Court of Appeal File No.: M42068
S.C.J. Court File No.: CV-12-9667-00CL

COURT OF APPEAL FOR ONTARIO

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

APPLICATION UNDER THE *COMPANIES CREDITORS' ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

BOOK OF AUTHORITIES OF THE APPELLANTS, INVESCO CANADA LTD., NORTHWEST & ETHICAL INVESTMENTS L.P., AND COMITÉ SYNDICAL NATIONAL DE RETRAITE BÂTIRENTE INC.

(Motion for Leave to Appeal from Sanction Order)

VOLUME 2 OF 2

January 28, 2013

KIM ORR BARRISTERS P.C.
19 Mercer Street, 4th Floor
Toronto, Ontario
M5V 1H2

James C. Orr (LSUC #23180M)
Won J. Kim (LSUC #32918H)
Megan B. McPhee (LSUC #48351G)
Michael C. Spencer (LSUC #59637F)

Tel: (416) 596-1414
Fax: (416) 598-0601

Lawyers for the Appellants, Invesco Canada Ltd., Northwest & Ethical Investments L.P., and Comité Syndical National de Retraite Bâtirente Inc.

TO: THE SERVICE LIST

Appeal Court File No: M42068

S.C.J. Court File No: CV-12-9667-00-CL

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OF SINO-FOREST CORPORATION

APPLICATION UNDER THE *COMPANIES CREDITORS' ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

SERVICE LIST
(as of January 22, 2013)

TO: BENNETT JONES LLP
3400 One First Canadian Place,
P.O. Box 130
Toronto, Ontario M5X 1A4

Robert W. Staley
Tel: 416.777.4857
Fax: 416.863.1716
Email: staleyr@bennettjones.com

Kevin Zych
Tel: 416.777.5738
Email: zychk@bennettjones.com

Derek J. Bell
Tel: 416.777.4638
Email: belld@bennettjones.com

Raj S. Sahni
Tel: 416.777.4804
Email: sahnir@bennettjones.com

Jonathan Bell
Tel: 416.777.6511
Email: bellj@bennettjones.com

Sean Zweig
Tel: 416.777.6254
Email: zweigs@bennettjones.com

Lawyers for the Applicant, Sino-Forest Corporation

AND TO: GOWLING LAFLEUR HENDERSON LLP
1 First Canadian Place
100 King Street West, Suite 1600
Toronto, Ontario M5X 1G5

Derrick Tay
Tel: 416.369.7330
Fax: 416.862.7661
Email: derrick.tay@gowlings.com

Clifton Prophet
Tel: 416.862.3509
Email: clifton.prophet@gowlings.com

Jennifer Stam
Tel: 416.862.5697
Email: jennifer.stam@gowlings.com

Ava Kim
Tel: 416.862.3560
Email: ava.kim@gowlings.com

Jason McMurtrie
Tel: 416.862.5627
Email: jason.mcmurtrie@gowlings.com

Lawyers for the Monitor

AND TO: FTI CONSULTING CANADA INC.
T-D Waterhouse Tower
79 Wellington Street West
Toronto-Dominion Centre, Suite 2010,
P.O. Box 104
Toronto, Ontario M5K 1G8

Greg Watson
Tel: 416.649.8100
Fax: 416.649.8101
Email: greg.watson@fticonsulting.com

Jodi Porepa
Tel: 416.649.8070
Email: Jodi.porepa@fticonsulting.com

Monitor

AND TO: AFFLECK GREENE MCMURTY LLP
365 Bay Street, Suite 200
Toronto, Ontario M5H 2V1

Peter Greene
Tel: 416.360.2800
Fax: 416.360.8767
Email: pgreene@agmlawyers.com

Kenneth Dekker
Tel: 416.360.6902
Fax: 416.360.5960
Email: kdekker@agmlawyers.com

Michelle E. Booth
Tel: 416.360.1175
Fax: 416.360.5960
Email: mbooth@agmlawyers.com

Lawyers for BDO

AND TO: BAKER MCKENZIE LLP
Brookfield Place
2100-181 Bay Street
Toronto, Ontario M5J 2T3

John Pirie
Tel: 416.865.2325
Fax: 416.863.6275
Email: john.pirie@bakermckenzie.com

David Gadsden
Tel: 416.865.6983
Email: david.gadsden@bakermckenzie.com

Lawyers for Poyry (Beijing) Consulting Company Limited

AND TO: TORYS LLP
79 Wellington Street West
Suite 3000, Box 270
Toronto-Dominion Centre
Toronto, Ontario M5K 1N2

John Fabello
Tel: 416.865.8228
Fax: 416.865.7380
Email: jfabello@torys.com

David Bish
Tel: 416.865.7353
Email: dbish@torys.com

Andrew Gray
Tel: 416.865.7630
Email: agray@torys.com

Lawyers for the Underwriters named in Class Actions

AND TO: LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP
Suite 2600, 130 Adelaide Street West
Toronto, Ontario M5H 3P5

Peter H. Griffin
Tel: 416.865.9500
Fax: 416.865.3558
Email: pgriffin@litigate.com

Peter J. Osborne
Tel: 416.865.3094
Fax: 416.865.3974
Email: posborne@litigate.com

Linda L. Fuerst
Tel: 416.865.3091
Fax: 416.865.2869
Email: lfuerst@litigate.com

Shara Roy
Tel: 416.865.2942
Fax: 416.865.3973
Email: sroy@litigate.com

Lawyers for Ernst & Young LLP

AND TO: GOODMANS LLP
333 Bay Street, Suite 3400
Toronto, Ontario M5H 2S7

Benjamin Zarnett
Tel: 416.597.4204
Fax: 416.979.1234
Email: bzarnett@goodmans.ca

Robert Chadwick
Tel: 416.597.4285
Email: rchadwick@goodmans.ca

Brendan O'Neill
Tel: 416.979.2211
Email: boneill@goodmans.ca

Caroline Descours
Tel: 416.597.6275
Email: cdescours@goodmans.ca

Lawyers for Ad Hoc Committee of Bondholders

AND TO: OSLER, HOSKIN & HARCOURT LLP
1 First Canadian Place
100 King Street West
Suite 6100, P.O. Box 50
Toronto, Ontario M5X 1B8

Larry Lowenstein
Tel: 416.862.6454
Fax: 416.862.6666
Email: llowenstein@osler.com

Edward Sellers
Tel: 416.862.5959
Email: esellers@osler.com

Geoffrey Grove
Tel: (416) 862-4264
Email: ggrove@osler.com

Lawyers for the Board of Directors of Sino-Forest Corporation

AND TO: COHEN MILSTEIN SELLERS & TOLL PLC
1100 New York, Ave., N.W.
West Tower, Suite 500
Washington, D.C. 20005

Steven J. Toll
Tel: 202.408.4600
Fax: 202.408.4699
Email: stoll@cohenmilstein.com

Matthew B. Kaplan
Tel: 202.408.4600
Email: mkaplan@cohenmilstein.com

Attorneys for the Plaintiff and the Proposed Class re New York action

AND TO: SISKINDS LLP
680 Waterloo Street
P.O. Box 2520
London, Ontario N6A 3V8

A. Dimitri Lascaris
Tel: 519.660.7844
Fax: 519.672.6065
Email: dimitri.lascaris@siskinds.com

Charles M. Wright
Tel: 519.660.7753
Email: Charles.wright@siskinds.com

Lawyers for an Ad Hoc Committee of Purchasers of the Applicant's Securities, including the Representative Plaintiffs in the Ontario Class Action against the Applicant

AND TO: KOSKIE MINSKY LLP
20 Queen Street West, Suite 900
Toronto, Ontario M5H 3R3

Kirk M. Baert
Tel: 416.595.2117
Fax: 416.204.2899
Email: kbaert@kmlaw.ca

Jonathan Ptak
Tel: 416.595.2149
Fax: 416.204.2903
Email: jptak@kmlaw.ca

Jonathan Bida
Tel: 416.595.2072
Fax: 416.204.2907
Email: jbida@kmlaw.ca

Garth Myers
Tel: 416.595.2102
Fax: 416.977.3316
Email: gmyers@kmlaw.ca

Lawyers for an Ad Hoc Committee of Purchasers of the Applicant's Securities, including the Representative Plaintiffs in the Ontario Class Action against the Applicant

AND TO: COHEN MILSTEIN SELLERS & TOLL PLC
88 Pine Street, 14th Floor
New York, NY 10005

Richard S. Speirs
Tel: 212.838.7797
Fax: 212.838.7745
Email: rspeirs@cohenmilstein.com

Stefanie Ramirez
Tel: 202.408.4600
Email: sramirez@cohenmilstein.com

Attorneys for the Plaintiff and the Proposed Class re New York action

AND TO: WARDLE DALEY BERNSTEIN LLP
2104 - 401 Bay Street, P.O. Box 21
Toronto Ontario M5H 2Y4

Peter Wardle
Tel: 416.351.2771
Fax: 416.351.9196
Email: pwardle@wdblaw.ca

Simon Bieber
Tel: 416.351.2781
Email: sbieber@wdblaw.ca

Erin Pleet
Tel: 416.351.2774
Email: epleet@wdblaw.ca

Lawyers for David Horsley

AND TO: McCARTHY TETRAULT LLP
Suite 2500, 1000 De La Gauchetiere St. West
Montreal, Québec, H3B 0A2

Alain N. Tardif
Tel: 514.397.4274
Fax : 514.875.6246
Email: atardif@mccarthy.ca

Mason Poplaw
Tel: 514.397.4155
Email: mpoplaw@mccarthy.ca

Céline Legendre
Tel: 514.397.7848
Email: clegendre@mccarthy.ca

Lawyers for Ernst & Young LLP

AND TO: THORNTON GROUT FINNIGAN LLP
Suite 3200, 100 Wellington Street West
P. O. Box 329, Toronto-Dominion Centre
Toronto, Ontario M5K 1K7

James H. Grout
Tel: 416.304.0557
Fax: 416.304.1313
Email: jgrout@tgf.ca

Kyle Plunkett
Tel: 416-304-7981
Fax: 416.304.1313
Email: kplunkett@tgf.ca

Lawyers for the Ontario Securities Commission

AND TO: MILLER THOMSON LLP
Scotia Plaza, 40 King Street West
Suite 5800
Toronto, Ontario M5H 3S1

Emily Cole
Tel: 416.595.8640
Email: ecole@millerthomson.com

Joseph Marin
Tel: 416.595.8579
Email: jmarin@millerthomson.com

Lawyers for Allen Chan

AND TO: PALIARE ROLAND ROSENBERG ROTHSTEIN LLP
155 Wellington Street, 35th Floor
Toronto, Ontario M5V 3H1

Ken Rosenberg
Tel: 416.646.4304
Fax: 416.646.4301
Email: ken.rosenberg@paliareroland.com

Massimo (Max) Starnino
Tel: 416.646.7431
Email: max.starnino@paliareroland.com

Lawyers for an Ad Hoc Committee of Purchasers of the Applicant's Securities, including the Representative Plaintiffs in the Ontario Class Action against the Applicant

AND TO: CLYDE & COMPANY
390 Bay Street, Suite 800
Toronto, Ontario M5H 2Y2

Mary Margaret Fox
Tel: 416.366.4555
Fax: 416.366.6110
Email: marymargaret.fox@clydeco.ca

Paul Emerson
Tel: 416.366.4555
Email: paul.emerson@clydeco.ca

Lawyers for ACE INA Insurance and Chubb Insurance Company of Canada

AND TO: FASKEN MARTINEAU LLP
333 Bay Street, Suite 2400,
Bay-Adelaide Centre, Box 20
Toronto, Ontario M5H 2T6

Stuart Brotman
Tel: 416.865.5419
Fax: 416.364.7813
Email: sbrotman@fasken.com

Conor O'Neill
Tel: 416 865 4517
Email: coneill@fasken.com

Canadian Lawyers for the Convertible Note Indenture Trustee (The Bank of New York Mellon)

AND TO: DAVIS LLP
1 First Canadian Place, Suite 6000
PO Box 367
100 King Street West
Toronto, Ontario M5X 1E2

Susan E. Friedman
Tel: 416.365.3503
Fax: 416.777.7415
Email: sfriedman@davis.ca

Bruce Darlington
Tel: 416.365.3529
Fax: 416.369.5210
Email: bdarlington@davis.ca

Brandon Barnes
Tel: 416.365.3429
Fax: 416.369.5241
Email: bbarnes@davis.ca

Lawyers for Kai Kat Poon

AND TO: KIM ORR BARRISTERS P.C.
19 Mercer St., 4th Floor
Toronto, ON M5V 1H2

James C. Orr
Tel: 416.349.6571
Fax: 416.598.0601
Email: jo@kimorr.ca

Won J. Kim
Tel: 416.349.6570
Fax: 416.598.0601
Email: wjk@kimorr.ca

Michael C. Spenser
Tel: 416.349.6599
Fax: 416.598.0601
Email: mcs@kimorr.ca

Megan B. McPhee
Tel: 416.349.6574
Fax: 416.598.0601
Email: mbm@kimorr.ca

Yonatan Rozenszajn
Tel: 416.349.6578
Fax: 416.598.0601
Email: yr@kimorr.ca

Tanya T. Jemec
Tel: 416.349.6573
Fax: 416-598.0601
Email: ttj@kimorr.ca

Lawyers for Invesco Canada Ltd., Northwest & Ethical Investments L.P. and Comité Syndical National De Retraite Batirente Inc.

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30.	*Western Canadian Shopping Centres Inc. v. Dutton*, 2001 SCC 46

Secondary Sources

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32.	*The Oxford English Dictionary*, 2nd ed., s.v. "integral"

33.	*Words & Phrases*, Volume 4, s.v. “integral”
34.	*Black’s Law Dictionary*, 6th ed., s.v. “integral”

Tab 17

Case Name:

Nortel Networks 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 Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation, Applicants

[2010] O.J. No. 1232

2010 ONSC 1708

63 C.B.R. (5th) 44

81 C.C.P.B. 56

2010 CarswellOnt 1754

Court File No. 09-CL-7950

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: March 3-5, 2010.
Judgment: March 26, 2010.

(106 paras.)

Bankruptcy and insolvency law -- Property of bankrupt -- Pensions and benefits -- Motion by the applicant Nortel corporations for approval of a settlement agreement dismissed -- The settlement agreement contained a clause that stating that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims -- The clause was not fair and reasonable -- The clause resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue -- Companies' Creditors Arrangement Act, s. 5.1(2).

Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Motion by the applicant Nortel corporations for approval of a settlement agreement dismissed -- The settlement agreement contained a clause that stating that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims -- The clause was not fair and reasonable -- The clause resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue -- Companies' Creditors Arrangement Act, s. 5.1(2).

Motion by the applicant Nortel corporations for approval of a settlement agreement. The settlement agreement provided for the termination of pension payments and the termination of benefits paid through Nortel's Health and Welfare Trust (HWT). The applicants were granted a stay of proceedings on January 14, 2009, pursuant to the Companies' Creditors Arrangement Act, but had continued to provide the HWT benefits and had continued contributions and special payments to the pension plans. The opposing long-term disability employees opposed the settlement agreement, principally as a result of the inclusion of a **release** of Nortel and its successors, advisors, directors and officers, from all future claims regarding the pension plans and the HWT in the absence of fraud. The Official Committee of Unsecured Creditors of **Nortel Networks** Inc. ("UCC"), and the informal Nortel Noteholder Group (the "Noteholders") opposed Clause H.2 of the settlement agreement. Clause H.2 stated that no party was precluded from arguing the applicability of any amendment to the Bankruptcy and Insolvency Act that changed the priority of claims. The Monitor supported the Settlement Agreement, submitting that it was necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The CAW and Board of Directors of Nortel also supported the settlement agreement.

HELD: Motion dismissed. Cause H.2 was not fair and reasonable. Clause H.2 resulted in an agreement that did not provide certainty and did not provide finality of a fundamental priority issue. The **third party** releases were necessary and connected to a resolution of the claims against the applicants, benefited creditors generally and were not overly broad or offensive to public policy.

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. 5.1(2)

Counsel:

Derrick Tay, Jennifer Stam and Suzanne Wood, for the Applicants.

Lyndon Barnes and Adam Hirsh, for the Nortel Directors.

Benjamin Zarnett, Gale Rubenstein, C. Armstrong and Melaney Wagner, for Ernst & Young Inc., Monitor.

Arthur O. Jacques, for the Nortel Canada Current Employees.

Deborah McPhail, for the Superintendent of Financial Services (non-PBGF).

Mark Zigler and Susan Philpott, for the Former and Long-Term Disability Employees.

Ken Rosenberg and M. Starnino, for the Superintendent of Financial Services in its capacity as Administrator of the Pension Benefit Guarantee Fund.

S. Richard Orzy and Richard B. Swan, for the Informal Nortel Noteholder Group.

Alex MacFarlane and Mark Dunsmuir, for the Unsecured Creditors' Committee of **Nortel Networks** Inc.

Leanne Williams, for Flextronics Inc.

Barry Wadsworth, for the CAW-Canada.

Pamela Huff, for the Northern Trust Company, Canada.

Joel P. Rochon and Sakie Tambakos, for the Opposing Former and Long-Term Disability Employees.

Robin B. Schwill, for the **Nortel Networks** UK Limited (In Administration).

Sorin Gabriel Radulescu, In Person.

Guy Martin, In Person, on behalf of Marie Josee Perrault.

Peter Burns, In Person.

Stan and Barbara Arnelien, In Person.

ENDORSEMENT

G.B. MORAWETZ J.:--

INTRODUCTION

1 On January 14, 2009, **Nortel Networks** Corporation ("NNC"), **Nortel Networks** Limited "(NNL"), **Nortel Networks** Global Corporation, **Nortel Networks** International Corporation and **Nortel Networks** Technology Corporation (collectively, the "Applicants") were granted a stay of proceedings pursuant to the *Companies' Creditors Arrangement Act* ("CCAA") and Ernst & Young Inc. was appointed as Monitor.

2 The Applicants have historically operated a number of pension, benefit and other plans (both funded and unfunded) for their employees and pensioners, including:

(i) Pension benefits through two registered pension plans, the **Nortel Networks** Limited Managerial and Non-Negotiated Pension Plan and the **Nortel Networks** Negotiated Pension Plan (the "Pension Plans"); and

(ii) Medical, dental, life insurance, long-term disability and survivor income and transition benefits paid, except for survivor termination benefits, through Nortel's Health and Welfare Trust (the "HWT").

3 Since the CCAA filing, the Applicants have continued to provide medical, dental and other benefits, through the HWT, to pensioners and employees on long-term disability ("Former and LTD

Employees") and active employees ("HWT Payments") and have continued all current service contributions and special payments to the Pension Plans ("Pension Payments").

4 Pension Payments and HWT Payments made by the Applicants to the Former and LTD Employees while under CCAA protection are largely discretionary. As a result of Nortel's insolvency and the significant reduction in the size of Nortel's operations, the unfortunate reality is that, at some point, cessation of such payments is inevitable. The Applicants have attempted to address this situation by entering into a settlement agreement (the "Settlement Agreement") dated as of February 8, 2010, among the Applicants, the Monitor, the Former Employees' Representatives (on their own behalf and on behalf of the parties they represent), the LTD Representative (on her own behalf and on behalf of the parties she represents), Representative Settlement Counsel and the CAW-Canada (the "Settlement Parties").

5 The Applicants have brought this motion for approval of the Settlement Agreement. From the standpoint of the Applicants, the purpose of the Settlement Agreement is to provide for a smooth transition for the termination of Pension Payments and HWT Payments. The Applicants take the position that the Settlement Agreement represents the best efforts of the Settlement Parties to negotiate an agreement and is consistent with the spirit and purpose of the CCAA.

6 The essential terms of the Settlement Agreement are as follows:

(a) until December 31, 2010, medical, dental and life insurance benefits will be funded on a pay-as-you-go basis to the Former and LTD Employees;
(b) until December 31, 2010, LTD Employees and those entitled to receive survivor income benefits will receive income benefits on a pay-as-you-go basis;
(c) the Applicants will continue to make current service payments and special payments to the Pension Plans in the same manner as they have been doing over the course of the proceedings under the CCAA, through to March 31, 2010, in the aggregate amount of $2,216,254 per month and that thereafter and through to September 30, 2010, the Applicants shall make only current service payments to the Pension Plans, in the aggregate amount of $379,837 per month;
(d) any allowable pension claims, in these or subsequent proceedings, concerning any Nortel Worldwide Entity, including the Applicants, shall rank *pari passu* with ordinary, unsecured creditors of Nortel, and no part of any such HWT claims shall rank as a preferential or priority claim or shall be the subject of a constructive trust or trust of any nature or kind;
(e) proofs of claim asserting priority already filed by any of the Settlement Parties, or the Superintendent on behalf of the Pension Benefits Guarantee Fund are disallowed in regard to the claim for priority;
(f) any allowable HWT claims made in these or subsequent proceedings shall rank *pari passu* with ordinary unsecured creditors of Nortel;
(g) the Settlement Agreement does not extinguish the claims of the Former and LTD Employees;
(h) Nortel and, *inter alia*, its successors, advisors, directors and officers, are released from all future claims regarding Pension Plans and the HWT, provided that nothing in the **release** shall **release** a director of the Applicants

from any matter referred to in subsection 5.1(2) of the CCAA or with respect to fraud on the part of any Releasee, with respect to that Releasee only;

(i) upon the expiry of all appeals and rights of appeal in respect thereof, Representative Settlement Counsel will withdraw their application for leave to appeal the decision of the Court of Appeal, dated November 26, 2009, to the Supreme Court of Canada on a with prejudice basis;[1]

(j) a CCAA plan of arrangement in the Nortel proceedings will not be proposed or approved if that plan does not treat the Pension and HWT claimants *pari passu* to the other ordinary, unsecured creditors ("Clause H.1"); and

(k) if there is a subsequent amendment to the *Bankruptcy and Insolvency Act* ("BIA") that "changes the current, relative priorities of the claims against Nortel, no party is precluded by this Settlement Agreement from arguing the applicability" of that amendment to the claims ceded in this Agreement ("Clause H.2").

