities Act*.

[62] In still another problem, the Defendants' argument defeats the purpose of s. 28 of the *Class Proceedings Act, 1992* which brings me to my judgment in *Coulson v. Citigroup Global Markets Canada Inc.*, which concerned whether a suspension of a Part XXIII cause of action under s. 28 of the *Class Proceedings Act, 1992* had come to an end and the limitation period had resumed running.

[63] In the context of the operation of a cause of action that did not have a leave requirement, I discussed the purpose of s. 28. In the case at bar, the Defendants would have it that the rationale for s. 28 that applies for causes of action without leave does not apply to causes of action for which leave is required. Once again, I disagree with the Defendants; the difference that the Defendants rely on is a distinction that does not make a difference to the rationale for s. 28 of the *Class Proceedings Act, 1992*.

[64] In *Coulson*, I explained the rationale behind s. 28 for Part XXIII causes of action and, in my opinion, the same rationale applies to Part XXIII.1 claims for which leave is an additional requirement. In paragraphs 43 to 45 and 48 to 50, I stated (with new emphasis added):

> 43. The Ontario Law Reform Commission in chapter 17 in its *Report on Class Actions* (Toronto: Ministry of the Attorney General, 1982) discussed the relationship between limitation periods and class actions and asked the question of what would be the effect, if any, of the putative plaintiff commencing an action before the expiry of the limitation period for his or her cause of action on the limitation periods of the claims of the putative class members. The Commission asked whether time would cease to run for the individual claims and if so, when did this occur: upon the commencement of the class action; upon the granting of certification; or, upon the filing of a motion to intervene?
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> 44. The Commission decided that statutory guidance was required to answer these questions and that guidance was also required to answer the question of when the limitation period, if suspended, would resume running against absent class members. The Commission explained the policy behind what would become s. 28 of the *Class Proceedings Act, 1992* at pp. 779-80 of its report, as follows:

> [T]he Commission sees the main policy objectives of class actions to be judicial economy and increased access to the courts. A general rule that the commencement of a class action suspends the running of limitation periods against absent class members, whether certification is granted or denied, would serve to promote the most efficient use of judicial resources. If the commencement of a class action did not have this effect, absent class members, where a class suit is filed shortly prior to the expiration of the statutory limitation period, would be forced to institute precautionary individual actions or to file formal motions to intervene as parties in order to preserve their legal rights. Moreover, even where, at the filing of a class action, the running of the limitation period had only commenced, protective measures would still be encouraged. Absent class members would be unsure whether certification would be granted and, in addition, they would be unable to ascertain with certainty the time that would elapse between the filing of the suit and the final resolution of the certification motion, particularly bearing in mind the possibility of appeal proceedings. In our view, such a result would be in direct contradiction to the class action goals of efficiency and economy of litigation.
>
> It is also apparent that this approach would militate against the policy of increased access to the courts and the vindication of small claims. It would be uneconomical for absent class members with individually nonrecoverable claims to incur the expense of filing precautionary motions to intervene. Furthermore, requiring absent class members so to act would frustrate one of our fundamental recommendations. In chapter 12, we recommend that class members should not be required to opt in to a class suit prior to a determination of the common questions in order to protect their right to participate in a favourable judgment. For the reasons advanced in support of that recommendation, we are of the opinion that a class member should not be required to indicate formally his participation in a putative class action in order to avoid the adverse effects of the running of a statute of limitations.
>
> It seems clear to the Commission that the approach that would most clearly further the policies underlying class actions would be one that called for a general suspension of the limitation period upon the commencement of an action in class form. ....

45. Thus, having regard to the access to justice policies of a class action regime, the Ontario Law Reform Commission reasoned that, putative class members injured by a mass wrong should be entitled to wait and see whether a class action would be available to them without fear of the expiry of a limitation period. Further, putative class members should not have to take steps to prevent a limitation period from barring individual causes of action that might turn out to be necessary if a class action was determined to be unavailable. Thus, the Commission recommended that limitation periods should be suspended with the commencement of a class action until the availability of a class action was determined. This recommendation has been implemented by s. 28 of the *Class Proceedings Act, 1992* that 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 and resumed running against a class member when ...."

48. I take the Ontario Law Reform Commission to be recommending the proposition that if a putative class member's cause of action is expressly mentioned in the statement of claim of a proposed class action, then that cause of action is suspended until the suspension is lifted by certain events**,** including a determination that dismisses the asserted cause of action without a determination of its merits. ….