7 The Settlement Agreement does *not* relate to a distribution of the HWT as the Settlement Parties have agreed to work towards developing a Court-approved distribution of the HWT corpus in 2010.

8 The Applicants' motion is supported by the Settlement Parties and by the Board of Directors of Nortel.

9 The Official Committee of Unsecured Creditors of **Nortel Networks** Inc. ("UCC"), the informal Nortel Noteholder Group (the "Noteholders"), and a group of 37 LTD Employees (the "Opposing LTD Employees") oppose the Settlement Agreement.

10 The UCC and Noteholders oppose the Settlement Agreement, principally as a result of the inclusion of Clause H.2.

11 The Opposing LTD Employees oppose the Settlement Agreement, principally as a result of the inclusion of the **third party** releases referenced in [6h] above.

THE FACTS

A. Status of Nortel's Restructuring

12 Although it was originally hoped that the Applicants would be able to restructure their business, in June 2009 the decision was made to change direction and pursue sales of Nortel's various businesses.

13 In response to Nortel's change in strategic direction and the impending sales, Nortel announced on August 14, 2009 a number of organizational updates and changes including the creation of groups to support transitional services and management during the sales process.

14 Since June 2009, Nortel has closed two major sales and announced a third. As a result of those transactions, approximately 13,000 Nortel employees have been or will be transferred to purchaser companies. That includes approximately 3,500 Canadian employees.

15 Due to the ongoing sales of Nortel's business units and the streamlining of Nortel's operations, it is expected that by the close of 2010, the Applicants' workforce will be reduced to only 475 employees. There is a need to wind-down and rationalize benefits and pension processes.

16 Given Nortel's insolvency, the significant reduction in Nortel's operations and the complexity and size of the Pension Plans, both Nortel and the Monitor believe that the continuation and funding of the Pension Plans and continued funding of medical, dental and other benefits is not a viable option.

B. The Settlement Agreement

17 On February 8, 2010 the Applicants announced that a settlement had been reached on issues related to the Pension Plans, and the HWT and certain employment related issues.

18 Recognizing the importance of providing notice to those who will be impacted by the Settlement Agreement, including the Former Employees, the LTD Employees, unionized employees, continuing employees and the provincial pension plan regulators ("Affected Parties"), Nortel brought a motion to this Court seeking the approval of an extensive notice and opposition process.

19 On February 9, 2010, this Court approved the notice program for the announcement and disclosure of the Settlement (the "Notice Order").

20 As more fully described in the Monitor's Thirty-Sixth, Thirty-Ninth and Thirty-Ninth Supplementary Reports, the Settlement Parties have taken a number of steps to notify the Affected Parties about the Settlement.

21 In addition to the Settlement Agreement, the Applicants, the Monitor and the Superintendent, in his capacity as administrator of the Pension Benefits Guarantee Fund, entered into a letter agreement on February 8, 2010, with respect to certain matters pertaining to the Pension Plans (the "Letter Agreement").

22 The Letter Agreement provides that the Superintendent will not oppose an order approving the Settlement Agreement ("Settlement Approval Order"). Additionally, the Monitor and the Applicants will take steps to complete an orderly transfer of the Pension Plans to a new administrator to be appointed by the Superintendent effective October 1, 2010. Finally, the Superintendent will not oppose any employee incentive program that the Monitor deems reasonable and necessary or the creation of a trust with respect to claims or potential claims against persons who accept directorships of a Nortel Worldwide Entity in order to facilitate the restructuring.

POSITIONS OF THE PARTIES ON THE SETTLEMENT AGREEMENT

The Applicants

23 The Applicants take the position that the Settlement is fair and reasonable and balances the interests of the parties and other affected constituencies equitably. In this regard, counsel submits that the Settlement:

(a) eliminates uncertainty about the continuation and termination of benefits to pensioners, LTD Employees and survivors, thereby reducing hardship and disruption;

(b) eliminates the risk of costly and protracted litigation regarding Pension Claims and HWT Claims, leading to reduced costs, uncertainty and potential disruption to the development of a Plan;
(c) prevents disruption in the transition of benefits for current employees;
(d) provides early payments to terminated employees in respect of their termination and severance claims where such employees would otherwise have had to wait for the completion of a claims process and distribution out of the estates;
(e) assists with the commitment and retention of remaining employees essential to complete the Applicants' restructuring; and
(f) does not eliminate Pension Claims or HWT Claims against the Applicants, but maintains their quantum and validity as ordinary and unsecured claims.

24 Alternatively, absent the approval of the Settlement Agreement, counsel to the Applicants submits that the Applicants are not required to honour such benefits or make such payments and such benefits could cease immediately. This would cause undue hardship to beneficiaries and increased uncertainty for the Applicants and other stakeholders.

25 The Applicants state that a central objective in the Settlement Agreement is to allow the Former and LTD Employees to transition to other sources of support.

26 In the absence of the approval of the Settlement Agreement or some other agreement, a cessation of benefits will occur on March 31, 2010 which would have an immediate negative impact on Former and LTD Employees. The Applicants submit that extending payments to the end of 2010 is the best available option to allow recipients to order their affairs.

27 Counsel to the Applicants submits that the Settlement Agreement brings Nortel closer to finalizing a plan of arrangement, which is consistent with the sprit and purpose of the CCAA. The Settlement Agreement resolves uncertainties associated with the outstanding Former and LTD Employee claims. The Settlement Agreement balances certainty with clarity, removing litigation risk over priority of claims, which properly balances the interests of the parties, including both creditors and debtors.

28 Regarding the priority of claims going forward, the Applicants submit that because a deemed trust, such as the HWT, is not enforceable in bankruptcy, the Former and LTD Employees are by default *pari passu* with other unsecured creditors.

29 In response to the Noteholders' concern that bankruptcy prior to October 2010 would create pension liabilities on the estate, the Applicants committed that they would not voluntarily enter into bankruptcy proceedings prior to October 2010. Further, counsel to the Applicants submits the court determines whether a bankruptcy order should be made if involuntary proceedings are commenced.

30 Further, counsel to the Applicants submits that the court has the jurisdiction to **release** third parties under a Settlement Agreement where the releases (1) are connected to a resolution of the debtor's claims, (2) will benefit creditors generally and (3) are not overly broad or offensive to public policy. See *Re Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 92 O.R. (3d) 513 (C.A.), [*Metcalfe*] at para. 71, leave to appeal refused, [2008] S.C.C.A. No. 337 and *Re Grace* [2008] O.J. No. 4208 (S.C.J.) [*Grace 2008*] at para. 40.

31 The Applicants submit that a settlement of the type put forward should be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all the circumstances. Elements of fairness and reasonableness include balancing the interests of parties, including any objecting creditor or creditors, equitably (although not necessarily equally); and ensuring that the agreement is beneficial to the debtor and its stakeholders generally, as per *Re Air Canada*, [2003] O.J. No. 5319 (S.C.J.) [*Air Canada*]. The Applicants assert that this test is met.

The Monitor

32 The Monitor supports the Settlement Agreement, submitting that it is necessary to allow the Applicants to wind down operations and to develop a plan of arrangement. The Monitor submits that the Settlement Agreement provides certainty, and does so with input from employee stakeholders. These stakeholders are represented by Employee Representatives as mandated by the court and these Employee Representatives were given the authority to approve such settlements on behalf of their constituents.

33 The Monitor submits that Clause H.2 was bargained for, and that the employees did give up rights in order to have that clause in the Settlement Agreement; particularly, it asserts that Clause H.1 is the counterpoint to Clause H.2. In this regard, the Settlement Agreement is fair and reasonable.

34 The Monitor asserts that the court may either (1) approve the Settlement Agreement, (2) not approve the Settlement Agreement, or (3) not approve the Settlement Agreement but provide practical comments on the applicability of Clause H.2.

Former and LTD Employees

35 The Former Employees' Representatives' constituents number an estimated 19,458 people. The LTD Employees number an estimated 350 people between the LTD Employee's Representative and the CAW-Canada, less the 37 people in the Opposing LTD Employee group.

36 Representative Counsel to the Former and LTD Employees acknowledges that Nortel is insolvent, and that much uncertainty and risk comes from insolvency. They urge that the Settlement Agreement be considered within the scope of this reality. The alternative to the Settlement Agreement is costly litigation and significant uncertainty.

37 Representative Counsel submits that the Settlement Agreement is fair and reasonable for all creditors, but especially the represented employees. Counsel notes that employees under Nortel are unique creditors under these proceedings, as they are not sophisticated creditors and their personal welfare depends on receiving distributions from Nortel. The Former and LTD Employees assert that this is the best agreement they could have negotiated.

38 Representative Counsel submits that bargaining away of the right to litigate against directors and officers of the corporation, as well at the trustee of the HWT, are examples of the concessions that have been made. They also point to the giving up of the right to make priority claims upon distribution of Nortel's estate and the HWT, although the claim itself is not extinguished. In exchange, the Former and LTD Employees will receive guaranteed coverage until the end of 2010. The Former and LTD Employees submit that having money in hand today is better than uncertainty going forward, and that, on balance, this Settlement Agreement is fair and reasonable.

39 In response to allegations that **third party** releases unacceptably compromise employees' rights, Representative Counsel accepts that this was a concession, but submits that it was satisfac-

tory because the claims given up are risky, costly and very uncertain. The releases do not go beyond s. 5.1(2) of the CCAA, which disallows releases relating to misrepresentations and wrongful or oppressive conduct by directors. Releases as to deemed trust claims are also very uncertain and were acceptably given up in exchange for other considerations.

40 The Former and LTD Employees submit that the inclusion of Clause H.2 was essential to their approval of the Settlement Agreement. They characterize Clause H.2 as a no prejudice clause to protect the employees by not releasing any future potential benefit. Removing Clause H.2 from the Settlement Agreement would be not the approval of an agreement, but rather the creation of an entirely new Settlement Agreement. Counsel submits that without Clause H.2, the Former and LTD Employees would not be signatories.

CAW

41 The CAW supports the Settlement Agreement. It characterizes the agreement as Nortel's recognition that it has a moral and legal obligation to its employees, whose rights are limited by the laws in this country. The Settlement Agreement temporarily alleviates the stress and uncertainty its constituents feel over the winding up of their benefits and is satisfied with this result.

42 The CAW notes that some members feel they were not properly apprised of the facts, but all available information has been disclosed, and the concessions made by the employee groups were not made lightly.

Board of Directors

43 The Board of Directors of Nortel supports the Settlement Agreement on the basis that it is a practical resolution with compromises on both sides.

Opposing LTD Employees

44 Mr. Rochon appeared as counsel for the Opposing LTD Employees, notwithstanding that these individuals did not opt out of having Representative Counsel or were represented by the CAW. The submissions of the Opposing LTD Employees were compelling and the court extends it appreciation to Mr. Rochon and his team in co-ordinating the representatives of this group.

45 The Opposing LTD Employees put forward the position that the cessation of their benefits will lead to extreme hardship. Counsel submits that the Settlement Agreement conflicts with the spirit and purpose of the CCAA because the LTD Employees are giving up legal rights in relation to a $100 million shortfall of benefits. They urge the court to consider the unique circumstances of the LTD Employees as they are the people hardest hit by the cessation of benefits.

46 The Opposing LTD Employees assert that the HWT is a true trust, and submit that breaches of that trust create liabilities and that the claim should not be released. Specifically, they point to a $37 million shortfall in the HWT that they should be able to pursue.

47 Regarding the **third party** releases, the Opposing LTD Employees assert that Nortel is attempting to avoid the distraction of **third party** litigation, rather than look out for the best interests of the Former and LTD Employees. The Opposing LTD Employees urge the court not to **release** the only individuals the Former and LTD Employees can hold accountable for any breaches of trust. Counsel submits that Nortel has a common law duty to fund the HWT, which the Former and LTD Employees should be allowed to pursue.

48 Counsel asserts that allowing these releases (a) is not necessary and essential to the restructuring of the debtor, (b) does not relate to the insolvency process, (c) is not required for the success of the Settlement Agreement, (d) does not meet the requirement that each party contribute to the plan in a material way and (e) is overly broad and therefore not fair and reasonable.

49 Finally, the Opposing LTD Employees oppose the *pari passu* treatment they will be subjected to under the Settlement Agreement, as they have a true trust which should grant them priority in the distribution process. Counsel was not able to provide legal authority for such a submission.

50 A number of Opposing LTD Employees made in person submissions. They do not share the view that Nortel will act in their best interests, nor do they feel that the Employee Representatives or Representative Counsel have acted in their best interests. They shared feelings of uncertainty, helplessness and despair. There is affidavit evidence that certain individuals will be unable to support themselves once their benefits run out, and they will not have time to order their affairs. They expressed frustration and disappointment in the CCAA process.

UCC

51 The UCC was appointed as the representative for creditors in the U.S. Chapter 11 proceedings. It represents creditors who have significant claims against the Applicants. The UCC opposes the motion, based on the inclusion of Clause H.2, but otherwise the UCC supports the Settlement Agreement.

52 Clause H.2, the UCC submits, removes the essential element of finality that a settlement agreement is supposed to include. The UCC characterizes Clause H.2 as a take back provision; if activated, the Former and LTD Employees have compromised nothing, to the detriment of other unsecured creditors. A reservation of rights removes the finality of the Settlement Agreement.

53 The UCC claims it, not Nortel, bears the risk of Clause H.2. As the largest unsecured creditor, counsel submits that a future change to the BIA could subsume the UCC's claim to the Former and LTD Employees and the UCC could end up with nothing at all, depending on Nortel's asset sales.

Noteholders

54 The Noteholders are significant creditors of the Applicants. The Noteholders oppose the settlement because of Clause H.2, for substantially the same reasons as the UCC.

55 Counsel to the Noteholders submits that the inclusion of H.2 is prejudicial to the non-employee unsecured creditors, including the Noteholders. Counsel submits that the effect of the Settlement Agreement is to elevate the Former and LTD Employees, providing them a payout of $57 million over nine months while everyone else continues to wait, and preserves their rights in the event the laws are amended in future. Counsel to the Noteholders submits that the Noteholders forego millions of dollars while remaining exposed to future claims.

56 The Noteholders assert that a proper settlement agreement must have two elements: a real compromise, and resolution of the matters in contention. In this case, counsel submits that there is no resolution because there is no finality in that Clause H.2 creates ambiguity about the future. The very object of a Settlement Agreement, assert the Noteholders, is to avoid litigation by withdrawing claims, which this agreement does not do.

Superintendent

57 The Superintendent does not oppose the relief sought, but this position is based on the form of the Settlement Agreement that is before the Court.

Northern Trust

58 Northern Trust, the trustee of the pension plans and HWT, takes no position on the Settlement Agreement as it takes instructions from Nortel. Northern Trust indicates that an oversight left its name off the **third party release** and asks for an amendment to include it as a party released by the Settlement Agreement.

LAW AND ANALYSIS

A. Representation and Notice Were Proper

59 It is well settled that the Former Employees' Representatives and the LTD Representative (collectively, the "Settlement Employee Representatives") and Representative Counsel have the authority to represent the Former Employees and the LTD Beneficiaries for purposes of entering into the Settlement Agreement on their behalf: *see Grace 2008, supra* at para. 32.

60 The court appointed the Settlement Employee Representatives and the Representative Settlement Counsel. These appointment orders have not been varied or appealed. Unionized employees continue to be represented by the CAW. The Orders appointing the Settlement Employee Representatives expressly gave them authority to represent their constituencies "for the purpose of settling or compromising claims" in these Proceedings. Former Employees and LTD Employees were given the right to opt out of their representation by Representative Settlement Counsel. After provision of notice, only one former employee and one active employee exercised the opt-out right.

B. Effect of the Settlement Approval Order

61 In addition to the binding effect of the Settlement Agreement, many additional parties will be bound and affected by the Settlement Approval Order. Counsel to the Applicants submits that the binding nature of the Settlement Approval Order on all affected parties is a crucial element to the Settlement itself. In order to ensure all Affected Parties had notice, the Applicants obtained court approval of their proposed notice program.

62 Even absent such extensive noticing, virtually all employees of the Applicants are represented in these proceedings. In addition to the representative authority of the Settlement Employee Representatives and Representative Counsel as noted above, Orders were made authorizing a Nortel Canada Continuing Employees' Representative and Nortel Canada Continuing Employees' Representative Counsel to represent the interests of continuing employees on this motion.

63 I previously indicated that "the overriding objective of appointing representative counsel for employees is to ensure that the employees have representation in the CCAA process": *Re **Nortel Networks** Corp.,* [2009] O.J. No. 2529 at para. 16. I am satisfied that this objective has been achieved.

64 The Record establishes that the Monitor has undertaken a comprehensive notice process which has included such notice to not only the Former Employees, the LTD Employees, the unionized employees and the continuing employees but also the provincial pension regulators and has given the opportunity for any affected person to file Notices of Appearance and appear before this court on this motion.

65 I am satisfied that the notice process was properly implemented by the Monitor.

66 I am satisfied that Representative Counsel has represented their constituents' interests in accordance with their mandate, specifically, in connection with the negotiation of the Settlement Agreement and the draft Settlement Approval Order and appearance on this Motion. There have been intense discussions, correspondence and negotiations among Representative Counsel, the Monitor, the Applicants, the Superintendent, counsel to the Board of the Applicants, the Noteholder Group and the Committee with a view to developing a comprehensive settlement. NCCE's Representative Counsel have been apprised of the settlement discussions and served with notice of this Motion. Representatives have held Webinar sessions and published press releases to inform their constituents about the Settlement Agreement and this Motion.

C. Jurisdiction to Approve the Settlement Agreement

67 The CCAA is a flexible statute that is skeletal in nature. It has been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". *Re Nortel,* [2009] O.J. No. 3169 (S.C.J.) at paras. 28-29, citing *Metcalfe, supra,* at paras. 44 and 61.

68 Three sources for the court's authority to approve pre-plan agreements have been recognized:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;
(b) the power of the court to make an order "on such terms as it may impose" pursuant to s. 11(4) of the CCAA; and
(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects: see *Re Nortel,* [2009] O.J. No. 3169 (S.C.J.) at para. 30, citing *Re Canadian Red Cross Society*, [1998] O.J. No. 3306 (Gen. Div.) [*Canadian Red Cross*] at para. 43; *Metcalfe, supra* at para. 44.

69 In *Re Stelco Inc.*, (2005), 78 O.R. (3d) 254 (C.A.), the Ontario Court of Appeal considered the court's jurisdiction under the CCAA to approve agreements, determining at para. 14 that it is not limited to preserving the *status quo*. Further, agreements made prior to the finalization of a plan or compromise are valid orders for the court to approve: *Grace 2008, supra* at para. 34.

70 In these proceedings, this court has confirmed its jurisdiction to approve major transactions, including settlement agreements, during the stay period defined in the Initial Order and prior to the proposal of any plan of compromise or arrangement: see, for example, *Re Nortel*, [2009] O.J. No. 5582 (S.C.J.); *Re Nortel* [2009] O.J. 5582 (S.C.J.) and *Re Nortel*, 2010 ONSC 1096 (S.C.J.).

71 I am satisfied that this court has jurisdiction to approve transactions, including settlements, in the course of overseeing proceedings during a CCAA stay period and prior to any plan of arrangement being proposed to creditors: see *Re Calpine Canada Energy Ltd.,* [2007] A.J. No. 917 (C.A.) [*Calpine*] at para. 23, affirming [2007] A.J. No. 923 (Q.B.); *Canadian Red Cross, supra*; *Air Canada, supra*; *Grace 2008, supra,* and *Re Grace Canada* [2010] O.J. No. 62 (S.C.J.) [*Grace 2010*], leave to appeal to the C.A. refused February 19, 2010; *Re Nortel*, 2010 ONSC 1096 (S.C.J.).

D. Should the Settlement Agreement Be Approved?

72 Having been satisfied that this court has the jurisdiction to approve the Settlement Agreement, I must consider whether the Settlement Agreement *should* be approved.

73 A Settlement Agreement can be approved if it is consistent with the spirit and purpose of the CCAA and is fair and reasonable in all circumstances. What makes a settlement agreement fair and reasonable is its balancing of the interests of all parties; its equitable treatment of the parries, including creditors who are not signatories to a settlement agreement; and its benefit to the Applicant and its stakeholders generally.

i) Sprit and Purpose

74 The CCAA is a flexible instrument; part of its purpose is to allow debtors to balance the conflicting interests of stakeholders. The Former and LTD Employees are significant creditors and have a unique interest in the settlement of their claims. This Settlement Agreement brings these creditors closer to ultimate settlement while accommodating their special circumstances. It is consistent with the spirit and purpose of the CCAA.

ii) Balancing of Parties' Interests

75 There is no doubt that the Settlement Agreement is comprehensive and that it has support from a number of constituents when considered in its totality.

76 There is, however, opposition from certain constituents on two aspects of the proposed Settlement Agreement: (1) the Opposing LTD Employees take exception to the inclusion of the **third party** releases; (2) the UCC and Noteholder Groups take exception to the inclusion of Clause H.2.

Third Party Releases

77 Representative Counsel, after examining documentation pertaining to the Pension Plans and HWT, advised the Former Employees' Representatives and Disabled Employees' Representative that claims against directors of Nortel for failing to properly fund the Pension Plans were unlikely to succeed. Further, Representative Counsel advised that claims against directors or others named in the **Third Party** Releases to fund the Pension Plans were risky and could take years to resolve, perhaps unsuccessfully. This assisted the Former Employees' Representatives and the Disabled Employees' Representative in agreeing to the **Third Party** Releases.

78 The conclusions reached and the recommendations made by both the Monitor and Representative Counsel are consistent. They have been arrived at after considerable study of the issues and, in my view, it is appropriate to give significant weight to their positions.

79 In *Grace 2008, supra,* and *Grace 2010, supra,* I indicated that a Settlement Agreement entered into with Representative Counsel that contains **third party** releases is fair and reasonable where the releases are necessary and connected to a resolution of claims against the debtor, will benefit creditors generally and are not overly broad or offensive to public policy.

80 In this particular case, I am satisfied that the releases are necessary and connected to a resolution of claims against the Applicants.

81 The releases benefit creditors generally as they reduces the risk of litigation against the Applicants and their directors, protect the Applicants against potential contribution claims and indemnity claims by certain parties, including directors, officers and the HWT Trustee; and reduce the risk of delay caused by potentially complex litigation and associated depletion of assets to fund potentially significant litigation costs.

82 Further, in my view, the releases are not overly broad or offensive to public policy. The claims being released specifically relate to the subject matter of the Settlement Agreement. The parties granting the **release** receive consideration in the form of both immediate compensation and the maintenance of their rights in respect to the distribution of claims.

Clause H.2

83 The second aspect of the Settlement Agreement that is opposed is the provision known as Clause H.2. Clause H.2 provides that, in the event of a bankruptcy of the Applicants, and notwithstanding any provision of the Settlement Agreement, if there are any amendments to the BIA that change the current, relative priorities of the claims against the Applicants, no party is precluded from arguing the applicability or non-applicability of any such amendment in relation to any such claim.

84 The Noteholders and UCC assert that Clause H.2 causes the Settlement Agreement to not be a "settlement" in the true and proper sense of that term due to a lack of certainty and finality. They emphasize that Clause H.2 has the effect of undercutting the essential compromises of the Settlement Agreement in imposing an unfair risk on the non-employee creditors of NNL, including NNI, after substantial consideration has been paid to the employees.

85 This position is, in my view, well founded. The inclusion of the Clause H.2 creates, rather than eliminates, uncertainty. It creates the potential for a fundamental alteration of the Settlement Agreement.

86 The effect of the Settlement Agreement is to give the Former and LTD Employees preferred treatment for certain claims, notwithstanding that priority is not provided for in the statute nor has it been recognized in case law. In exchange for this enhanced treatment, the Former Employees and LTD Beneficiaries have made certain concessions.

87 The Former and LTD Employees recognize that substantially all of these concessions could be clawed back through Clause H.2. Specifically, they acknowledge that future Pension and HWT Claims will rank *pari passu* with the claims of other ordinary unsecured creditors, but then go on to say that should the BIA be amended, they may assert once again a priority claim.

88 Clause H.2 results in an agreement that does not provide certainty and does not provide finality of a fundamental priority issue.

89 The Settlement Parties, as well as the Noteholders and the UCC, recognize that there are benefits associated with resolving a number of employee-related issues, but the practical effect of Clause H.2 is that the issue is not fully resolved. In my view, Clause H.2 is somewhat inequitable from the standpoint of the other unsecured creditors of the Applicants. If the creditors are to be bound by the Settlement Agreement, they are entitled to know, with certainty and finality, the effect of the Settlement Agreement.

90 It is not, in my view, reasonable to require creditors to, in effect, make concessions in favour of the Former and LTD Employees today, and be subject to the uncertainty of unknown legislation in the future.

91 One of the fundamental purposes of the CCAA is to facilitate a process for a compromise of debt. A compromise needs certainty and finality. Clause H.2 does not accomplish this objective. The inclusion of Clause H.2 does not recognize that at some point settlement negotiations cease and parties bound by the settlement have to accept the outcome. A comprehensive settlement of claims

in the magnitude and complexity contemplated by the Settlement Agreement should not provide an opportunity to re-trade the deal after the fact.

92 The Settlement Agreement should be fair and reasonable in all the circumstances. It should balance the interests of the Settlement Parties and other affected constituencies equitably and should be beneficial to the Applicants and their stakeholders generally.

93 It seems to me that Clause H.2 fails to recognize the interests of the other creditors of the Applicants. These creditors have claims that rank equally with the claims of the Former Employees and LTD Employees. Each have unsecured claims against the Applicants. The Settlement Agreement provides for a transfer of funds to the benefit of the Former Employees and LTD Employees at the expense of the remaining creditors. The establishment of the Payments Charge crystallized this agreed upon preference, but Clause H.2 has the effect of not providing any certainty of outcome to the remaining creditors.

94 I do not consider Clause H.2 to be fair and reasonable in the circumstances.

95 In light of this conclusion, the Settlement Agreement cannot be approved in its current form.

96 Counsel to the Noteholder Group also made submissions that three other provisions of the Settlement Agreement were unreasonable and unfair, namely:

(i) ongoing exposure to potential liability for pension claims if a bankruptcy order is made before October 1, 2010;
(ii) provisions allowing payments made to employees to be credited against employees' claims made, rather than from future distributions or not to be credited at all; and
(iii) lack of clarity as to whether the proposed order is binding on the Superintendent in all of his capacities under the *Pension Benefits Act* and other applicable law, and not merely in his capacity as Administrator on behalf of the Pension Benefits Guarantee Fund.

97 The third concern was resolved at the hearing with the acknowledgement by counsel to the Superintendent that the proposed order would be binding on the Superintendent in all of his capacities.

98 With respect to the concern regarding the potential liability for pension claims if a bankruptcy order is made prior to October 1, 2010, counsel for the Applicants undertook that the Applicants would not take any steps to file a voluntary assignment into bankruptcy prior to October 1, 2010. Although such acknowledgment does not bind creditors from commencing involuntary bankruptcy proceedings during this time period, the granting of any bankruptcy order is preceded by a court hearing. The Noteholders would be in a position to make submissions on this point, if so advised. This concern of the Noteholders is not one that would cause me to conclude that the Settlement Agreement was unreasonable and unfair.

99 Finally, the Noteholder Group raised concerns with respect to the provision which would allow payments made to employees to be credited against employees' claims made, rather than from future distributions, or not to be credited at all. I do not view this provision as being unreasonable and unfair. Rather, it is a term of the Settlement Agreement that has been negotiated by the Settle-

ment Parties. I do note that the proposed treatment with respect to any payments does provide certainty and finality and, in my view, represents a reasonable compromise in the circumstances.

DISPOSITION

100 I recognize that the proposed Settlement Agreement was arrived at after hard-fought and lengthy negotiations. There are many positive aspects of the Settlement Agreement. I have no doubt that the parties to the Settlement Agreement consider that it represents the best agreement achievable under the circumstances. However, it is my conclusion that the inclusion of Clause H.2 results in a flawed agreement that cannot be approved.

101 I am mindful of the submission of counsel to the Former and LTD Employees that if the Settlement Agreement were approved, with Clause H.2 excluded, this would substantively alter the Settlement Agreement and would, in effect, be a creation of a settlement and not the approval of one.

102 In addition, counsel to the Superintendent indicated that the approval of the Superintendent was limited to the proposed Settlement Agreement and would not constitute approval of any altered agreement.

103 In *Grace 2008*, *supra*, I commented that a line-by-line analysis was inappropriate and that approval of a settlement agreement was to be undertaken in its entirety or not at all, at para. 74. A similar position was taken by the New Brunswick Court of Queen's Bench in *Wandlyn Inns Limited (Re)* (1992), 15 C.B.R. (3d) 316. I see no reason or basis to deviate from this position.

104 Accordingly, the motion is dismissed.

105 In view of the timing of the timing of the **release** of this decision and the functional funding deadline of March 31, 2010, the court will make every effort to accommodate the parties if further directions are required.

106 Finally, I would like to express my appreciation to all counsel and in person parties for the quality of written and oral submissions.

G.B. MORAWETZ J.

cp/e/qlrxg/qlpxm/qlaxw/qlced/qljyw

1 On March 25, 2010, the Supreme Court of Canada released the following: *Donald Sproule et al. v. **Nortel Networks** Corporation et al.* (Ont.) (Civil) (By Leave) (33491) (The motions for directions and to expedite the application for leave to appeal are dismissed. The application for leave to appeal is dismissed with no order as to costs./La requête en vue d'obtenir des directives et la requête visant à accélérer la procédure de demande d'autorisation d'appel sont rejetées. La demande d'autorisation d'appel est rejetée; aucune ordonnance n'est rendue concernant les dépens.): <http://scc.lexum.umontreal.ca/en/news_**release**/2010/10-03-25.3 a/10-03-25.3a.html>

Tab 18

Case Name:

R. v. Malmo-Levine; R. v. Caine

David Malmo-Levine, appellant;
v.
Her Majesty The Queen, respondent, and Attorney General of Ontario, British Columbia Civil Liberties Association and Canadian Civil Liberties Association, interveners
And between
Victor Eugene Caine, appellant;
v.
Her Majesty The Queen, respondent, and Attorney General of Ontario, British Columbia Civil Liberties Association and Canadian Civil Liberties Association, interveners.

[2003] S.C.J. No. 79

[2003] A.C.S. no 79

2003 SCC 74

2003 CSC 74

[2003] 3 S.C.R. 571

[2003] 3 R.C.S. 571

233 D.L.R. (4th) 415

314 N.R. 1

[2004] 4 W.W.R. 407

J.E. 2004-131

191 B.C.A.C. 1

23 B.C.L.R. (4th) 1

179 C.C.C. (3d) 417

16 C.R. (6th) 1

114 C.R.R. (2d) 189

59 W.C.B. (2d) 116

File Nos.: 28026, 28148.

Supreme Court of Canada

Heard: May 6, 2003;
Judgment: December 23, 2003.

Present: McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache, Binnie, Arbour, LeBel and Deschamps JJ.

(304 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Catchwords:

Constitutional law -- Charter of Rights -- Fundamental justice -- Liberty and security of person -- Narcotic Control Act prohibiting possession of marihuana -- Imprisonment available as penalty for simple possession -- Whether prohibition infringes s. 7 of Canadian Charter of Rights and Freedoms -- Narcotic Control Act, R.S.C. 1985, c. N-1, s. 3(1), Schedule.

Constitutional law -- Charter of Rights -- Equality rights -- Narcotic Control Act prohibiting possession of marihuana for purpose of trafficking -- Whether prohibition infringes s. 15 of Canadian Charter of Rights and Freedoms -- Narcotic Control Act, R.S.C. 1985, c. N-1, s. 4(2), Schedule.

Constitutional law -- Division of powers -- Criminal law -- Narcotic Control Act prohibiting possession of marihuana -- Whether prohibition within legislative competence of Parliament -- Constitution Act, 1867, s. 91(27).

Summary:

Two RCMP officers on regular patrol observed C and a male passenger sitting in a van by the ocean. As the officers approached, C, who was in the driver's seat, started the engine and began to back up. As one of the officers came alongside the van, he smelled a strong odour of recently smoked marihuana. C produced for the officer a partially smoked joint which weighed 0.5 gram. He possessed the joint for his own use and not for any other purpose. The former *Narcotic Control Act*

states in s. 3(1) that "[e]xcept as authorized by this Act or the regulations, no person shall have a narcotic in his possession". Narcotics are defined in the schedules to the Act. Marihuana is a scheduled drug. The penalty on summary conviction for possession of marihuana is a maximum fine of $1,000 or imprisonment for up to six months or both for a first offence and a maximum fine of $2,000 or imprisonment for up to one year or both for a subsequent offence. C's application for a declaration that the provisions of the *Narcotic Control Act* prohibiting the possession of marihuana were unconstitutional was denied at trial. He was convicted of simple possession. The Court of Appeal, in a majority decision, upheld the conviction.

M, who describes himself as a "marihuana/freedom activist", helps operate an organization known as the Harm Reduction Club, a co-operative, non-profit association which recognizes some potential harm associated with the use of marihuana and seeks to reduce it. In December 1996, police entered the premises of the Club and seized over 300 grams of marihuana, much of it in the form of "joints". M was charged with possession of marihuana for the purpose of trafficking under s. 4(2) of the former *Narcotic Control Act*. At trial, M sought to call evidence in support of a constitutional challenge but the trial judge refused to admit the evidence and dismissed the challenge. M was convicted and the Court of Appeal, in a majority decision, upheld the conviction.

Held (Arbour, LeBel and Deschamps JJ. dissenting on C's appeal): The appeals should be dismissed.

Per McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache and Binnie JJ.: All sides agree that marihuana is a psychoactive drug which "causes alteration of mental function". That, indeed, is the purpose for which the accused use it. There are concurrent findings in the courts below of "harm" that is neither insignificant nor trivial. Certain groups in society share a particular vulnerability to its effects. While members of these groups, whose identity cannot in general be distinguished from other users in advance, are relatively small as a percentage of all marihuana users, their numbers are significant in absolute terms. The trial judge in C's case estimated "chronic users" to number about 50,000. Pregnant women and schizophrenics are also said to be at particular risk. Advancing the protection of these and other vulnerable individuals through criminalization of the possession of marihuana is a policy choice that falls within the broad legislative scope conferred on Parliament. Equally, it is open to Parliament to decriminalize or otherwise modify any aspect of the marihuana laws that it no longer considers to be good public policy.

The questions before the Court are issues of law, not policy, namely whether the prohibition, including the availability of imprisonment for simple possession, is not valid legislation, either because it does not properly fall within Parliament's legislative competence, or because the prohibition, and in particular the availability of imprisonment, violate the guarantees of the *Canadian Charter of Rights and Freedoms*.

Control of a psychoactive drug that causes alteration in mental functions raises issues of public health and safety, both for the user and for those in the broader society affected by his or her conduct. The use of marihuana is therefore a proper subject matter for the exercise of the criminal law power. The federal criminal law power is plenary in nature and has been broadly construed. For a law to be classified as a criminal law, it must have a valid criminal law purpose backed by a prohibition and a penalty. The criminal power extends to those laws that are designed to promote public peace, safety, order, health or some other legitimate public purpose. The purpose of the *Narcotic Control Act* fits within the criminal law power, which includes the protection of vulnerable groups. The conclusion that the present prohibition against the use of marihuana can be supported under the

criminal law power makes it unnecessary to deal with whether it also falls under the peace, order and good government power.

The availability of imprisonment for the offence of simple possession of marihuana is sufficient to trigger scrutiny under s. 7 of the *Charter*. However, M's desire to build a lifestyle around the recreational use of marihuana does not attract *Charter* protection.

For a rule or principle to constitute a principle of fundamental justice for the purposes of s. 7, it must be a legal principle about which there is significant societal consensus that it is fundamental to the way in which the legal system ought fairly to operate, and it must be identified with sufficient precision to yield a manageable standard against which to measure deprivations of life, liberty or security of the person.

The delineation of the principles of fundamental justice must inevitably take into account the social nature of our collective existence. To that limited extent, societal values play a role in the delineation of the boundaries of the rights and principles in question. However, the balancing of individual and societal interests within s. 7 is only relevant when elucidating a particular principle of fundamental justice. That done, it is not within the ambit of s. 7 to bring into account such "societal interests" as health care costs. Those considerations will be looked at, if at all, under s. 1.

Even if the "harm principle" relied upon by the accused could be characterized as a legal principle, it does not meet the other requirements. First, there is no sufficient consensus that the harm principle is vital or fundamental to our societal notion of criminal justice. While the presence of harm to others may justify legislative action under the criminal law power, the absence of proven harm does not create an unqualified s. 7 barrier to legislative action. Nor is there any consensus that the distinction between harm to others and harm to self is of controlling importance. Finally, the harm principle is not a manageable standard against which to measure deprivation of life, liberty or security of the person.

While the "harm principle" is not a principle of fundamental justice, the state nevertheless has an interest in the avoidance of harm to those subject to its laws which may justify legislative action. Harm need not be shown to the court's satisfaction to be "serious and substantial" before Parliament can impose a prohibition. Once it is demonstrated, as it has been here, that the harm is not *de minimis*, or not "insignificant or trivial", the precise weighing and calculation of the nature and extent of the harm is Parliament's job.

A criminal law that is shown to be arbitrary or irrational will infringe s. 7. However, in light of the state interest in the avoidance of harm to its citizens, the prohibition on marihuana possession is neither arbitrary nor irrational. Marihuana is a psychoactive drug whose "use causes alteration of mental function", according to the trial judge in C's case. This alteration creates a potential harm to others when the user engages in driving, flying and other activities involving complex machinery. Chronic users may suffer "serious" health problems. Vulnerable groups are at particular risk, including adolescents with a history of poor school performance, pregnant women and persons with pre-existing conditions such as cardiovascular diseases, respiratory diseases, schizophrenia or other drug dependencies. These findings of fact disclose a sufficient state interest to support Parliament's intervention should Parliament decide that it is wise to continue to intervene, subject to a constitutional standard of gross disproportionality. While Parliament has directly addressed some of the potential harmful conduct elsewhere in the *Criminal Code*, one type of legal control to prevent harm does not logically oust other potential forms of legal control, subject as always to the limitation of

gross disproportionality. Moreover, Parliament's decision to move in one area of public health and safety without at the same time moving in other areas (e.g., alcohol or tobacco) is not, on that account alone, arbitrary or irrational.

The issue of punishment should be approached in light of s. 12 of the *Charter* (which protects against "cruel and unusual treatment or punishment"), and, in that regard, the constitutional standard is one of gross disproportionality. The lack of any mandatory minimum sentence together with the existence of well-established sentencing principles mean that the mere availability of imprisonment on a marihuana charge cannot, without more, violate the principle against gross disproportionality.

A finding that a particular form of penalty violates s. 12 of the *Charter* may call for a constitutional remedy in relation to the penalty, but leave intact the criminalization of the conduct, which may still be constitutionally punishable by an alternative form of penalty.

The operative concept here is the use of incarceration, not the availability of incarceration. Possession of marihuana carries no minimum sentence. In most possession cases, offenders (whether vulnerable or not) receive discharges or conditional sentences. This is particularly true where the amounts of marihuana involved are small and for recreational uses, where the usual sentence is a conditional discharge. There is no impediment in the legislation to a trial judge imposing a fit sentence after a conviction for simple possession of marihuana.

The "availability" of imprisonment in respect of the scheduled drugs under the *Narcotic Control Act* is part of a statutory framework for dealing with drugs generally and is not specifically directed at marihuana. The case law discloses that it is only in the presence of aggravating circumstances, not likely to be present in the situation of "vulnerable persons", where a court has been persuaded that imprisonment for simple possession of marihuana was, in the particular case, a fit sentence. There is no need to turn to the *Charter* for relief against an unfit sentence. If imprisonment is not a fit sentence in a particular case it will not be imposed, and if imposed, it will be reversed on appeal.

The effects on the accused of enforcement of the prohibition are not so grossly disproportionate that they render the prohibition on marihuana possession contrary to s. 7 of the *Charter*. The consequences complained of by the accused are largely the product of deliberate disobedience to the law of the land. If the court imposes a sentence on conviction that is no more than a fit sentence, which it is required to do, the other adverse consequences of conviction are really associated with the criminal justice system in general rather than this offence in particular. In any system of criminal law there will be prosecutions that turn out to be unfounded, publicity that is unfairly adverse, costs associated with a successful defence, lingering and perhaps unfair consequences attached to a conviction for a relatively minor offence by other jurisdictions, and so on. These effects are serious but they are part of the social and individual costs of having a criminal justice system. Whenever Parliament exercises its criminal law power, such costs will arise. To suggest that such "inherent" costs are fatal to the exercise of the power is to overshoot the function of s. 7.

Applying a standard of gross disproportionality, the effects on accused persons of the present law, including the potential of imprisonment, fall within the broad latitude within which the Constitution permits legislative action.

The so-called "ineffectiveness" of the prohibition on marihuana possession is simply another way of characterizing a refusal to comply with the law. That refusal cannot be elevated to a constitutional argument against validity based on the invocation of fundamental principles of justice. Moreover, balancing the law's salutary and deleterious effects is a function that is more properly reserved for s.

1. As the accused have not established an infringement of s. 7, there is no need to call on the government for a s. 1 justification.

M's equality claim must fail. Prohibiting possession of marihuana for the purpose of trafficking does not infringe s. 15(1) of the *Charter*. A taste for marihuana is not a "personal characteristic" in the sense required to trigger s. 15 protection, but is a lifestyle choice that bears no analogy with the personal characteristics listed.

In the circumstances of M's case, the trial judge erred in excluding the expert evidence of legislative and constitutional facts M wished to adduce, which was relevant to his challenge under the *Charter*. While the trial judge was clearly unimpressed by what M wished to establish, in the circumstances he ought to have admitted the evidence, despite his misgivings, so as to permit M to put forward a full record in the event of an appeal. The complications that would otherwise have attended the hearing of the appeal, however, were obviated by the parties' agreement to treat C's evidence of legislative fact as equally applicable to M's appeal. In the result, the trial judge's error did not prejudice M.

Per Arbour J. (dissenting on C's appeal): The impugned provisions fall under the criminal law head of power. As long as the legislation is directed at a legitimate public health evil and contains a prohibition accompanied by a penal sanction, and provided that it is not otherwise a "colourable" intrusion upon provincial jurisdiction, Parliament has, under s. 91(27) of the *Constitution Act, 1867*, discretion to determine the extent of the harm it considers sufficient for legislative action. However, where Parliament relies on the protection of health as its legitimate public purpose, it has to demonstrate the injurious or undesirable effect from which it seeks to safeguard the public. While there is no constitutional threshold level of harm required before Parliament may use its broad criminal law power, conduct with little or no threat of harm is unlikely to qualify as a public health evil.

A law that has the potential to imprison a person whose conduct causes little or no reasoned risk of harm to others offends the principles of fundamental justice. Such a law violates a person's right to liberty under s. 7 of the *Charter*. Be it as a criminal sanction or as a sanction to any other prohibition, imprisonment must, as a constitutional minimum standard, be reserved for those whose conduct causes a reasoned risk of harm to others. In victimizing conduct, the attribution of fault is relatively straightforward because of the close links between the actor's culpable conduct and the resulting harm to the victim. Harm caused to collective interests, as opposed to harm caused to identifiable individuals, is not easy to quantify and even less easy to impute to a distinguishable activity or actor. In order to determine whether specific conduct, which perhaps only causes direct harm to the actor, or which seems rather benign, causes more than little or no risk of harm to others, courts must assess the interest of society in prohibiting and sanctioning the conduct. "Societal interests" may indeed form part of the s. 7 analysis where the operative principle of fundamental justice necessarily involves issues like the protection of society. Societal interests in prohibiting conduct are evaluated by balancing the harmful effects on society should the conduct in question not be prohibited by law against the effects of prohibiting the conduct. The harm or risk of harm to society caused by the prohibited conduct must outweigh any harm that may result from enforcement.