> 49. The purpose of s. 28 of the *Class Proceedings Act, 1992* is to protect class members from the operation of limitation periods until it has been determined whether class members may obtain access to justice through membership in a class proceeding as an alternative to obtaining access to justice by pursuing individual actions. In the absence of s. 28, class members would have to commence a multitude of individual actions and then, if a class action was certified, the class members who have the choice of opting out or of abandoning or having their individual actions stayed. The operation of s. 28 makes it unnecessary for class members to commence multitudes of individual claims by protecting them from the operation of limitation periods until it is determined whether they actually have the option of membership in a class proceeding that mentions their claim.
>
> 50. I would not read into s. 28 of the *Class Proceedings Act, 1992* any qualification to the language "a cause of action asserted in a class proceeding." In the case at bar, a s. 130 claim was asserted on behalf of the class members identified in the statement of claim in a proposed class proceeding. In my opinion, s. 28 temporarily or conditionally suspended the running of the limitation period in respect of that claim.

[65] In *Logan v. Canada (Minister of Health),* [2003] O.J. No. 418 (S.C.J.) at para. 23, aff'd [2004] O.J. No. 2769 (C.A.), Justice Winkler described the purpose of s. 28 of the *Class Proceedings Act* as follows:

> …. The CPA is remedial legislation aimed at providing judicial economy for the court system and access to that system for plaintiffs with non-economic claims. If potential class members are forced to commence individual actions while awaiting certification of class proceeding to protect individual limitation periods, it would defeat these purposes. The court system could be potentially burdened with volumes of claims, all of which would be redundant should the proceeding be certified as a class proceeding. Further, requiring each class member to file an individual claim could go a long way toward eliminating the economic advantage of class proceedings for any class member with a small claim.

[66] During the course of argument, I asked the Defendants' lawyers whether they agreed that a practical consequence of their argument was that putative class members with causes of action under Part XXIII.1 would have to commence individual leave motions to protect their claims from the operation of the absolute three-year limitation period regardless of whether the Part XXIII.1 cause of action was mentioned in the proposed class action. They agreed that this was true, which I took to be a concession or a submission that the purposes of s. 28 of the *Class Proceeding Act, 1992* protecting class members from the operation of limitation periods until it could be determined whether there was a viable class action did not apply when the proposed cause of action was for misrepresentations in the secondary market.

[67] With respect, it seems to me, that the distinction between these two statutory causes of action; namely, that one is actionable without leave and the other is actionable only with leave, does not and should not make a difference to the interpretation and operation of s.28 of the *Class Proceedings Act, 1992*. The purported distinction between Part XXIII and Part XXIII.1 causes of action should not require putative class members, be they a single soldier, a platoon, or division, to go on the march to seek leave to commence an action under Part XXIII.1 of the *Securities Act* once a class action mentioning the Part XXIII.1 claim has been commenced.

E. Conclusion

[68] For the above reasons, I grant Mr. Sharma's motion for the joinder of Mr. Pennyfeather, and I declare that in the case at bar the limitation period in s. 138.14 of the *Securities* Act, R.S.O. 1990, s. S.5 is suspended pursuant to s. 28 of the *Class Proceedings Act, 1992.*

[69] With respect to costs, it is my opinion that the costs of this motion should be in the cause.

[70] To be blunt, this motion was brought either because the Defendants were wrong about the operation of s. 28 of the *Class Proceedings Act, 1992* and Mr. Sharma was unsure about whether the Defendants were wrong, or because Mr. Sharma was unaware or unsure about whether s. 28 of the *Class Proceedings Act, 1992* was available to protect Class Members from what appeared to be a possible limitation period problem. In my opinion, the fairest costs award in these circumstances is to order costs in the cause.

[71] Finally, it is time for all the parties to move both the leave motion and the certification motion forward. The parties should settle on a timetable, failing which a case conference should be arranged to set a timetable.

Perell, J.

Released: March 31, 2011

CITATION: Sharma v. Timminco Limited 2011 ONSC 8024
COURT FILE NO.: 09-CV-378701CP
DATE: March 31, 2011

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

Ravinder Kumar Sharma

Plaintiff

- and -

Timminco Limited, Photon Consulting LLC, Rogol Energy Consulting LLC, Michael Rogol, Dr. Heinz Schimmerlbusch, Robert Dietrich, René Boisvert, Arthur R. Spector, Jack L. Messman, John C. Fox, Michael D. Winfield, Mickey M. Yaksich, and John P. Walsh

Defendants

REASONS FOR DECISION

Perell, J.

Released: March 31, 2011

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

ONTARIO
SUPERIOR COURT OF JUSTICE

Proceeding commenced at Toronto

Proceeding under the *Class Proceedings Act, 1992*

BRIEF OF AUTHORITIES OF THE PLAINTIFFS (SETTLEMENT APPROVAL)

(Returnable February 4, 2013)

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