The harm associated with marihuana use does not justify the state's decision to use imprisonment as a sanction against the prohibition of its possession. Apart from the risks of impairment while driving, flying or operating complex machinery and the impact of marihuana use on the health care and welfare systems, the harms associated with marihuana use are exclusively health risks for the individual user, ranging from almost non-existent for low/occasional/moderate users of marihuana to

relatively significant for chronic users. Harm to self does not satisfy the constitutional requirement that whenever the state resorts to imprisonment, there must be a minimum harm to others as an essential part of the offence.

The majority argue that the potential for imprisonment of members of vulnerable groups is not serious, since it is only in the "presence of aggravating circumstances" that imprisonment for possession will be a fit sentence. This does not strengthen their position; it highlights the difficulty. By their reasoning, it is those who are not members of vulnerable groups and who therefore pose no more than negligible harm to themselves or others who face the threat of imprisonment due to "aggravating circumstances". The position that the fitness of sentences for possession should be considered under s. 12, and not under s. 7, runs counter to the notion that ss. 8 to 14 of the *Charter* are specific illustrations of the principles of fundamental justice. Where a principle of fundamental justice is invoked which is not specifically set out in ss. 8 to 12, the analysis is appropriately conducted pursuant to s. 7.

Sending vulnerable people to jail to protect them from self-inflicted harm does not respect the harm principle as a principle of fundamental justice. Similarly, the fact that some vulnerable people may harm themselves by using marihuana is not a sufficient justification to send other members of the population to jail for engaging in that activity. The state cannot prevent the general population, under threat of imprisonment, from engaging in conduct that is harmless to them, on the basis that other, more vulnerable persons may harm themselves if they engage in it, particularly if one accepts that imprisonment would be inappropriate for the targeted vulnerable groups.

The two spheres of risks to others identified by the trial judges are not sufficient to justify recourse to the most severe penalty imposed by law, a sentence generally viewed as a last resort. First, while the risk that persons experiencing the acute effects of the drug may be less adept at driving, flying and engaging in other activities involving complex machinery is indeed a valid concern, the act of driving while under the influence of alcohol or drugs is a separate activity from mere possession and use. Dangerous driving is already dealt with in the *Criminal Code*, and rightly so, because it is this act which risks victimizing identifiable others as well as society as a whole. The second negative effect on society as a whole that was identified, i.e., general harm to the health care and welfare systems, is just too remote and minor to justify the threat of imprisonment for simple possession of marihuana. Canadians do not expect to face the prospect of imprisonment whenever they embark on some adventure which involves a possibility of injury to themselves. There is no reason to single out those who may jeopardize their health by smoking marihuana. If there remained any doubt as to whether the harms associated with marihuana use justify the state in using imprisonment as a sanction against its possession, this doubt disappears when the harms caused by the prohibition are put in the balance. The record shows, and the trial judges found, that the prohibition of simple possession of marihuana attempts to prevent a low quantum of harm to society at a very high cost. A negligible burden on the health care and welfare systems, coupled with the many significant negative effects of the prohibition, do not amount to more than little or no reasoned risk of harm to society.

As found by the majority, the prohibition of possession for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act* does not discriminate against M in violation of s. 15 of the *Charter* since the decision to possess and traffic in marihuana is not an immutable personal characteristic, and treating persons who choose to do so in a differential manner in no way infringes human dignity or reinforces prejudicial stereotypes or historical disadvantage. On the record, M's constitutional challenge to the prohibition of possession for the purpose of trafficking based on s. 7 fails.

The Crown has not made any submissions regarding s. 1 of the *Charter*, and none of the courts below considered the issue. The burden is on the Crown to establish that the infringement was justified under s. 1. It has not met this burden.

Per LeBel J. (dissenting on C's appeal): There was agreement with the majority that the harm principle should not be raised to the level of a principle of fundamental justice within the meaning of s. 7 of the *Charter*. However, fundamental rights are at stake and were breached and this Court must intervene as part of its constitutional duty to uphold the fundamental principles of our constitutional order. On the available evidence, the law, as it stands, is an arbitrary response to social problems. The Crown has failed to properly delineate the societal concerns and individual rights at stake, more particularly the liberty interest involved in this appeal. A breach of fundamental rights is made out if and when the response to a societal problem may overreach in such a way as to taint the particular legislative response with arbitrariness. Such a legislative overreach happened here. While it cannot be denied that marihuana can cause problems of varying nature and severity to some people or to groups of them, the harm its consumption may cause seems rather mild on the evidence available. On the other hand, the harm and the problems connected with the form of criminalization chosen by Parliament seem plain and important. Few people appear to be jailed for simple possession but the law remains on the books. The reluctance to enforce it to the extent of actually jailing people for the offence of simple possession seems consistent with the perception that the law as it stands amounts to some sort of legislative overreach to the apprehended problems associated with marihuana consumption. Moreover, besides the availability of jail as a punishment, the enforcement of the law has tarred hundreds of thousands of Canadians with the stigma of a criminal record. The fundamental liberty interest has thus been infringed by the adoption and implementation of a legislative response which is disproportionate to the societal problems at issue and therefore arbitrary, in breach of s. 7 of the *Charter*.

Per Deschamps J. (dissenting on C's appeal): Whether pursuant to its jurisdiction over peace, order and good government or under its criminal law power, the prohibition of the possession of drugs lies within Parliament's jurisdiction.

The "harm principle" cannot validly be characterized as a principle of fundamental justice within the meaning of s. 7 of the *Charter*. The criminal law finds its justification in the protection of society, both as a whole and in its individual components. While there can be no doubt that the state is justified in using its criminal law tools to prevent harm to others, the "harm principle" is too narrow to encompass all the elements that may place limits on the state's exercise of the criminal law.

The inclusion of cannabis in the schedule to the *Narcotic Control Act* infringes the accused's right to liberty without regard for the principles of fundamental justice. For the state to be able to justify limiting an individual's liberty, the legislation upon which it bases its actions must not be arbitrary. In this case, the legislation is arbitrary. First, it seems doubtful that it is appropriate to classify marihuana consumption as conduct giving rise to a legitimate use of the criminal law in light of the *Charter*, since, apart from the risks related to the operation of vehicles and the impact on public health care and social assistance systems, the moderate use of marihuana is on the whole harmless. Second, in view of the availability of more tailored methods, the choice of the criminal law for controlling conduct that causes little harm to moderate users or to control high-risk groups for whom the effectiveness of deterrence or correction is highly dubious is out of keeping with Canadian society's standards of justice. Third, the harm caused by prohibiting marihuana is fundamentally dispro-

portionate to the problems that the state seeks to suppress. This harm far outweighs the benefits that the prohibition can bring.

Since the Crown did not attempt to justify the prohibition under s. 1 of the *Charter*, it has not satisfied its burden.

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History and Disposition:

APPEALS from a judgment of the British Columbia Court of Appeal (2000), 138 B.C.A.C. 218, 226 W.A.C. 218, 145 C.C.C. (3d) 225, 34 C.R. (5th) 91, 74 C.R.R. (2d) 189, [2000] B.C.J. No. 1095 (QL), 2000 BCCA 335, affirming the decision of the British Columbia Supreme Court in R. v.

Malmo-Levine (1998), 54 C.R.R. (2d) 291, [1998] B.C.J. No. 1025 (QL), and the decision of the Provincial Court in R. v. Caine, [1998] B.C.J. No. 885 (QL). Appeal in Malmo-Levine dismissed. Appeal in Caine dismissed, Arbour, LeBel and Deschamps JJ. dissenting.

Counsel:

David Malmo-Levine, on his own behalf.

John W. Conroy, Q.C., for the appellant Caine.

S. David Frankel, Q.C., Kevin Wilson and W. Paul Riley, for the respondent.

Milan Rupic, for the intervener the Attorney General of Ontario.

Joseph J. Arvay, Q.C., for the intervener the British Columbia Civil Liberties Association.

Andrew K. Lokan and Andrew C. Lewis, for the intervener the Canadian Civil Liberties Association.

The judgment of McLachlin C.J. and Gonthier, Iacobucci, Major, Bastarache and Binnie JJ. was delivered by

1 **GONTHIER and BINNIE JJ.**:-- In these appeals, the Court is required to consider whether Parliament has the legislative authority to criminalize simple possession of marihuana and, if so, whether that power has been exercised in a manner that is contrary to the *Canadian Charter of Rights and Freedoms*. The appellant Caine argues in particular that it is a violation of the principles of fundamental justice for Parliament to provide for a term of imprisonment as a sentence for conduct which he says results in little or no harm to other people. The appellant Malmo-Levine puts in issue the constitutional validity of the prohibition against possession for the purpose of trafficking in marihuana.

2 The British Columbia Court of Appeal rejected the appellants' challenges to the relevant provisions of the *Narcotic Control Act*, R.S.C. 1985, c. N-1 ("NCA"), and, in our view, it was right to do so. Upholding as we do the constitutional validity of the simple possession offence, it follows, for the same reasons, that Malmo-Levine's challenge to the prohibition against possession for the purpose of trafficking must also be rejected.

3 All sides agree that marihuana is a psychoactive drug which "causes alteration of mental function". That, indeed, is the purpose for which the appellants use it. Certain groups in society share a particular vulnerability to its effects. While members of these groups, whose identity cannot in general be distinguished from other users in advance, are relatively small as a percentage of all marihuana users, their numbers are significant in absolute terms. The trial judge estimated "chronic users" to number about 50,000. A recent Senate Special Committee report estimated users under 16 (which may overlap to some extent with the chronic user group) also at 50,000 individuals (*Cannabis: Our Position for a Canadian Public Policy* (2002) (the "Senate Committee Report"), vol. I, at pp. 165-66). Pregnant women and schizophrenics are also said to be at particular risk. Advancing the protection of these vulnerable individuals, in our opinion, is a policy choice that falls within the broad legislative scope conferred on Parliament.

4 A conviction for the possession of marihuana for personal use carries no mandatory minimum sentence. In practice, most first offenders are given a conditional discharge. Imprisonment is generally reserved for situations that also involve trafficking or hard drugs. Except in very exceptional circumstances, imprisonment for simple possession of marihuana would constitute a demonstrably unfit sentence and, if imposed, would rightly be set aside on appeal. Availability of imprisonment in a statute that deals with a wide variety of drugs from opium and heroin to crack and cocaine is not unconstitutional, and its rare imposition for marihuana offences (as a scheduled drug) can and should be dealt with under ordinary sentencing principles. A fit sentence, by definition, complies with s. 7 of the *Charter*. The mere fact of the *availability* of imprisonment in a statute dealing with a variety of prohibited drugs does not, in our view, make the criminalization of possession of a psychoactive drug like marihuana contrary to the principles of fundamental justice.

5 The appellants have assembled much evidence and argument attacking the wisdom of the criminalization of simple possession of marihuana. They say that the line between criminal and non-criminal conduct has been drawn inappropriately and that the evil effects of the law against marihuana outweigh the benefits, if any, associated with its prohibition. These are matters of legitimate controversy, but the outcome of that debate is not for the courts to determine. The Constitution provides no more than a framework. Challenges to the wisdom of a legislative measure within that framework should be addressed to Parliament. Our concern is solely with the issue of constitutionality. We conclude that it is within Parliament's legislative jurisdiction to criminalize the possession of marihuana should it choose to do so. Equally, it is open to Parliament to decriminalize or otherwise modify any aspect of the marihuana laws that it no longer considers to be good public policy.

6 The appeals are therefore dismissed.

I. Facts

A. *Malmo-Levine*

7 The appellant describes himself as a "marihuana/freedom activist". Self-represented in these proceedings, his primary concern is with interference by the state in what he believes to be the personal autonomy of its citizens. He stated in his oral argument:

> I'm part of a growing number of such activists, who view cannabis re-legalization as a key part of protecting human rights and our Mother Earth, while, at the same time, helping to end [the] war on poverty.
>
> As you can see, I'm not a lawyer. I am, however, a cannabis user and a researcher, and I would like very much to be a cannabis retailer and perhaps grow a few plants.

8 Malmo-Levine does not deny that marihuana use can have harmful effects. On the contrary, since October 1996, he has helped operate an organization in East Vancouver known as the "Harm Reduction Club", a co-operative, non-profit association which recognizes some potential harm associated with the use of marihuana and seeks to reduce it. The stated object of the Club is to educate its users and the general public about marihuana and provide unadulterated marihuana at cost. It provides instruction about safe smoking habits "to minimize any harm from the use of marihuana",

and requires its members to pledge not to operate motor vehicles or heavy equipment while under its influence.

9 On December 4, 1996, police entered the premises of the Harm Reduction Club and seized 316 grams of marihuana, much of it in the form of "joints". The appellant was charged with possession of cannabis (marihuana) for the purpose of trafficking. At trial, he sought to call evidence in support of a constitutional challenge but the trial judge refused to admit the evidence. On appeal, the majority of the Court of Appeal dismissed the appeal, Prowse J.A. dissenting.

B. *Caine*

10 On June 13, 1993, two RCMP officers on regular patrol observed the appellant and a male passenger sitting in a van by the ocean at White Rock, B.C. As the officers approached, the appellant, who was seated in the driver's seat, started the engine and began to back up. As one of the officers came alongside the van, he smelled a strong odour of recently smoked marihuana. The appellant Caine produced for the officer a partially smoked cigarette of marihuana that weighed 0.5 gram. He possessed the marihuana cigarette for his own use and not for any other purpose.

11 The appellant Caine's application for a declaration that the provisions of the NCA prohibiting the possession of marihuana were unconstitutional was denied at trial. The appeal was also dismissed, Prowse J.A. dissenting.

II. Relevant Statutory and Constitutional Provisions

Narcotic Control Act, R.S.C. 1985, c. N-1 (repealed S.C. 1996, c. 19, s. 94, effective May 14, 1997 (SI/97-47))

12 Section 2 of the NCA defines "marihuana" as *Cannabis sativa* L. and a "narcotic" as "any substance included in the schedule or anything that contains any substance included in the schedule". Marihuana became a scheduled drug when *The Opium and Narcotic Drug Act, 1923*, S.C. 1923, c. 22 (the predecessor to the NCA) was enacted by Parliament. The relevant provisions of the NCA, impugned insofar as they relate to the simple possession and use of marihuana, state:

> **3.**(1) Except as authorized by this Act or the regulations, no person shall have a narcotic in his possession.
>
> (2) Every person who contravenes subsection (1) is guilty of an offence and liable
>
> (*a*) on summary conviction for a first offence, to a fine not exceeding one thousand dollars or to imprisonment for a term not exceeding six months or to both and, for a subsequent offence, to a fine not exceeding two thousand dollars or to imprisonment for a term not exceeding one year or to both; or
>
> (*b*) on conviction on indictment, to imprisonment for a term not exceeding seven years.
>
> ...

Schedule

...

3. *Cannabis sativa*, its preparations, derivatives and similar synthetic preparations, including:

(1) Cannabis resin,
(2) Cannabis (marihuana),
(3) Cannabidiol,
(4) Cannabinol (3-n-amyl-6,6,9-trimethyl-6-dibenzopyran-l-ol),
(4.1) Nabilone (([plus or minus])-trans-3 (1,1-dimethylheptyl)-6, 6a, 7, 8, 10, 10a-hexahydro-1-hydroxy-6,6-dimethyl-9H-dibenzo[b,d] pyran-9-one),
(5) Pyrahexyl (3-n-hexyl-6,6,9-trimethyl-7,8, 9,10-tetrahydro-6-dibenzopyran-l-ol), and
(6) Tetrahydrocannabinol,

but not including:

(7) non-viable Cannabis seed.

Canadian Charter of Rights and Freedoms

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

Constitution Act, 1867

91. It shall be lawful for the Queen, by and with the Advice and Consent of the Senate and House of Commons, to make Laws for the Peace, Order, and good Government of Canada, in relation to all Matters not coming within the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces; and for greater Certainty, but not so as to restrict the Generality of the foregoing Terms of this Section, it is hereby declared that (notwithstanding anything in this Act) the exclusive Legislative Authority of the Parliament of Canada extends to all Matters coming within the Classes of Subjects next herein-after enumerated; that is to say, --

...

27. The Criminal Law, except the Constitution of Courts of Criminal Jurisdiction, but including the Procedure in Criminal Matters.

III. Judicial History

A. *Trial Court*

1. Malmo-Levine (1998), 54 C.R.R. (2d) 291 (B.C.S.C.)

13 Curtis J., after a lengthy *voir dire*, refused to hear evidence tendered to show the offence of possession of marihuana for the purpose of trafficking to be unconstitutional. He found that the proposed evidence was not relevant to his analysis under s. 7 of the *Charter*.

14 In his view, the freedom to use marihuana is not a matter of fundamental, personal importance, and such use is therefore not protected by s. 7 of the *Charter*. "There being no right to use marijuana created by the right to life, liberty and security of the person, the question of the principles of fundamental justice need not be considered" (p. 295). Malmo-Levine was subsequently convicted under s. 4(2) of the NCA for possession of marihuana for the purpose of trafficking.

2. Caine, [1998] B.C.J. No. 885 (QL) (Prov. Ct.)

15 Howard Prov. Ct. J. heard extensive evidence about the alleged harm caused by marihuana. We will address her careful findings of fact in this regard later in these reasons. In the end, she held that she was bound by the decision in *Malmo-Levine* that the NCA did not infringe s. 7. Caine was therefore convicted under s. 3 of the NCA for simple possession.

B. *British Columbia Court of Appeal* (2000), 138 B.C.A.C. 218, 2000 BCCA 335

1. Braidwood J.A.

16 Braidwood J.A., Rowles J.A. concurring, concluded that the "harm principle" was a principle of fundamental justice within the meaning of s. 7. "[The harm principle] is a legal principle and it is concise. Moreover, there is a consensus among reasonable people that it is vital to our system of justice. Indeed, I think that it is common sense that you don't go to jail unless there is a potential that your activities will cause harm to others" (para. 134).

17 In the result, however, he judged that the deprivation of the appellants' liberty caused by the penal provisions of the NCA was in accordance with the harm principle, and did not violate s. 7: "It is for Parliament to determine what level of risk is acceptable and what level of risk requires action. The *Charter* only demands ... a 'reasoned apprehension of harm' that is not [in]significant or trivial. The appellants have not convinced me that such harm is absent in this case" (para. 158). He therefore dismissed the appeals.

2. Prowse J.A. (dissenting)

18 Prowse J.A. disagreed that the threshold of harm justifying parliamentary intervention is harm that is "not insignificant or trivial". In her view, harm must be "serious" and "substantial" to survive a *Charter* challenge. She concluded that s. 3(1) of the NCA breached the appellants' s. 7 *Charter* rights in a manner inconsistent with a principle of fundamental justice. She would have adjourned the proceedings to permit counsel to make further submissions with respect to the justification of the breach under s. 1 of the *Charter*.

IV. Constitutional Questions

19 On October 19, 2001, the Chief Justice stated the following constitutional questions in the case of *R. v. Caine*:

1. Does prohibiting possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 7 of the *Canadian Charter of Rights and Freedoms*?
2. If the answer to Question 1 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?
3. Is the prohibition on the possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), within the legislative competence of the Parliament of Canada as being a law enacted for the peace, order and good government of Canada pursuant to s. 91 of the *Constitution Act, 1867*; as being enacted pursuant to the criminal law power in s. 91(27) thereof; or otherwise?

20 In the *Malmo-Levine* appeal, additional constitutional questions were stated putting in issue the validity of the prohibition against possession for the purpose of trafficking in marihuana in light of s. 7 (fundamental justice) and s. 15 (equality rights) of the *Charter*.

V. Analysis

21 The controversy over the criminalization of the use of marihuana has raged in Canada for at least 30 years. In 1972, the Commission of Inquiry into the Non-Medical Use of Drugs (the "Le Dain Commission"), in its preliminary report entitled *Cannabis*, recommended that the prohibition against its use be removed from the *criminal* law. In 1974, the federal government introduced Bill S-19, which would have removed penal sanctions for possession of marihuana for a first offence and substituted a monetary fine in its place. The Bill, however, died on the Order Paper. At the beginning of the 32nd Parliament in 1980, the Throne Speech proclaimed:

> It is time ... to move cannabis offences to the Food and Drugs Act and remove the possibility of imprisonment for simple possession.
>
> (*House of Commons Debates*, vol. I, 1st Sess., 32nd Parl., April 14, 1980, at p. 5)

22 The trial judge in *Caine* estimated that over 600,000 Canadians now have criminal records for cannabis-related offences, and that widespread use despite the criminal prohibition encourages disrespect for the law. At the time of the hearing of the appeal in this Court, the government announced its intention of introducing a bill to eliminate the availability of imprisonment for simple possession. Bill C-38, as introduced, states that possession of amounts less than 15 grams of marihuana will render an individual "guilty of an offence punishable on summary conviction and liable to a fine" (s. 4(5.1)). Furthermore, the offence would be designated as a contravention, pursuant to the *Contraventions Act*, S.C. 1992, c. 47, with the effect that an individual convicted for such possession would not receive a criminal record.

23 These reports and legislative initiatives were directed to crafting what was thought to be the best legislative response to the marihuana controversy. Whether the Bill should proceed, and if so in what form, is a matter of legislative policy for Parliament to decide. The question before us is

purely a matter of law. Is the prohibition, including the availability of imprisonment for simple possession, beyond the powers of Parliament, either because it does not properly fall within Parliament's legislative competence, or because the prohibition, and in particular the availability of imprisonment, violate the *Charter*'s guarantees of rights and freedoms?

24 The legal issues arising on these appeals can be grouped under the following headings:

A. Exclusion of Constitutional Fact Evidence at the Trial of Malmo-Levine

B. The *Narcotic Control Act*

C. Evidence of Harm

D. Division of Powers

E. Section 7 of the *Charter*

F. Section 15 of the *Charter*

25 We turn, then, to the first issue.

A. *Exclusion of Constitutional Fact Evidence at the Trial of Malmo-Levine*

26 Curtis J. refused to admit expert evidence of legislative and constitutional facts relevant to the *Charter* challenge on the basis that, even if Malmo-Levine succeeded in establishing what he set out to establish, it would make no difference to the legal result. In the trial judge's view, "[t]here is no legal basis for hearing evidence in support of the defence challenge to the constitutionality of the marijuana laws; it is simply not relevant" (p. 296).

27 In our view, the evidence which Malmo-Levine wished to adduce, which was essentially the same as the evidence tendered in *Caine*, was relevant to his *Charter* challenge. His argument was clearly not frivolous. A trial judge is not required to listen to pointless, irrelevant or repetitive evidence that does not advance the work of the court, but here the proffered evidence was none of those things. Malmo-Levine was prepared to deal with serious matters in a serious way. Had the Crown been prepared to accept his evidentiary points, an admission by Crown counsel or an agreed Statement of Facts could have been filed to make unnecessary the hearing of *viva voce* evidence. In the absence of any such Crown admissions, we agree with the British Columbia Court of Appeal that in the circumstances of this case the trial judge erred in excluding this "legislative fact" evidence. In the *Caine* case, the trial judge took judicial notice of certain government reports and documents, and proceeded to hear *viva voce* expert evidence on the more debatable aspects of the marihuana controversy. This was the correct procedure.

28 While the courts apply the requirements of judicial notice less stringently to the admission of legislative fact than to adjudicative fact (*Danson v. Ontario (Attorney General)*, [1990] 2 S.C.R. 1086, at p. 1099), courts should nevertheless proceed cautiously to take judicial notice even as "legislative facts" of matters that are reasonably open to dispute, particularly where they relate to an issue that could be dispositive: *R. v. Find*, [2001] 1 S.C.R. 863, 2001 SCC 32; *Public School Boards' Assn. of Alberta v. Alberta (Attorney General)*, [2000] 1 S.C.R. 44, 2000 SCC 2. The evidence of harm, or the lack of it, was central to the argument raised by both Malmo-Levine and Caine. They

regarded it as dispositive. Moreover, much of the evidence of "harm" was controversial, and needed to be tested by cross-examination.

29 Curtis J. was clearly unimpressed by what Malmo-Levine wished to establish. In some aspects, we have reached the same conclusion. However, with respect, the trial judge ought to have admitted the evidence despite his misgivings in the circumstances so as to permit Malmo-Levine to put forward a full record in the event of an appeal.

30 The complications that would otherwise have attended the hearing of the appeal however were obviated by the parties' agreement to treat the *Caine* evidence of legislative fact as equally applicable to Malmo-Levine's appeal. In the result, we agree with the Court of Appeal that the trial judge's error did not, in those circumstances, prejudice Malmo-Levine.

B. *The Narcotic Control Act*

1. History of the NCA

31 The NCA is structured as an omnibus measure covering all controlled drugs including heroin, crack cocaine and opium. The first such Act was passed by Parliament in 1908 in the form of *An Act to prohibit the importation, manufacture and sale of Opium for other than medicinal purposes*, S.C. 1908, c. 50, which aimed to control the use of narcotics for non-medicinal purposes. In 1911, this statute was replaced by *The Opium and Drug Act*, S.C. 1911, c. 17, which added prohibitions with regards to cocaine, morphine and eucaine. In 1923, Parliament enacted a consolidated *Opium and Narcotic Drug Act, 1923*, S.C. 1923, c. 22, which added cannabis to the list of prohibited drugs. There was no discussion or debate in the house as to why this drug was added. In 1932, a number of important amendments were made in the *Act to amend The Opium and Narcotic Drug Act, 1929*, S.C. 1932, c. 20, referring to both synthetic and natural drugs. By 1938, the Act prohibited over 15 scheduled drugs (S.C. 1938, c. 9) (see Senate Committee Report, vol. II, at pp. 256-58).

32 In 1954, the *Opium and Narcotic Drug Act* was amended, and the offence of possession was supplemented by a new offence: "possession ... for the purpose of trafficking" (S.C. 1954, c. 38, s. 3). A reverse onus applied to this offence, meaning that those possessing large quantities of narcotics had to prove that they were *not* in possession for the purpose of trafficking (Senate Committee Report, vol. II, at p. 264). The Act contained much harsher penalties for trafficking than for possession, leading Braidwood J.A. to conclude that "Parliament's primary purpose was to stamp out the drug traffic and punish the traffickers" (para. 81).

33 Less than a decade later, Parliament replaced the *Opium and Narcotic Drug Act* with the *Narcotic Control Act*, S.C. 1960-61, c. 35, which gave effect to Canada's international commitments under the *Single Convention on Narcotic Drugs, 1961*, Can. T.S. 1964 No. 30. When debating the Bill, the Minister of National Health characterized marihuana as a gateway drug, stating that "[i]t ... may well provide a stepping stone to addiction to heroin" (*House of Commons Debates*, vol. VI, 4th Sess., 24th Parl., June 7, 1961, at p. 5981). This strategy was to try to treat and cure the "evil" of marihuana by reducing the supply of drugs through stiff penalties, and reducing the demand for drugs by providing treatment for existing addicts.

34 In 1997, the NCA and Parts III and IV of the *Food and Drugs Act* were repealed and replaced by the *Controlled Drugs and Substances Act*, S.C. 1996, c. 19 ("CDSA"). The new Act was designed to discharge Canada's more recent international obligations with regard to narcotics. It introduced a legislative framework for the import, export, distribution and use of substances scheduled

under previous legislation (Senate Committee Report, vol. II, at p. 286). More than 150 substances now appear in the schedules to the CDSA.

2. Sanctions under the NCA

35 Since the enactment of the *Opium Act* in 1908, the sanctions for drug possession have been steadily decreasing. In 1929, the penalty for the offence of possession was a minimum of six months to a maximum of seven years or a fine of between $200 and $1,000, or both. It was also within the discretion of the court to sentence offenders to hard labour or a whipping: *The Opium and Narcotic Drug Act, 1929*, S.C. 1929, c. 49, s. 4. See, e.g., *R. v. Forbes* (1937), 69 C.C.C. 140 (B.C. Co. Ct.) (accused sentenced to 18 months of hard labour plus a $200 fine for possession of marihuana).

36 With the amendment of the *Opium and Narcotic Drug Act* in 1954, penalties for offences involving trafficking increased. For simple possession however, the availability of hard labour was removed. The mandatory six-month prison sentence was repealed in 1961 when the *Narcotic Control Act* was enacted. However, the 1961 Act provided, under s. 17(1), that if the accused was a drug addict, the court could impose custody for treatment for an indeterminate period in lieu of another sentence.

37 In 1969, possession was redesignated as a hybrid offence, and the penalty on summary conviction for possession carried a maximum fine of $1,000 or imprisonment for a term not exceeding six months or both for a first offence and, for a subsequent offence, a fine not exceeding $2,000 or imprisonment for a term not exceeding one year or both: S.C. 1968-69, c. 41, s. 12. The penalties are heavier, of course, if the Crown proceeds by indictment. These provisions were still in effect when the NCA was repealed in 1996.

3. Statutory Framework of the NCA

38 Parliament did not attach the penalty of imprisonment directly to marihuana offences. Rather, the NCA states at s. 3(1) that "[e]xcept as authorized by this Act or the regulations, no person shall have a narcotic in his possession". Narcotics are defined in the schedules to the NCA. Marihuana is a scheduled drug. The trial judge found that while marihuana is a psychoactive drug, it is not (medically speaking) a narcotic. It is deemed to be a "narcotic" only for the parliamentary purposes of the NCA schedule.

39 Various attacks were made on this statutory vehicle in the companion Ontario appeal, *R. v. Clay*, [2003] 3 S.C.R. 735, 2003 SCC 75, including allegations of overbreadth, and are considered further in our reasons for rejecting that appeal, released concurrently.

C. *Evidence of Harm*

40 The evidentiary issue at the core of the appellants' constitutional challenge is the "harm principle", and the contention that possession of marihuana for personal use is a "victimless crime". The appellants say that even with respect to the user himself or herself there is no cogent evidence of "significant" or "non-trivial" harm.

41 Malmo-Levine, a self-styled "chronic user", does not deny the existence of harm. The name of his organization, after all, is the "Harm Reduction Club". In his factum, he acknowledges that "Cannabis misuse can cause harm". In oral argument he said that

> my purpose here was to try to shift the debate from whether the harms are trivial, insignificant, to whether the harms are mitigatable and reducible.

and

> vulnerable groups, the chronic users, the mentally ill, the pregnant mothers, and the immature youth, are the ones that need harm reduction the most.

1. Admissions by the Appellants

42 The appellants Malmo-Levine, Caine and Clay filed with the Court a Joint Statement of Legislative Facts in which they make the following limited admissions:

(i) Dependency

The appellants state that "[t]here appears to be little or no risk of physical addiction arising from cannabis use; however, a small percentage of users do seemingly develop problems with psychological dependence... . Psychological dependence is reportedly experienced by only 2% of all cannabis users".

(ii) Driving, flying, or operating complex machinery

The appellants acknowledge that "[c]annabis may be contributing to accidents". Note, as well, that the following is printed on the Harm Reduction Club's Membership Card (run by Mr. Malmo-Levine): "I, [name], promise not to operate any heavy machinery while impaired on any marijuana".

(iii) Damage to lungs

The appellants acknowledge that "Dr. Tashkin has recently demonstrated that chronic cannabis smoking will lead to chronic bronchial inflammation".

(iv) Schizophrenia and psychosis

The appellants state that "[c]annabis has not been shown to cause psychoses or schizophrenia, although there is some question as to whether or not cannabis can modify the course of a pre-existing psychosis."

(v) Amotivational syndrome

The appellants state that "diminished motivation may be a symptom of chronic intoxication but one which dissipates upon cessation of use".

(vi) Effect on fetus/newborns

The appellants state that "[w]hile some tests have shown some impairment of memory, verbal ability and verbal expression of ideas in school age children, the changes were measurably small. More importantly, however, these minimal testing differences have not been linked to poor school performance in later years."

(vii) Reproductive system

The appellants state that "[t]here may ... be a brief or acute decrease of sex hormone level in the brain, but this level soon returns to normal even without the complete cessation of cannabis smoking".

43 There is no doubt that Canadian society has become much more sceptical about the alleged harm caused by the use of marihuana since the days when Emily Murphy, an Edmonton magistrate, warned that persons under the influence of marihuana "los[e] all sense of moral responsibility... . are immune to pain ... becom[ing] raving maniacs ... liable to kill ... using the most savage methods of eruelty" (*The Black Candle* (1922), at pp. 332-33). However, to exonerate marihuana from such extreme forms of denunciation is not to say it is harmless.

2. The Le Dain Commission Report

44 The Le Dain Commission, established in 1969 and reporting in 1972, recommended decriminalization of marihuana but nevertheless identified various concerns regarding its use, including the following four identified by the majority of commissioners as the major areas of social concern (at p. 268):

1. "the effect of cannabis on adolescent maturation;"
2. "the implications of cannabis use for the safe operation of motor vehicles and other machinery;"
3. "the possibility that the long-term heavy use of cannabis will result in a significant amount of mental deterioration and disorder;" and
4. "the role played by cannabis in the development and spread of multi-drug use."

45 Research and further studies in the intervening 30 years have caused reconsideration of some of these findings.

3. The Trial Judge's Findings in *Caine*

46 Howard Prov. Ct. J., in response to some of the more strident warnings of the harm allegedly caused by marihuana use, reviewed the extensive evidence before her court to put in perspective the potential harms associated with the use of marihuana, as presently understood, as follows (at para. 40):

1. the occasional to moderate use of marihuana by a healthy adult is not ordinarily harmful to health, even if used over a long period of time;

2. there is no conclusive evidence demonstrating any irreversible organic or mental damage to the user, except in relation to the lungs and then only to

those of a chronic, heavy user such as a person who smokes at least 1 and probably 3-5 marihuana joints per day;

3. there is no evidence demonstrating irreversible, organic or mental damage from the use of marihuana by an ordinary healthy adult who uses occasionally or moderately;
4. marihuana use does cause alteration of mental function and as such should not be used in conjunction with driving, flying or operating complex machinery;
5. there is no evidence that marihuana use induces psychosis in ordinary healthy adults who use [marihuana] occasionally or moderately and, in relation to the heavy user, the evidence of marihuana psychosis appears to arise only in those having a predisposition towards such a mental illness;
6. marihuana is not addictive;
7. there is a concern over potential dependence in heavy users, but marihuana is not a highly reinforcing type of drug, like heroin or cocaine and consequently physical dependence is not a major problem; psychological dependence may be a problem for the chronic user;
8. there is no causal relationship between marihuana use and criminality;
9. there is no evidence that marihuana is a gateway drug and the vast majority of marihuana users do not go on to try hard drugs ... .
10. marihuana does not make people aggressive or violent, but on the contrary it tends to make them passive and quiet;
11. there have been no deaths from the use of marihuana;
12. there is no evidence of an amotivational syndrome, although chronic use of marihuana could decrease motivation, especially if such a user smokes so often as to be in a state of chronic intoxication;

13. assuming current rates of consumption remain stable, the health related costs of marihuana use are very, very small in comparison with those costs associated with tobacco and alcohol consumption.

47 Having concluded that the use of marihuana is not as harmful as is sometimes claimed, the trial judge went on to state in *Caine* that marihuana is not "a completely harmless drug for all individual users" (para. 42). She stated at paras. 121-22:

> The evidence before me demonstrates that there is a reasonable basis for believing that the following health risks exist with [marihuana use].
>
> There is a general risk of harm to the users of marihuana from the acute effects of the drug, but these adverse effects are rare and transient. Persons experiencing the acute effects of the drug will be less adept at driving, flying and other activities involving complex machinery. In this regard they represent a risk of harm to others in society. At current rates of use, accidents caused by users under the influence of marihuana cannot be said to be significant.

48 Key to Howard Prov. Ct. J.'s findings was the identification of perhaps 50,000 chronic users, who cannot be identified in advance, but who pose both a risk to themselves and a potential cost to society at paras. 123-26:

> There is also a risk that any individual who chooses to become a casual user, may end up being a chronic user of marihuana, or a member of one of the vulnerable persons identified in the materials. It is not possible to identify these persons in advance.
>
> As to the chronic users of marihuana, there are health risks for such persons. The health problems are serious ones but they arise primarily from the act of smoking rather than from the active ingredients in marihuana. Approximately 5% of all marihuana users are chronic users. At current rates of use, this comes to approximately 50,000 persons. There is a risk that, upon legalization, rates of use will increase, and with that the absolute number of chronic users will increase.
>
> In addition, there are health risks for those vulnerable persons identified in the materials. There is no information before me to suggest how many people might fall into this group. Given that it includes young adolescents who may be more prone to becoming chronic users, I would not estimate this group to be min[u]scule.
>
> All of the risks noted above carry with them a cost to society, both to the health care and welfare systems. At current rates of use, these costs are negligible compared to the costs associated with alcohol and drugs [*sic*]. There is a risk that, with legalization, user rates will increase and so will these costs. [Emphasis added.]

49 Over 20 years after the Le Dain Commission's Report, the Hall Report was released in Australia. The trial judge noted in *Caine* that "[t]here was general agreement among the witnesses who appeared before me (save perhaps for Dr. Morgan) that the conclusions contained in the Hall Report were sound ... based on the scientific information available at this time" (par. 48). The 1994 Hall Report found the following to be "chronic effects":

> [T]he major *probable* adverse effects [from chronic use] appear to be:

-- respiratory diseases associated with smoking as the method of administration, such as chronic bronchitis, and the occurrence of histopathological changes that may be precursors to the development of malignancy;

-- development of a cannabis dependence syndrome, characterized by an inability to abstain from or to control cannabis use;

-- subtle forms of cognitive impairment, most particularly of attention and memory, which persist while the user remains chronically intoxicated, and may or may not be reversible after prolonged abstinence from cannabis.

> [T]he major *possible* adverse effects [from chronic use that is, effects] which remain to be confirmed by further research [are]:

-- an increased risk of developing cancers of the aerodigestive tract, i.e. oral cavity, pharynx, and oesophagus;

-- an increased risk of leukemia among offspring exposed while in utero;

-- a decline in occupational performance marked by underachievement in adults in occupations requiring high level cognitive skills, and impaired educational attainment in adolescents;

-- birth defects occurring among children of women who used cannabis during their pregnancies.

> (W. Hall, N. Solowij and J. Lemon, *National Drug Strategy: The health and psychological consequences of cannabis use* (1994) (the "Hall Report"), at p. ix (emphasis in original))

50 In 2001, a revised version of the Hall Report was released. Its conclusions are similar to the 1994 Report except that the cognitive impairment probability was demoted to a possibility, the cancer risk (from smoking marihuana) was promoted from a possibility to a probability and the risks of leukemia and birth defects were no longer listed.

51 The trial judge noted that the 1994 Hall Report identified three traditional "high risk groups" (at para. 46):

> (1) Adolescents with a history of poor school performance ...
> (2) Women of childbearing age ...; and
> (3) Persons with pre-existing diseases such as cardiovascular diseases, respiratory diseases, schizophrenia or other drug dependencies ... .

The inclusion of "women of childbearing age" may have to be reconsidered in light of more recent studies casting doubt on marihuana as a potential source of birth defects. However, given the im-

mense importance of potential birth defects for all concerned, and the widely recognized need for further research, we have to accept that on this point as on many others "the jury is still out".

52 The trial judge noted, at para. 46, that the findings of the 1994 Hall Report were similar (except for the leukemia and birth defects concerns) to a report entitled *Cannabis: a health perspective and research agenda* (1997), published a few years later by the World Health Organization, Division of Mental Health and Prevention of Substance Abuse, which contained the following statement about the "acute health effects", i.e., the effects experienced by users during and for a period following the use of marihuana (at p. 30):

> *Acute health effects of cannabis use*
>
> The acute effects of cannabis use have been recognized for many years, and recent studies have confirmed and extended earlier findings. These may be summarized as follows:
>
> -- cannabis impairs cognitive development (capabilities of learning), including associative processes; free recall of previously learned items is often impaired when cannabis is used both during learning and recall periods;
>
> -- cannabis impairs psychomotor performance in a wide variety of tasks, such as motor coordination, divided attention, and operative tasks of many types; human performance on complex machinery can be impaired for as long as 24 hours after smoking as little as 20mg of THC in cannabis; there is an increased risk of motor vehicle accidents among persons who drive when intoxicated by cannabis.

53 The chronic and therapeutic effects of marihuana use were also listed by the World Health Organization and are set out in the Appendix.

4. Parliamentary Reports

54 Our attention was drawn by the parties to a number of parliamentary reports issued since the decision of the courts below, of which we may and do take judicial notice.

55 In September 2002, the Senate Special Committee on Illegal Drugs concluded that "the state of knowledge supports the belief that, for the vast majority of recreational users, cannabis use presents no harmful consequences for physical, psychological or social well-being in either the short or the long term" (vol. I, at p. 165).

56 At the same time, the Senate Committee acknowledged potential harm to a minority of users, including the vulnerable groups identified by the Hall Report and reported by the trial judge (vol. I, at pp. 166-67):

> The Committee feels that, because of its potential effects on the endogenous cannabinoid system and cognitive and psychosocial functions, any use in those under age 16 is at-risk use;
>
> Our estimation would suggest that approximately 50,000 youths fall in this category.
>
> ...
>
> Heavy use of smoked cannabis can have certain negative consequences for physical health, in particular for the respiratory system (chronic bronchitis, cancer of the upper respiratory tract).
>
> Heavy use of cannabis can result in negative psychological consequences for users, in particular impaired concentration and learning and, in rare cases and with people already predisposed, psychotic and schizophrenic episodes.
>
> Heavy use of cannabis can result in consequences for a user's social well-being, in particular their occupational and social situation and their ability to perform tasks.
>
> Heavy use of cannabis can result in dependence requiring treatment; however, dependence caused by cannabis is less severe and less frequent tha[n] dependence on other psychotropic substances, including alcohol and tobacco.

57 Echoing many other studies and reports, the Senate Committee underlined the need for further research, e.g., with respect to the potential impact of marihuana use on some psychiatric disorders (vol. I, at p. 151):

> As it is, most scientific reports come to the same conclusion: more research is needed, with more rigorous protocols, allowing in particular for comparison with other populations and other substances.

58 In December 2002, the House of Commons Special Committee on Non-Medical Use of Drugs reported on the therapeutic benefits and potential adverse effects to some users of marihuana, and recommended that possession of marihuana be dealt with by a scheme of "ticketing, except where the offence is committed in the presence of specified aggravating circumstances", such as impaired driving (*Policy for the New Millennium: Working Together to Redefine Canada's Drug Strategy* (2002), at p. 130).

59 On May 27, 2003, the Minister of Justice introduced Bill C-38 which would eliminate the potential of imprisonment following a conviction for possession of no more than 15 grams of marihuana.

60 The Senate and House of Commons Committee Reports are consistent with the conclusions reached by the courts in British Columbia that, while marihuana is not a "harmless" drug, nevertheless the degree and extent of harm associated with its use is subject to continuing controversy, as is the wisdom of the present legislative scheme.

61 We have been shown no reason to interfere with these findings of fact. It seems clear that the use of marihuana has less serious and permanent effects than was once claimed, but its psychoactive and health effects can be harmful, and in the case of members of vulnerable groups the harm may be serious and substantial.

62 We turn, now, to the legal arguments raised by the parties.

D. *Division of Powers*

63 The appellant Caine contends that Parliament has no power to criminalize the possession of marihuana for personal use under either the residuary power of peace, order and good government ("POGG") or the criminal law power.

1. The Purpose of the NCA

64 The appellant Caine further argues that the Crown is resorting impermissibly to a "shifting purpose" in its effort to salvage the marihuana prohibition. He contends that the legislative origins of the prohibition on cannabis had nothing to do with legitimate claims that cannabis was injurious to public health but was based on racism against oriental drug users and irrational, unproven and unfounded fears. In light of changed thinking and greater knowledge, the alleged legislative facts underlying this original purpose have been refuted. The prohibition has thus ceased to be *intra vires*. As pointed out in *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295, at p. 335:

> Purpose is a function of the intent of those who drafted and enacted the legislation at the time, and not of any shifting variable.

65 We need not review the law on this point because the argument was rejected on the facts by Braidwood J.A., who reviewed the legislative history in detail and concluded that the prohibition on simple possession of marihuana always "had more than one rationale. It was always meant to prevent the harm to society caused by drug addiction, such as the petty thefts that occur to raise funds to buy drugs" (para. 96). The post-1954 laws further evolved this general purpose with a larger plan to treat and "cure" drug addicts to eliminate the "market" for drug traffickers in Canada. We accept this analysis. Thus, although there was no explanation given during the parliamentary debates as to why cannabis (marihuana) was added to the NCA in 1923, the evidence supports the conclusion of Braidwood J.A. that a major purpose of the prohibition has been, since its enactment and continued thereafter, to be to protect health and public safety. This purpose did not change when the treatment provisions were added to the NCA in 1961. The purpose and character of the legislation remained the same, but new means were added to advance the original objectives of health and public safety. In these circumstances, it cannot be said that the Crown's argument is flawed by reliance on an impermissibly "shifting" purpose.

2. Legislative Jurisdiction with Respect to Narcotics

66 We turn next to the issue as to whether the NCA falls under Parliament's residuary jurisdiction for POGG, or whether it is an exercise of the criminal law power under s. 91(27) of the *Constitution Act, 1867*, or whether, as the appellants contend, it falls within neither head of federal jurisdiction and is *ultra vires*.

(a) *Peace, Order and Good Government*

67 Almost 25 years ago, a majority of this Court upheld the constitutional validity of the NCA under Parliament's residual authority to legislate for POGG: *R. v. Hauser*, [1979] 1 S.C.R. 984. Pigeon J., for the majority, took the view that the NCA "is essentially legislation adopted to deal with a genuinely new problem which did not exist at the time of Confederation and clearly cannot be put in the class of 'Matters of a merely local or private nature'" (p. 1000). Accordingly, Pigeon J. reasoned, the subject matter of the NCA is similar to other new developments such as aviation and radio communication. Dickson J., as he then was, dissented on this point, finding that the NCA should be considered as a matter of federal criminal power, relying on the Court's earlier decision in *Industrial Acceptance Corp. v. The Queen*, [1953] 2 S.C.R. 273, which had upheld the *Opium and Narcotic Drug Act, 1929*, under the federal criminal power.

68 The dissenting judgment of Dickson J. in *Hauser* focussed in part on whether the federal Crown had the authority to prosecute crimes (see, e.g., at p. 1011). Some commentators have speculated that the Court strained to locate the law within the POGG power because the Court was deeply divided on this issue: see, e.g., P. W. Hogg, *Constitutional Law of Canada* (2002 student ed.), at p. 438. To the extent that such considerations were a factor in the thinking of the majority, the authority of the federal Attorney General to prosecute offences created under the criminal law power has since been affirmed in *Attorney General of Canada v. Canadian National Transportation, Ltd.*, [1983] 2 S.C.R. 206 (federal power to prosecute crimes under the *Combines Investigation Act*, R.S.C. 1970, c. C-23, ss. 15(2) and 32(1)(*c*)), and *R. v. Wetmore*, [1983] 2 S.C.R. 284 (federal power to prosecute under the *Food and Drugs Act*, R.S.C. 1970, c. F-27, ss. 8, 9 and 26). See also *R. v. S. (S.)*, [1990] 2 S.C.R. 254, at p. 283 (Parliament has jurisdiction to delegate powers to provincial officials to prosecute offences under the *Young Offenders Act*, S.C. 1980-81-82-83, c. 110, s. 4).

69 In *Labatt Breweries of Canada Ltd. v. Attorney General of Canada*, [1980] 1 S.C.R. 914, at pp. 944-45, the Court outlined three instances in which the federal residual power applies:

> (i) the existence of a national emergency;
> (ii) with respect to a subject matter which did not exist at the time of Confederation and is clearly not in a class of matters of a merely local or private nature;
> (iii) where the subject matter "goes beyond local or provincial concern and must, from its inherent nature, be the concern of the Dominion as a whole".

70 It is not contended that the use of marihuana rises to the level of a national emergency. As to the second category, if, as we conclude *infra*, the NCA is a valid exercise of the criminal law power, it would not be consistent with that conclusion to uphold it under the branch of POGG that deals with "new" legislative subject matter not otherwise allocated. To that extent we disagree with the view taken by the majority in *Hauser, supra*.

71 These observations leave only the third category as a potential source of authority under POGG. The Attorney General of Canada contends that the control of narcotics is a legislative subject matter that "goes beyond local or provincial concern and must, from its inherent nature, be the concern of the Dominion as a whole". He puts his position as follows:

> The importation, manufacture, distribution, and use of psychoactive substances are matters having an impact on the country as a whole, and which can only be

> dealt with on an integrated national basis. Additionally, the international aspects are such that these matters cannot be effectively addressed at the local level.

72 We do not exclude the possibility that the NCA might be justifiable under the "national concern" branch on the rationale adopted in *R. v. Crown Zellerbach Canada Ltd.*, [1988] 1 S.C.R. 401, at p. 432, where we held that concerted action amongst provincial and federal entities, each acting within their respective spheres of legislative jurisdiction, was essential to deal with Canada's international obligations regarding the environment. In our view, however, the Court should decline in this case to revisit Parliament's residual authority to deal with drugs in general (or marihuana in particular) under the POGG power. If, as is presently one of the options under consideration, Parliament removes marihuana entirely from the criminal law framework, Parliament's continuing legislative authority to deal with marihuana use on a purely regulatory basis might well be questioned. The Court would undoubtedly have more ample legislative facts and submissions in such a case than we have in this appeal. Our conclusion that the present prohibition against the use of marihuana can be supported under the criminal law power makes it unnecessary to deal with the Attorney General's alternative position under the POGG power, and we leave this question open for another day.

(b) *The Criminal Law Power*

73 The federal criminal law power is "plenary in nature" and has been broadly construed:

> A crime is an act which the law, with appropriate penal sanctions, forbids; but as prohibitions are not enacted in a vacuum, we can properly look for some evil or injurious or undesirable effect upon the public against which the law is directed. That effect may be in relation to social, economic or political interests; and the legislature has had in mind to suppress the evil or to safeguard the interest threatened.
>
> (*Reference re Validity of Section 5(a) of the Dairy Industry Act*, [1949] S.C.R. 1 (the "*Margarine Reference*"), at p. 49)

In the present case the "evil or injurious or undesirable effect" is the harm attributed to the non-medical use of marihuana.

74 For a law to be classified as a criminal law, it must possess three prerequisites: a valid criminal law purpose backed by a prohibition and a penalty (*Reference re Firearms Act (Can.)*, [2000] 1 S.C.R. 783, 2000 SCC 31, at para. 27). The criminal power extends to those laws that are designed to promote public peace, safety, order, health or other legitimate public purpose. In *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1995] 3 S.C.R. 199, it was held that some legitimate public purpose must underlie the prohibition. In *Labatt Breweries, supra*, in holding that a health hazard may ground a criminal prohibition, Estey J. stated the potential purposes of the criminal law rather broadly as including "public peace, order, security, health and morality" (p. 933). Of course Parliament cannot use its authority improperly, e.g. colourably, to invade areas of provincial competence: *Scowby v. Glendinning*, [1986] 2 S.C.R. 226, at p. 237.

75 In various instances members of this Court have upheld the constitutionality of the NCA on the basis of the criminal power: *Industrial Acceptance Corp., supra*; *Hauser, supra, per* Dickson J., dissenting on this point, at p. 1060; and *Schneider v. The Queen*, [1982] 2 S.C.R. 112, *per* Laskin C.J., at p. 115. Other courts interpreting the *Opium Act* and its successors have also reached this

conclusion. See, e.g., *Dufresne v. The King* (1912), 5 D.L.R. 501 (Que. K.B.), and *Ex p. Wakabayashi*, [1928] 3 D.L.R. 226 (B.C.S.C.).

76 The purpose of the NCA fits within the criminal law power, which includes the protection of vulnerable groups: *Rodriguez v. British Columbia (Attorney General)*, [1993] 3 S.C.R. 519, at p. 595. See also *R. v. Morgentaler*, [1988] 1 S.C.R. 30, at pp. 74-75, in which s. 251 of the *Criminal Code* prohibiting abortions except in therapeutic situations was held to have a valid objective, namely protecting the life and health of pregnant women, although it failed the s. 1 test on other grounds. On somewhat related issues arising under the *Charter*, the protection of vulnerable groups has also been upheld under s. 1 as a valid federal objective of the exercise of the criminal law power. In *R. v. Sharpe*, [2001] 1 S.C.R. 45, 2001 SCC 2, we upheld s. 163.1(4) of the *Criminal Code* prohibiting the possession of child pornography, noting that the prevention of harm threatening vulnerable members of society is a valid limit on freedom of expression. Similarly in *R. v. Butler*, [1992] 1 S.C.R. 452, at p. 497, we concluded that "legislation proscribing obscenity is a valid objective which justifies some encroachment on the right to freedom of expression". In so doing, we emphasized the impact of the exploitation of women and children, depicted in publications and films, which can in certain circumstances, lead to "abject and servile victimization". In *R. v. Keegstra*, [1995] 2 S.C.R. 381, we held that the restrictions on free speech imposed by the hate speech provision in the *Criminal Code* was a justifiable limit under s. 1 because of potential attacks on minorities.

77 The protection of vulnerable groups from self-inflicted harms does not, as Caine argues, amount to no more than "legal moralism". Morality has traditionally been identified as a legitimate concern of the criminal law (*Labatt Breweries, supra*, at p. 933) although today this does not include mere "conventional standards of propriety" but must be understood as referring to societal values beyond the simply prurient or prudish: *Butler, supra*, at p. 498; *R. v. Murdock* (2003), 11 C.R. (6th) 43 (Ont. C.A.), at para. 32. The protection of the chronic users identified by the trial judge, and adolescents who may not yet have become chronic users, but who have the potential to do so, is a valid criminal law objective. In *R. v. Hydro-Québec*, [1997] 3 S.C.R. 213, the Court held at para. 131 that "Parliament has for long exercised extensive control over such matters as food and drugs by prohibitions grounded in the criminal law power". See also *Berryland Canning Co. v. The Queen*, [1974] 1 F.C. 91 (T.D.), at pp. 94-95; *Standard Sausage Co. v. Lee* (1933), 60 C.C.C. 265 (B.C.C.A.), supplemented by addendum at (1934), 61 C.C.C. 95. In our view, the control of a "psychoactive drug" that "causes alteration of mental function" clearly raises issues of public health and safety, both for the user as well as for those in the broader society affected by his or her conduct.

78 The use of marihuana is therefore a proper subject matter for the exercise of the criminal law power. *Butler* held, at p. 504, that if there is a reasoned apprehension of harm Parliament is entitled to act, and in our view Parliament is also entitled to act on reasoned apprehension of harm even if on some points "the jury is still out". In light of the concurrent findings of "harm" in the courts below, we therefore confirm that the NCA in general, and the scheduling of marihuana in particular, properly fall within Parliament's legislative competence under s. 91(27) of the *Constitution Act, 1867*.

79 Prior to the enactment of the *Charter* in 1982, that finding, which validates the exercise of the criminal law power, would have ended the appellants' challenge. Now, of course, Parliament must not only find legislative authority within the *Constitution Act, 1867*, but it must exercise that authority subject to the individual rights and freedoms guaranteed by the *Charter*.

80 We therefore turn to the appellants' *Charter* arguments.

E. *Section 7 of the Charter*

81 The appellant Malmo-Levine argues that smoking marihuana is integral to his preferred lifestyle, and that the criminalization of marihuana in both its possession and trafficking aspects is an unacceptable infringement of his personal liberty.

82 The appellant Caine, on the other hand, takes aim at the potential for imprisonment for conviction of possession of marihuana, and argues that imprisonment for such an offence is not in accordance with the principles of fundamental justice. If the penalty falls, he says, the substantive offence must fall with it.

83 These "liberty" interests are, of course, very different. We propose therefore first to identify the s. 7 "interest" properly at stake, then secondly to discuss the applicable principles of fundamental justice. Thirdly we will examine whether the deprivation of the s. 7 interest thus identified is in accordance with the principles of fundamental justice relevant to these appeals. As will be seen, we find no s. 7 infringement. It will therefore not be necessary to move to s. 1 to determine if an infringement would be justified in a free and democratic society.

1. The Interests at Stake

84 We say at once that the availability of imprisonment for the offence of simple possession is sufficient to trigger s. 7 scrutiny: *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486. However, Malmo-Levine's position (which is supported by the intervener British Columbia Civil Liberties Association) requires us to address whether broader considerations of personal autonomy, short of imprisonment, are also sufficient to invoke s. 7 protection. The appellant Caine, whose factum talks of the "fun" or "social" use of cannabis, writes, at para. 30:

> It is submitted that a decision whether or not to possess and consume Cannabis (marijuana), even if potentially harmful to the user, is analogous to the decision by an individual as to what food to eat or not eat and whether or not to eat fatty foods, and as such is a decision of fundamental personal importance involving a choice made by the individual involving that individual's personal autonomy.

85 In *Morgentaler, supra*, Wilson J. suggested that liberty "grants the individual a degree of autonomy in making decisions of fundamental personal importance", "without interference from the state" (p. 166). Liberty accordingly means more than freedom from physical restraint. It includes "the right to an irreducible sphere of personal autonomy wherein individuals may make inherently private choices free from state interference": *Godbout v. Longueuil (City)*, [1997] 3 S.C.R. 844, at para. 66; *B. (R.) v. Children's Aid Society of Metropolitan Toronto*, [1995] 1 S.C.R. 315, at para. 80. This is true only to the extent that such matters "can properly be characterized as fundamentally or inherently personal such that, by their very nature, they implicate basic choices going to the core of what it means to enjoy individual dignity and independence": *Godbout, supra*, at para. 66. See also *Blencoe v. British Columbia (Human Rights Commission)*, [2000] 2 S.C.R. 307, 2000 SCC 44, at para. 54; *Buhlers v. British Columbia (Superintendent of Motor Vehicles)* (1999), 170 D.L.R. (4th) 344 (B.C.C.A.), at para. 109; *Horsefield v. Ontario (Registrar of Motor Vehicles)* (1999), 44 O.R. (3d) 73 (C.A.).

86 While we accept Malmo-Levine's statement that smoking marihuana is central to his lifestyle, the Constitution cannot be stretched to afford protection to whatever activity an individual chooses to define as central to his or her lifestyle. One individual chooses to smoke marihuana; another has an obsessive interest in golf; a third is addicted to gambling. The appellant Caine invokes a taste for fatty foods. A society that extended constitutional protection to any and all such lifestyles would be ungovernable. Lifestyle choices of this order are not, we think, "basic choices going to the core of what it means to enjoy individual dignity and independence" (*Godbout, supra*, at para. 66).

87 In our view, with respect, Malmo-Levine's desire to build a lifestyle around the recreational use of marihuana does not attract *Charter* protection. There is no free-standing constitutional right to smoke "pot" for recreational purposes.

88 The appellants also invoke their s. 7 interest in "security of the person". In *Morgentaler, supra*, Dickson C.J. accepted that "serious state-imposed psychological stress" (p. 56 (emphasis added)) would suffice to infringe this interest. The appellants, however, contend that use of marihuana is non-addictive. Prohibition would not therefore lead to a level of stress that is constitutionally cognizable. A very different issue would arise if the marihuana was required for medical purposes, but neither appellant uses marihuana for such a purpose.

89 The availability of imprisonment is a different matter. We have no doubt that the risk of being sent to jail engages the appellants' liberty interest. Accordingly, it is necessary to move to the next stage of the s. 7 analysis to determine what are the relevant principles of fundamental justice and whether this risk of deprivation of liberty is in accordance with the principles of fundamental justice.

2. Principles of Fundamental Justice

90 The appellants accept that Parliament may act to avoid harm to others without violating principles of fundamental justice. They focus on the alleged absence of such harm, and contend that it is a denial of fundamental justice to deprive them of their liberty where such denial does not enhance a legitimate interest of the state. To hold otherwise, they say, would require the courts to endorse the arbitrary or irrational use of the criminal law power, contrary to the principles of fundamental justice. As Sopinka J. stated in *Rodriguez, supra*, at p. 594:

> Where the deprivation of the right in question does little or nothing to enhance the state's interest (whatever it may be), it seems to me that a breach of fundamental justice will be made out, as the individual's rights will have been deprived for no valid purpose.

91 The appellants' s. 7 arguments have several branches predicated on the requirement of harm. First, they argue that the only permissible target of the criminal law is harm to others; in their view, the criminal law cannot prohibit conduct that harms only the accused. Second, they argue that, in any event, marihuana is not a harmful substance, so that the prohibition of simple possession is arbitrary or irrational. Third, they argue that the criminalization of cannabis possession has adverse consequences, both for those users who are charged and convicted and, because of the disrespect engendered by the law, for the administration of justice generally, that are wholly disproportionate to the societal interests sought to be served by the prohibition. Finally, they submit that the criminali-

zation of cannabis possession is discriminatory and unfair, in light of Parliament's failure to criminalize the possession and use of alcohol and tobacco.

92 The appellant Malmo-Levine further submits that any harm-based analysis should focus on the healthy user who engages in harm-reduction strategies. He argues that the Court of Appeal erred "when they characterized the harms that may come with cannabis use as inherent, instead of a product of mis-cultivation, mis-distribution and mis-use" (Malmo-Levine's factum, at para. 2).

93 We will deal first with a number of preliminary points raised by the appellants.

(a) *The Propriety of Balancing Societal and Individual Interests in Section 7*

94 The appellant Caine submits that the British Columbia Court of Appeal erred in importing into s. 7 a number of societal interests that have nothing to do with the "principles of fundamental justice" but that he says should be considered, if at all, under a s. 1 justification. In other words, he argues that societal interests are not relevant to defining the right granted under s. 7 but only to determining whether a limit on that right is a reasonable one prescribed by law as can be demonstrably justified in a free and democratic society.

95 Braidwood J.A. considered that "the operative principle of fundamental justice" in these cases is the harm principle (see para. 159). However, having concluded that the prohibition against simple possession complies with the harm principle, he went on to consider a second question -- "whether the *NCA* strikes the 'right balance' between the rights of the individual and the interests of the State" (para. 160). As authority for this approach, reference was made to *Cunningham v. Canada*, [1993] 2 S.C.R. 143; *Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission)*, [1990] 1 S.C.R. 425, at p. 539, *per* La Forest J.; and *Rodriguez, supra*, at pp. 592-93, *per* Sopinka J. Prowse J.A., in dissent, engaged in a similar balancing exercise.

96 We do not think that these authorities should be taken as suggesting that courts engage in a free-standing inquiry under s. 7 into whether a particular legislative measure "strikes the right balance" between individual and societal interests in general, or that achieving the right balance is itself an overarching principle of fundamental justice. Such a general undertaking to balance individual and societal interests, *independent of any identified principle of fundamental justice*, would entirely collapse the s. 1 inquiry into s. 7. The procedural implications of such a collapse are significant. Counsel for the appellant Caine, for example, urges that the appellants having identified a threat to the liberty or security of the person, the evidentiary onus should switch at once to the Crown *within s. 7* "to provide evidence of the significant harm that it relies upon to justify the use of criminal sanctions" (Caine's factum, at para. 24).

97 We do not agree. In *R. v. Mills*, [1999] 3 S.C.R. 668, a majority of this Court pointed out that, despite certain similarities between the balancing of interests in ss. 7 and 1, there are important differences. Firstly, the issue under s. 7 is the delineation of the boundaries of the rights and principles in question whereas under s. 1 the question is whether an infringement may be justified (para. 66). Secondly, it was affirmed that under s. 7 it is the claimant who bears the onus of proof throughout. It is only if an infringement of s. 7 is established that the onus switches to the Crown to justify the infringement under s. 1. Thirdly, the range of interests to be taken into account under s. 1 is much broader than those relevant to s. 7. The Court said in *Mills*, at para. 67 :

> Because of these differences, the nature of the issues and interests to be balanced is not the same under the two sections. As Lamer J. (as he then was) stated in *Re B.C. Motor Vehicle Act, supra*, at p. 503: "the principles of fundamental justice are to be found in the basic tenets of our legal system". In contrast, s. 1 is concerned with the values underlying a free and democratic society, which are broader in nature. In *R. v. Oakes*, [1986] 1 S.C.R. 103, Dickson C.J. stated, at p. 136, that these values and principles "embody, to name but a few, respect for the inherent dignity of the human person, commitment to social justice and equality, accommodation of a wide variety of beliefs, respect for cultural and group identity, and faith in social and political institutions which enhance the participation of individuals and groups in society". In *R. v. Keegstra*, [1990] 3 S.C.R. 697, at p. 737, Dickson C.J. described such values and principles as "numerous, covering the guarantees enumerated in the *Charter* and more".

98 The balancing of individual and societal interests within s. 7 is only relevant when elucidating a particular principle of fundamental justice. As Sopinka J. explained in *Rodriguez, supra*, "in arriving at these principles [of fundamental justice], a balancing of the interest of the state and the individual is required" (pp. 592-93 (emphasis added)). Once the principle of fundamental justice has been elucidated, however, it is not within the ambit of s. 7 to bring into account such "societal interests" as health care costs. Those considerations will be looked at, if at all, under s. 1. As Lamer C.J. commented in *R. v. Swain*, [1991] 1 S.C.R. 933, at p. 977:

> It is not appropriate for the state to thwart the exercise of the accused's right by attempting to bring societal interests into the principles of fundamental justice and to thereby limit an accused's s. 7 rights. Societal interests are to be dealt with under s. 1 of the *Charter*, where the Crown has the burden of proving that the impugned law is demonstrably justified in a free and democratic society.

99 The principles of fundamental justice asserted by the appellants include the contentions that their conduct should only be the subject of criminal sanction to the extent it harms others, that the state cannot infringe their interests in an arbitrary or irrational manner, or impose criminal sanctions that are disproportionate to the importance of the state interest sought to be protected. Implicit in each of these principles is, of course, the recognition that the appellants do not live in isolation but are part of a larger society. The delineation of the principles of fundamental justice must inevitably take into account the social nature of our collective existence. To that limited extent, societal values play a role in the delineation of the boundaries of the rights and principles in question.

(b) *Malmo-Levine's "Harm Reduction" Argument*

100 We wish to be clear that we do not accept Malmo-Levine's argument that Parliament should proceed on the assumption that users will use marihuana "responsibly". We accept his point that careful use can *mitigate* the harmful effects, but it is open to Parliament to proceed on the more reasonable assumption that psychoactive drugs will to some extent be misused. Indeed, the evidence indicates the existence of both use and misuse by chronic users and by vulnerable groups who cause harm to themselves.

(c) *Malmo-Levine's Pleasure Principle*

101 Malmo-Levine's related argument, that the pleasure of a large number of people should not be curtailed because of (he says) relatively minor harm to a minority, is similarly misplaced under s. 7. Utilitarian arguments that urge a cost-benefit calculation of alleged benefit to the many versus alleged harm to the few, to the extent such arguments are relevant under the *Charter*, belong in s. 1. The appellants must first of all establish a violation of their s. 7 rights. Only if they are able to do so is the government then required to show that the purported limitation is demonstrably justified in a free and democratic society.

(d) *The "Harm Principle"*

102 The appellants contend that unless the state can establish that the use of marihuana is harmful to others, the prohibition against simple possession cannot comply with s. 7. Our colleague Arbour J. accepts this proposition as correct to the extent that "the state resorts to imprisonment" (para. 244). Accordingly, a closer look at the alleged "harm principle" is called for.

103 We should be clear about the direction of the appellants' argument. It is agreed by all parties that the *existence* of harm, especially harm to others, is a state interest sufficient to ground the exercise of the criminal law power. The appellants' contention, however, is that the *absence* of demonstrated harm to others deprives Parliament of the power to impose criminal liability. That is what they call the "harm principle".

104 We think it right to state at the outset that we do not agree that the "harm principle" plays the *essential* role assigned to it by the appellants in testing the criminal law against the requirements of the *Charter*. Further, with respect to our colleague's focus on the availability (if not the imposition) of imprisonment for the simple possession of marihuana, we think the punishment debate is more appropriately addressed under s. 12 of the *Charter* ("cruel and unusual treatment or punishment"), rather than under s. 7, although clearly it has implications for both s. 7 and s. 1, as will shortly be discussed.

105 The British Columbia Court of Appeal also dealt with this case on the premise that the harm principle was a controlling principle under s. 7 of the *Charter*. It is therefore appropriate that we deal with it in some detail.

(i) History and Definition of the Harm Principle

106 What is the "harm principle"? The appellants rely, in particular, on the writings of the liberal theorist, J. S. Mill, who attempted to establish clear boundaries for the permissible intrusion of the state into private life:

> The object of this Essay is to assert one very simple principle, as entitled to govern absolutely the dealings of society with the individual in the way of compulsion and control, whether the means used be physical force in the form of legal penalties, or the moral coercion of public opinion. That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilised community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant... . The only part of the

> conduct of any one, for which he is amenable to society, is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign. [Emphasis added.]
>
> (J. S. Mill, *On Liberty and Considerations on Representative Government* (1946), at pp. 8-9)

107 Thus Mill's principle has two essential features. First, it rejects paternalism -- that is, the prohibition of conduct that harms only the actor. Second, it excludes what could be called "moral harm". Mill was of the view that such moral claims are insufficient to justify use of the criminal law. Rather, he required clear and tangible harm to the rights and interests of others.

108 At the same time, Mill acknowledged an exception to his requirement of harm "to others" for vulnerable groups. He wrote that "this doctrine is meant to apply to human beings in the maturity of their faculties... . Those who are still in a state to require being taken care of by others, must be protected against their own actions as well as against external injury" (p. 9).

109 Mill's statement has the virtues of insight and clarity but he was advocating certain general philosophic principles, not interpreting a constitutional document. Moreover, even his philosophical supporters have tended to agree that justification for state intervention cannot be reduced to a single factor -- harm -- but is a much more complex matter. One of Mill's most distinguished supporters, Professor H. L. A. Hart, wrote:

> Mill's formulation of the liberal point of view may well be too simple. The grounds for interfering with human liberty are more various than the single criterion of 'harm to others' suggests: cruelty to animals or organizing prostitution for gain do not, as Mill himself saw, fall easily under the description of harm to others. Conversely, even where there is harm to others in the most literal sense, there may well be other principles limiting the extent to which harmful activities should be repressed by law. So there are multiple criteria, not a single criterion, determining when human liberty may be restricted. [Emphasis added.]
>
> (H. L. A. Hart, "Immorality and Treason", originally appearing in *The Listener* (July 30, 1959), at pp. 162-63, reprinted in *Morality and the Law* (1971), 49, at p. 51)

To the same effect, see Professor J. Feinberg, *The Moral Limits of the Criminal Law* (1984), vol. 1: *Harm to Others*, at p. 12; vol. 4: *Harmless Wrongdoing*, at p. 323.

(ii) Is the Harm Principle a Principle of Fundamental Justice?

110 The appellants submit that the harm principle is a principle of fundamental justice for the purposes of s. 7 that operates to place limits on the type of conduct the state may criminalize. This limitation exists independently of the division of powers under ss. 91 and 92 of the *Constitution Act, 1867*. In other words, the appellants contend that there is a double threshold. Even if the Crown is able to establish that the creation of a particular criminal offence is a valid exercise of the criminal law power, there is a second level of constraint on the type of conduct that can be made criminal by virtue of s. 7 of the *Charter*.

111 We agree that there is a form of "double threshold", in that the *Charter* imposes requirements that are separate from those imposed by ss. 91 and 92 of the *Constitution Act, 1867*. However, we do not agree with the attempted elevation of the harm principle to a principle of fundamental justice. That is, in our view the harm principle is not the constitutional standard for what conduct may or may not be the subject of the criminal law for the purposes of s. 7.

112 In *Re B.C. Motor Vehicle Act, supra*, Lamer J. (as he then was) explained that the principles of fundamental justice lie in "the basic tenets of our legal system. They do not lie in the realm of general public policy but in the inherent domain of the judiciary as guardian of the justice system" (p. 503). This Court provided further guidance as to what constitutes a principle of fundamental justice for the purposes of s. 7, in *Rodriguez, supra, per* Sopinka J. (at pp. 590-91 and 607):

> A mere common law rule does not suffice to constitute a principle of fundamental justice, rather, as the term implies, principles upon which there is some consensus that they are vital or fundamental to our societal notion of justice are required. Principles of fundamental justice must not, however, be so broad as to be no more than vague generalizations about what our society considers to be ethical or moral. They must be capable of being identified with some precision and applied to situations in a manner which yields an understandable result. They must also, in my view, be legal principles.
>
> ...
>
> While the principles of fundamental justice are concerned with more than process, reference must be made to principles which are "fundamental" in the sense that they would have general acceptance among reasonable people. [Emphasis added.]

113 The requirement of "general acceptance among reasonable people" enhances the legitimacy of judicial review of state action, and ensures that the values against which state action is measured are not just fundamental "in the eye of the beholder only": *Rodriguez*, at pp. 607 and 590 (emphasis in original). In short, for a rule or principle to constitute a principle of fundamental justice for the purposes of s. 7, it must be a legal principle about which there is significant societal consensus that it is fundamental to the way in which the legal system ought fairly to operate, and it must be identified with sufficient precision to yield a manageable standard against which to measure deprivations of life, liberty or security of the person.

a. *Is the Harm Principle a Legal Principle?*

114 In our view, the "harm principle" is better characterized as a description of an important state interest rather than a normative "legal" principle. Be that as it may, even if the harm principle could be characterized as a legal principle, we do not think that it meets the other requirements, as explained below.

b. *There Is No Sufficient Consensus that the Harm Principle Is Vital or Fundamental to Our Societal Notion of Criminal Justice*

115 Contrary to the appellants' assertion, we do not think there is a consensus that the harm principle is the sole justification for criminal prohibition. There is no doubt that our case law and aca-

demic commentary are full of statements about the criminal law being aimed at conduct that "affects the public", or that constitutes "a wrong against the public welfare", or is "injurious to the public", or that "affects the community". No doubt, as stated, the *presence* of harm to others may justify legislative action under the criminal law power. However, we do not think that the *absence* of proven harm creates the unqualified barrier to legislative action that the appellants suggest. On the contrary, the state may sometimes be justified in criminalizing conduct that is either not harmful (in the sense contemplated by the harm principle), or that causes harm only to the accused.

116 The appellants cite in aid of their position the observation of Sopinka J., writing for the majority in *Butler, supra*, that "[t]he objective of maintaining conventional standards of propriety, independently of any harm to society, is no longer justified in light of the values of individual liberty which underlie the *Charter*" (p. 498). However, Sopinka J. went on to clarify that it is open to Parliament to legislate "on the basis of some fundamental conception of morality for the purposes of safeguarding the values which are integral to a free and democratic society" (p. 493 (emphasis added)).

117 Several instances of crimes that do not cause harm to others are found in the *Criminal Code*, R.S.C. 1985, c. C-46. Cannibalism is an offence (s. 182) that does not harm another sentient being, but that is nevertheless prohibited on the basis of fundamental social and ethical considerations. Bestiality (s. 160) and cruelty to animals (s. 446) are examples of crimes that rest on their offensiveness to deeply held social values rather than on Mill's "harm principle".

118 A duel fought by consenting adults is an example of a crime where the victim is no less culpable than the perpetrator, and there is no harm that is not consented to, but the prohibition (s. 71 of the *Code*) is nevertheless integral to our ideas of civilized society. See also *R. v. Jobidon*, [1991] 2 S.C.R. 714. Similarly, in *R. v. F. (R.P.)* (1996), 105 C.C.C. (3d) 435, the Nova Scotia Court of Appeal upheld the prohibition of incest under s. 155 of the *Criminal Code* despite a *Charter* challenge by five consenting adults. In none of these instances of consenting adults does the criminal law conform to Mill's expression of the harm principle that "[o]ver himself, over his own body and mind, the individual is sovereign", as referenced earlier at para. 106.

119 Various jurists and commentators are said by the appellants to have endorsed the idea that harm is required, but we think that these sources, read in context, do not support the "harm principle" as defined by the appellants.

120 One source relied on by the appellants -- the writings of Sir James Fitzjames Stephen -- illustrates this point. Reference was made to Stephen's statement that the criminal law

> must be confined within narrow limits, and can be applied only to definite overt acts or omissions capable of being distinctly proved, which acts or omissions inflict definite evils, either on specific persons or on the community at large.
>
> (J. F. Stephen, *A History of the Criminal Law of England* (1883), vol. II, at pp. 78-79)

121 However, Stephen himself was a prominent critic of Mill's harm principle. He believed that "immoral" behaviour *can* be a proper subject for the criminal law. Clearly, his reference to "evils" inflicted on the community includes the idea of moral harm, which Mill specifically excluded from

the scope of his "harm principle". Stephen thus supported a much larger view of the legitimate purposes of the criminal law than is permitted by the appellants' argument.

122 The appellants also rely on a 1982 report by the Law Reform Commission of Canada entitled *The Criminal Law in Canadian Society* which concludes, at p. 45, that the criminal law "ought to be reserved for reacting to conduct that is seriously harmful". This seems, on its face, to support the harm principle. However, the report goes on to state, at p. 45, that such harm

> may be caused or threatened to the collective safety or integrity of society through the infliction of direct damage or the undermining of what the Law Reform Commission terms fundamental or essential values -- those values or interests necessary for social life to be carried on, or for the maintenance of the kind of society cherished by Canadians. [Emphasis added.]

Such a definition of "harm" is clearly contrary to Mill's harm principle as endorsed by the appellants.

c. *Nor Is There Any Consensus that the Distinction Between Harm to Others and Harm to Self Is of Controlling Importance*

123 Our colleague Arbour J. takes the view that when the state wishes to make imprisonment available as a sanction for criminal conduct, it must be able to show the potential of such conduct to cause harm to others (para. 244). With respect, we do not think there is any such principle anchored in our law. As this Court noted in *Rodriguez, supra*, attempted suicide was an offence under Canadian criminal law (found in the original *Code* at s. 238) until its repeal by S.C. 1972, c. 13, s. 16. Sopinka J. emphasized, at p. 597, that

> the decriminalization of attempted suicide cannot be said to represent a consensus by Parliament or by Canadians in general that the autonomy interest of those wishing to kill themselves is paramount to the state interest in protecting the life of its citizens.

The offence of attempted suicide was removed from the *Criminal Code* because Parliament came to prefer other ways of addressing the problem of suicide. In that case, as here, there was an important distinction between constitutional competence, which is for the courts to decide, and the wisdom of a particular measure, which, within its constitutional sphere, is up to Parliament.

124 Putting aside, for the moment, the proper approach to the appropriateness of imprisonment (which, as stated, we think should be addressed under s. 12 rather than s. 7), we do not accept the proposition that there is a general prohibition against the criminalization of harm to self. Canada continues to have paternalistic laws. Requirements that people wear seatbelts and motorcycle helmets are designed to "save people from themselves". There is no consensus that this sort of legislation offends our societal notions of justice. Whether a jail sentence is an appropriate penalty for such an offence is another question. However, the objection in that aspect goes to the validity of an assigned punishment -- it does not go to the validity of prohibiting the underlying conduct.

125 A recent discussion policy paper from the Law Commission of Canada entitled *What is a Crime? Challenges and Alternatives* (2003) highlights the difficulties in distinguishing between harm to others and harm to self. It notes that "in a society that recognizes the interdependency of its

citizens, such as universally contributing to healthcare or educational needs, harm to oneself is often borne collectively" (p. 17).

126 In short, there is no consensus that tangible harm to others is a necessary precondition to the creation of a criminal law offence.

d. *The Harm Principle Is Not a Manageable Standard Against Which to Measure Deprivation of Life, Liberty or Security of the Person*

127 Even those who agree with the "harm principle" as a regulator of the criminal law frequently disagree about what it means and what offences will meet or offend the harm principle. In the absence of any agreed definition of "harm" for this purpose, allegations and counter-allegations of non-trivial harm can be marshalled on every side of virtually every criminal law issue, as one author explains:

> The harm principle is effectively collapsing under the weight of its own success. Claims of harm have become so pervasive that the harm principle has become meaningless: the harm principle no longer serves the function of a *critical principle* because non-trivial harm arguments permeate the debate. Today, the issue is no longer *whether* a moral offense causes harm, but rather what type and what amount of harms the challenged conduct causes, and how the harms compare. On those issues, the harm principle is silent. [Emphasis in original.]
>
> (B. E. Harcourt, "The Collapse of the Harm Principle" (1999), 90 *J. Crim. L. & Criminology* 109, at p. 113)

Professor Harcourt goes on to point out that it is the "hidden normative dimensions ... [that] do the work in the harm principle, not the abstract, simple notion of harm" (p. 185). In other words, the existence of harm (however defined) does no more than open a gateway to the debate; it does not give any precise guidance about its resolution.

128 Harm, as interpreted in the jurisprudence, can take a multitude of forms, including economic, physical and social (e.g., injury and/or offence to fundamental societal values). In the present appeal, for example, the respondents put forward a list of "harms" which they attribute to marihuana use. The appellants put forward a list of "harms" which they attribute to marihuana prohibition. Neither side gives much credence to the "harms" listed by the other. Each claims the "net" result to be in its favour.

129 In the result, we do not believe that the content of the "harm" principle as described by Mill and advocated by the appellants provides a manageable standard under which to review criminal or other laws under s. 7 of the *Charter*. Parliament, we think, is entitled to act under the criminal law power in the protection of legitimate state interests other than the avoidance of harm to others, subject to *Charter* limits such as the rules against arbitrariness, irrationality and gross disproportionality, discussed below.

(iii) <u>"Avoidance of Harm" Is Nevertheless a Valid State Interest</u>

130 While we do not agree with the courts below that the "harm principle" is a principle of fundamental justice, there is nevertheless a state interest in the avoidance of harm to those subject to its laws which may justify parliamentary action.

131 In other words, avoidance of harm is a "state interest" within the rule against arbitrary or irrational state conduct mentioned in *Rodriguez, supra*, at p. 594, previously cited, that:

> Where the deprivation of the right in question does little or nothing to enhance the state's interest (whatever it may be), it seems to me that a breach of fundamental justice will be made out, as the individual's rights will have been deprived for no valid purpose. [Emphasis added.]

132 The conclusion that the state has a particular interest in acting to protect vulnerable groups is also consistent with *Charter* jurisprudence affirming the state's power to intervene to protect children whose lives are in jeopardy and to promote their well-being: *New Brunswick (Minister of Health and Community Services) v. G. (J.)*, [1999] 3 S.C.R. 46, at para. 70; *B. (R.), supra*, at para. 88 (*per* La Forest J.).

133 We do not agree with Prowse J.A. that harm must be shown to the court's satisfaction to be "serious" and "substantial" before Parliament can impose a prohibition. Once it is demonstrated, as it has been here, that the harm is not *de minimis*, or in the words of Braidwood J.A., the harm is "not [in]significant or trivial", the precise weighing and calculation of the nature and extent of the harm is Parliament's job. Members of Parliament are elected to make these sorts of decisions, and have access to a broader range of information, more points of view, and a more flexible investigative process than courts do. A "serious and substantial" standard of review would involve the courts in micromanagement of Parliament's agenda. The relevant constitutional control is not micromanagement but the general principle that the parliamentary response must not be grossly disproportionate to the state interest sought to be protected, as will be discussed.

134 Having said that, our understanding of the view taken of the facts by the courts below is that while the risk of harm to the great majority of users can be characterized at the lower level of "neither trivial nor insignificant", the risk of harm to members of the vulnerable groups reaches the higher level of "serious and substantial". This distinction simply underlines the difficulties of a court attempting to quantify "harm" beyond a *de minimis* standard.

(iv) In Light of the State Interest Thus Identified, the Prohibition Is Neither Arbitrary nor Irrational

135 A criminal law that is shown to be arbitrary or irrational will infringe s. 7: *R. v. Arkell*, [1990] 2 S.C.R. 695, at p. 704; *R. v. Hamon* (1993), 85 C.C.C. (3d) 490 (Que. C.A.), at p. 492. Our colleagues LeBel and Deschamps JJ. consider the marihuana prohibition to be disproportionate to the societal problems at issue, and, thus arbitrary. This, we think, puts the threshold of judicial intervention too low. LeBel J. writes that "it cannot be denied that marihuana can cause problems of varying nature and severity to some people or to groups of them" (para. 280). That being the case, we think the *Charter* allows Parliament a broad, though certainly not unlimited, legislative capacity to respond. Marihuana is a psychoactive drug whose "use causes alteration of mental function" according to the trial judge. This alteration creates a potential harm to others when the user engages in "driving, flying and other activities involving complex machinery". Chronic users may suffer "seri-

ous" health problems. Vulnerable groups are at particular risk, including adolescents with a history of poor school performance, pregnant women and persons with pre-existing diseases such as cardiovascular diseases, respiratory diseases, schizophrenia or other drug dependencies. These findings of fact disclose a sufficient state interest to support Parliament's intervention should Parliament decide that it is wise to continue to do so, subject to a constitutional standard of *gross* disproportionality, discussed below.

136 The criminalization of possession is a statement of society's collective disapproval of the use of a psychoactive drug such as marihuana (*Morgentaler, supra*, at p. 70), and, through Parliament, the continuing view that its use should be deterred. The prohibition is not arbitrary but is rationally connected to a reasonable apprehension of harm. In particular, criminalization seeks to take marihuana out of the hands of users and potential users, so as to prevent the associated harm and to eliminate the market for traffickers. In light of these findings of fact it cannot be said that the prohibition on marihuana possession is arbitrary or irrational, although the wisdom of the prohibition and its related penalties is always open to reconsideration by Parliament itself.

137 It is true that Parliament can and has directly addressed some of the potential harmful conduct elsewhere in the *Criminal Code*. Section 253, for example, prohibits driving while impaired. One type of legal control to prevent harm does not logically oust other potential forms of legal control, subject as always to the limitation of gross disproportionality discussed below.

138 The appellants also contend that Parliament's failure to criminalize the consumption of alcohol and tobacco, while criminalizing the use of marihuana (which the appellants say is, if anything, *less* harmful) shows the arbitrariness of the law. It is clear that the consumption of alcohol and tobacco can be harmful. Moreover in some respects the harm is of a type comparable to that caused by marihuana consumption. Much of the bronchial harm associated with marihuana, for instance, comes from the smoking aspect rather than its intoxicating properties.

139 However, if Parliament is otherwise acting within its jurisdiction by enacting a prohibition on the use of marihuana, it does not lose that jurisdiction just because there are other substances whose health and safety effects could arguably justify similar legislative treatment. To hold otherwise would involve the courts in not only defining the outer limits of the legislative action allowed by the Constitution but also in ordering Parliament's priorities within those limits. That is not the role of the courts under our constitutional arrangements.

140 Parliament may, as a matter of constitutional law, determine what is *not* criminal as well as what is. The choice to use the criminal law in a particular context does not require its use in any other: *RJR-MacDonald, supra*, at para. 50. Parliament's decision to move in one area of public health and safety without at the same time moving in other areas is not, on that account alone, arbitrary or irrational.

(v) The Allegation of Disproportionality

141 Having rejected the appellants' contention that Parliament is without authority to criminalize conduct unless it causes harm to others, as well as their claim that criminalization of marihuana is arbitrary and irrational, we proceed to the next level of their argument, namely that even if it is not arbitrary and irrational, criminalization is nevertheless disproportionate to any threat posed by marihuana use.

142 In *Suresh v. Canada (Minister of Citizenship and Immigration)*, [2002] 1 S.C.R. 3, 2002 SCC 1, at para. 47, the Court accepted that the means taken to achieve an objective can be so disproportionate to the desired end so as to offend the principles of fundamental justice:

> Determining whether deportation to torture violates the principles of fundamental justice requires us to balance [under s. 7] Canada's interest in combatting terrorism and the Convention refugee's interest in not being deported to torture. Canada has a legitimate and compelling interest in combatting terrorism. But it is also committed to fundamental justice. The notion of proportionality is fundamental to our constitutional system. Thus we must ask whether the government's proposed response is reasonable in relation to the threat. In the past, we have held that some responses are so extreme that they are *per se* disproportionate to any legitimate government interest: see *Burns, supra*. We must ask whether deporting a refugee to torture would be such a response. [Emphasis added.]

See also *United States v. Burns*, [2001] 1 S.C.R. 283, 2001 SCC 7, at para. 78.

143 In short, after it is determined that Parliament acted pursuant to a legitimate state interest, the question can still be posed under s. 7 whether the government's legislative measures in response to the use of marihuana were, in the language of *Suresh*, "so extreme that they are *per se* disproportionate to any legitimate government interest" (para. 47 (emphasis added)). As we explain below, the applicable standard is one of *gross* disproportionality, the proof of which rests on the claimant.

144 The aspect of proportionality of interest to the appellants is the alleged lack of proportionality between the contribution of the marihuana prohibition to public health and safety (the appellants say the prohibition is so ineffective that it contributes little) and the adverse effects on persons subject to the prohibition, including those who are charged and convicted of the offence (the appellants say the adverse effects are severe and lasting). The relevant effects include those that relate to the life, liberty or security of an individual, and that are the product of the state action complained of.

145 We have already rejected Mr. Malmo-Levine's "pleasure principle" on the basis that depriving the general user of the freedom to smoke "pot" is not the violation of a freestanding constitutional right. We turn now to the effects of the criminalization of marihuana possession on accused persons.

3. The Availability of Imprisonment

146 Although this issue belongs to the s. 7 analysis, we wish to highlight its importance here to address our disagreement with Arbour J., for whom the availability of imprisonment is the controlling consideration (paras. 216, 244, 256 and 257).

147 Our colleague writes at para. 257:

> While the cases referred to by my colleagues clearly illustrate the state's interest in the protection of vulnerable groups from others who might harm them, they are far from suggesting that it is the vulnerable ones who should be sent to jail for their self-protection. Implicit in my colleagues' argument is that the state would be justified in threatening with imprisonment adolescents with a history of

> poor school performance, women of childbearing age and persons with pre-existing diseases such as cardiovascular diseases, respiratory diseases, schizophrenia and other drug dependencies, who are at particular risk of harming themselves by using marihuana. I do not think that an exception to the harm principle is justified to allow the state to threaten with imprisonment vulnerable people in order to prevent them from harming themselves.

148 We disagree with our colleague's view that it is unconstitutional for the state to attempt to deter vulnerable people from self-harm by criminalization of the harmful conduct backed up, where appropriate, by the "threat" of imprisonment. We disagree with the premise that vulnerable people of the sort she describes are in fact threatened with jail, or that imposition of a jail term in the circumstances she envisages would be upheld as a fit sentence or a constitutional sentence.

149 A finding that a particular form of penalty violates s. 12 may call for a constitutional remedy in relation to the penalty, but leave intact the criminalization of the conduct, which may still be constitutionally punishable by an alternative form of penalty.

150 Braidwood J.A., too, rested his analysis on the availability of imprisonment. He found that "it is common sense that you don't go to jail unless there is a potential that your activities will cause harm to others" (para. 134). The appellant in *Clay, supra*, released concurrently, similarly argued at para. 25 of his factum that "[w]hile a reasonable apprehension of a 'not insignificant' or 'not trivial' harm may suffice to justify a regulatory prohibition on the personal and private consumption of a substance, it is not constitutionally adequate for justifying the use of incarceration and the imposition of a criminal record to deter such consumption" (emphasis added) . We agree with the observation that the operative concept here is the use of incarceration, not the availability of incarceration.

151 In addition to the possible penalty of imprisonment, the appellants highlight a number of other consequences of being charged and convicted for possession of marihuana, including the effects of having a criminal record, the cost of mounting a defence, and the potential adverse impact on education and job prospects (even prior to trial, and whether or not a conviction results). They submit that these harms to the individual accused are disproportionate to any societal interest served by the (largely ineffective) suppression of marihuana use.

152 As the appellants' principal argument on this branch of the case relates to the availability of imprisonment, we will turn first to that issue.

(a) *No Mandatory Minimum Sentence*

153 Possession of marihuana carries no minimum sentence. However, the general framework of the NCA permits imprisonment, and marihuana is one of the scheduled drugs. The prescription of sentencing options by Parliament reflects its view of the seriousness of the offence, and is ordinarily taken into consideration by the sentencing judge.

154 Imprisonment is imposed by the courts for simple possession only in exceptional circumstances. Our colleague Arbour J. writes, as mentioned earlier, about threatening with jail underachieving school age adolescents, women of childbearing age and the mentally afflicted, but the cases show that this analysis rests on a faulty premise. In most possession cases, offenders (whether vulnerable or not) receive discharges or conditional sentences. This is particularly true where the amounts of marihuana involved are small and for recreational uses, where the usual sentence is a conditional discharge. See, e.g., C. C. Ruby and D. L. Martin, *Criminal Sentencing Digest* (loose-

leaf), 30 para. 320, at p. 1251; *R. v. Fleming* (1992), 21 W.A.C. 79 (B.C.C.A.); *R. v. Culley* (1977), 36 C.C.C. (2d) 433 (Ont. C.A.).

155 The reality is this. There is no impediment (such as a mandatory minimum sentence) to a trial judge imposing a fit sentence after a conviction for simple possession of marihuana. The "availability" of imprisonment in respect of the scheduled drugs under the NCA is part of a statutory framework for dealing with drugs generally and is not specifically directed at marihuana. The case law discloses that it is only in the presence of aggravating circumstances, not likely to be present in the situation of the "vulnerable persons" referred to by our colleague, where a court has been persuaded that imprisonment for simple possession of marihuana was, in the particular case, a fit sentence.

156 In *R. v. Dauphinee* (1984), 62 N.S.R. (2d) 156 (S.C. App. Div.), a three-month sentence of imprisonment for simple possession of one ounce of marihuana was upheld on appeal because the offender had five prior narcotics possession offences and the trial judge noted that the accused showed no signs of amending his conduct. Prison sentences are also occasionally handed out where an individual has been sentenced for a more serious drug offence. See, e.g., *R. v. Witter*, [1997] O.J. No. 2248 (QL) (Gen. Div.) (six-month sentence for possession of marihuana to be served concurrently with three-year sentence for trafficking in cocaine; accused had nine prior narcotics convictions); *R. v. Coady* (1994), 24 W.C.B. (2d) 459 (Nfld. S.C.T.D.) (sentenced to 14 days' imprisonment for possession of 70 grams of marihuana to be served concurrently with nine-month sentence for possession of hashish with intent to traffic); *R. v. Richards* (1989), 88 N.S.R. (2d) 425 (S.C. App. Div.) (four-month sentence for possession of 113.5 grams of marihuana to be served concurrently with a sentence of one year for possession of 15 grams of cocaine, plus one year's probation; respondent had six prior narcotics-related convictions; the court noted his behaviour endangered the safety of his family and no leniency was warranted in light of his recidivism). In addition, some incarcerations associated with possession offences result from the failure to pay fines, or where the Crown has agreed to permit a plea bargain for a lesser included offence. See B. A. MacFarlane, R. J. Frater and C. Proulx, *Drug Offences in Canada* (3rd ed. (loose-leaf)), at p. 29-20.

157 It is no doubt true that in an earlier era judges may have resorted to imprisonment more frequently than would be considered acceptable under the *Charter*, but the argument here is a post-*Charter* argument. It asks whether the marihuana prohibition *can* be -- and is *required* to be -- applied consistently with the *Charter*. In our view, the answer to both questions is yes.

158 First, as mentioned above, we believe that the issue of punishment should be approached in light of s. 12 of the *Charter* (which protects against "cruel and unusual treatment or punishment"), and, in that regard, the constitutional standard is one of gross disproportionality. Second, in our opinion, the lack of any mandatory minimum sentence together with the existence of well-established sentencing principles mean that the mere availability of imprisonment on a marihuana charge cannot, without more, violate the principle against gross disproportionality.

(b) *The Section 12 Standard -- Gross Disproportionality*

159 The standard set out in s. 12 of the *Charter* sheds light on the requirements of s. 7. As Lamer J. explained in *Re B.C. Motor Vehicle Act, supra*, ss. 8 to 14 of the *Charter* may be seen as specific illustrations of the principles of fundamental justice in s. 7. While proportionality "is the essence of a s. 12 analysis" (*R. v. Morrisey*, [2000] 2 S.C.R. 90, 2000 SCC 39, at para. 44), the constitutional standard is gross disproportionality. As the majority explained in *Morrisey* (at para. 26) :

> Where a punishment is merely disproportionate, no remedy can be found under s. 12. Rather, the court must be satisfied that the punishment imposed is grossly disproportionate for the offender, such that Canadians would find the punishment abhorrent or intolerable. [First emphasis added; second emphasis in original.]

See *R. v. Smith*, [1987] 1 S.C.R. 1045, *per* Lamer J., at p. 1072:

> The test for review under s. 12 of the *Charter* is one of gross disproportionality, because it is aimed at punishments that are more than merely excessive. We should be careful not to stigmatize every disproportionate or excessive sentence as being a constitutional violation, and should leave to the usual sentencing appeal process the task of reviewing the fitness of a sentence. [Emphasis added.]

See also *Steele v. Mountain Institution*, [1990] 2 S.C.R. 1385, at p. 1417: "The test for determining whether a sentence is disproportionately long is very properly stringent and demanding. A lesser test would tend to trivialize the *Charter*". See also *R. v. Latimer*, [2001] 1 S.C.R. 3, 2001 SCC 1, at para. 77.

160 Is there then a principle of fundamental justice embedded in s. 7 that would give rise to a constitutional remedy against a punishment that does not infringe s. 12? We do not think so. To find that gross and excessive disproportionality of punishment is required under s. 12 but a lesser degree of proportionality suffices under s. 7 would render incoherent the scheme of interconnected "legal rights" set out in ss. 7 to 14 of the *Charter* by attributing contradictory standards to ss. 12 and 7 in relation to the same subject matter. Such a result, in our view, would be unacceptable.

161 Accordingly, even if we were persuaded by our colleague Arbour J. that punishment should be considered under s. 7 instead of s. 12, the result would remain the same. In both cases, the constitutional standard is gross disproportionality. In neither case is the standard met.

162 Further, even if the penalty of imprisonment were found to violate the gross disproportionality standard, the constitutional remedy would have to address the range of available penalties rather than the decriminalization of the underlying conduct of marihuana possession.

(c) *Proportionality in Sentencing*

163 At this point, we turn from the *Charter* to the *Criminal Code*, in which Parliament has made the idea of proportionality central to the principles of sentencing. Section 718.1 of the *Criminal Code* provides that "[a] sentence must be proportionate to the gravity of the offence and the degree of responsibility of the offender." The importance of proportionality in punishment has been discussed on several occasions by this Court. See, for instance, *R. v. Proulx*, [2000] 1 S.C.R. 61, 2000 SCC 5, at para. 82, where Lamer C.J., writing for the Court, referred to "the fundamental principle of sentencing, which provides that a sentence must be proportional to the gravity of the offence and the degree of responsibility of the offender". See also *R. v. Wust*, [2000] 1 S.C.R. 455, 2000 SCC 18, at para. 18; *R. v. M. (C.A.)*, [1996] 1 S.C.R. 500, at para. 40; and *Re B.C. Motor Vehicle Act, supra, per* Wilson J. (concurring), at p. 533.

164 The requirement of proportionality in sentencing undermines rather than advances the appellants' argument. There is no need to turn to the *Charter* for relief against an unfit sentence. If im-

prisonment is not a fit sentence in a particular case it will not be imposed, and if imposed, it will be reversed on appeal.

165 There is no plausible threat, express or implied, to imprison accused persons -- including vulnerable ones -- for whom imprisonment is not a fit sentence.

166 On another branch of the imprisonment argument, our colleague Arbour J. argues that it is unconstitutional for the state to attempt to prevent the general population, under threat of imprisonment, from engaging in conduct that is harmless to them, on the basis that other, more vulnerable persons may harm themselves if they engage in it (para. 258). In our view, with respect, this proposition is too broadly stated. In the present context, as previously noted, the evidence shows that it is not possible generally to distinguish in advance the general population from its more vulnerable members. Chronic users emerge from unexpected sources. If our colleague is correct, the impossibility of precise identification of "chronic users" in advance would incapacitate Parliament from taking any action at all to help those in need of its protection, a proposition we do not accept. Further, we do not agree with our colleague that it is a straightforward matter to distinguish between harm to self and harm to others. We noted earlier the recent comment of the Law Commission of Canada that "in a society that recognizes the interdependency of its citizens, such as universally contributing to healthcare or educational needs, harm to oneself is often borne collectively" (p. 17).

167 We agree with the appellants that imprisonment would ordinarily be an unfit sentence for a conviction on simple possession of marihuana. We disagree, however, that this observation gives rise to a finding of unconstitutionality. Rather, it gives rise, in appropriate circumstances, to an ordinary sentence appeal.

168 In the result, where there is no minimum mandatory sentence, the mere availability of imprisonment on a charge of marihuana possession does not violate the s. 7 principle against gross disproportionality. There are circumstances, as noted, where imprisonment would constitute a fit sentence.

4. A More General Principle of Disproportionality

169 As stated, the proportionality argument made by the appellants is broader than the mere disproportionality of penalty. They are correct to point out that interaction by an accused with the criminal justice system brings with it a number of consequences, not least among them the possibility of a criminal record. We agree that the proportionality principle of fundamental justice recognized in *Burns* and *Suresh* is not exhausted by its manifestation in s. 12. The content of s. 7 is not limited to the sum of ss. 8 to 14 of the *Charter*. See, for instance, *R. v. Hebert*, [1990] 2 S.C.R. 151; *Thomson Newspapers, supra*. We thus accept that the principle against gross disproportionality under s. 7 is broader than the requirements of s. 12 and is not limited to a consideration of the penalty attaching to conviction. Nevertheless the standard under s. 7, as under s. 12, remains one of *gross* disproportionality. In other words, if the use of the criminal law were shown by the appellants to be grossly disproportionate in its effects on accused persons, when considered in light of the objective of protecting them from the harm caused by marihuana use, the prohibition would be contrary to fundamental justice and s. 7 of the *Charter*.

170 In this respect, the appellants urge three factors. Firstly, they point to the adverse consequences to the individual accused other than imprisonment. Secondly, they suggest that the relative ineffectiveness of the ban shows that the prohibition only marginally advances the interest of the state, and that this should facilitate a judicial finding of gross disproportionality. Thirdly, and more

generally, the appellants state that the salutary effects of the law are vastly outweighed by the deleterious effects.

171 We address these three aspects of the appellants' disproportionality argument in turn.

(a) *The Consequences to the Individual Other Than Imprisonment*

172 In addition to the possibility of imprisonment, the appellants refer to harms flowing from having a criminal record. At para. 26 of their Joint Statement of Legislative Facts, they state:

> The impact of criminal convictions on the futures of young Canadians has historically been identified as one of the most serious social harms generated by the criminal prohibition of cannabis. Upon being charged, tremendous costs are incurred during the pre-trial period, costs which tend to have a much more dramatic impact on young people. Most of the young people charged with cannabis offences are on the low end of the socioeconomic scale and, thus, for them the financial burden is particularly onerous. Once a person is found guilty of a cannabis charge, s/he must confront the additional adverse effects associated with having a criminal record for such an offence.

There is no doubt that having a criminal record has serious consequences. The legislative policy embodied in the NCA is that a conviction for the possession of marihuana *should* have serious consequences. Therein lies the deterrent effect of the prohibition. The wisdom of this policy is, as mentioned, under review by Parliament. It appears that this review has been prompted, in part, by a recognition of the significant effects of being involved in the criminal justice system. For instance, background information from Health Canada states:

> [B]eing prosecuted and convicted in a criminal court bears a stigma that can have far-reaching consequences in an individual's life in such areas as job choices, travel and education. Participating in the criminal court process can also involve personal upheaval.

(Health Canada. Information: Cannabis Reform Bill, May 2003)

173 However, the question before us is not whether Parliament *should* change its policy but whether it is *required* by the Constitution to do so. As Dickson C.J. commented in *Reference re ss. 193 and 195.1(1)(c) of the Criminal Code (Man.)*, [1990] 1 S.C.R. 1123, at p. 1142: "The issue is not whether the legislative scheme is frustrating or unwise but whether the scheme offends the basic tenets of our legal system."

174 On this branch of the case the Court can only ask whether the effects on the accused are so grossly disproportionate that they render the prohibition contrary to s. 7 of the *Charter*. Once it is determined that Parliament acted pursuant to a valid state interest in attempting to suppress the use for recreational purposes of a particular psychoactive drug, and given the findings of harm flowing from marihuana use, already discussed, we do not think that the consequences in this case trigger a finding of gross disproportionality. Firstly, the consequences are largely the product of deliberate disobedience to the law of the land. In his factum, Malmo-Levine speaks of "mass civil disobedience". He writes (at para. 10):

> The glaring hypocrisy of the war on "some" drugs, and the obvious effectiveness of cannabis will ensure users are never going to back down, and that we intend to out-grow the "low-functioning" stigma foisted upon us and assume our rightful place as the "mellow and imaginative" section of society.

This may be so, but evaluation of adverse effects has to take the nature of this political confrontation into account. Secondly, if the court imposes a sentence on conviction that is no more than a fit sentence, which it is required to do, the other adverse consequences are really associated with the criminal justice system in general rather than this offence in particular. In any system of criminal law there will be prosecutions that turn out to be unfounded, publicity that is unfairly adverse, costs associated with a successful defence, lingering and perhaps unfair consequences attached to a conviction for a relatively minor offence by other jurisdictions, and so on. These effects are serious but they are part of the social and individual costs of having a criminal justice system. Whenever Parliament exercises its criminal law power, such costs will arise. To suggest that such "inherent" costs are fatal to the exercise of the power is to overshoot the function of s. 7.

175 We agree that the effects on an accused person of the criminalization of marihuana possession are serious. They are the legitimate subject of public controversy. They will undoubtedly be addressed in parliamentary debate. Applying a standard of gross disproportionality however, it is our view that the effects on accused persons of the present law, including the potential of imprisonment, fall within the broad latitude within which the Constitution permits legislative action.

(b) *Ineffectiveness of the Prohibition of Marihuana*

176 The appellants next argue that the adverse effects on accused persons of the prohibition on possession are grossly disproportionate to any legitimate state interest because the prohibition is simply ineffective. It contributes virtually nothing to advancing the state interest in preventing the use of marihuana. Reliance is placed in this regard on the view of the trial judge in *Caine* who stated: "Thus, in Canada, it would appear that the variations in consumption rates noted above (in particular, the decline in consumption since 1969) have occurred with no apparent statistical relationship to any increase or decrease in the severity of the law or its application" (para. 57). Also, at para. 62: "It is a fair and common sense conclusion that marihuana consumption would increase upon legalization, thereby leading to an increase in the absolute number of chronic users and vulnerable persons adversely affected by the drug. However, it is impossible to conclude, from the evidence before me, whether this increase would be substantial, moderate, or negligible."

177 This Court has exercised caution in accepting arguments about the alleged ineffectiveness of legal measures: see *Reference re Firearms Act (Can.), supra*, where the Court held that "[t]he efficacy of a law, or lack thereof, is not relevant to Parliament's ability to enact it under the division of powers analysis" (para. 57). While somewhat different considerations come into play under a *Charter* analysis, it remains important that some deference be accorded to Parliament in assessing the utility of its chosen responses to perceived social ills.

178 Questions about which types of measures and associated sanctions are best able to deter conduct that Parliament considers undesirable is a matter of legitimate ongoing debate. The so-called "ineffectiveness" is simply another way of characterizing the refusal of people in the appellants' position to comply with the law. It is difficult to see how that refusal can be elevated to a constitutional argument against validity based on the invocation of fundamental principles of justice. In-

deed, it would be inconsistent with the rule of law to allow compliance with a criminal prohibition to be determined by each individual's personal discretion and taste.

(c) *The Balance of Salutary and Deleterious Effects*

179 Finally, the appellants say that the prohibition is disproportionate to the state's interest because its negative consequences are grossly disproportionate to its positive features, if any.

180 In this connection, Braidwood J.A. reproduced a summary of the evidence of harm to society resulting from the prohibition itself including disrespect for the law among those who disagree with it; distrust of health and educational authorities who have "promoted false and exaggerated allegations about marihuana"; lack of communication between youth and their elders about the use of marihuana; risks from involvement with criminals and hard-drug users; lack of governmental control over drug quality; "the creation of a lawless sub-culture"; financial costs associated with enforcing the law; and "the inability to engage in meaningful research into the properties, effects and dangers of the drug, because possession of the drug is unlawful" (para. 28).

181 In effect, the exercise undertaken by Braidwood J.A. was to balance the law's salutary and deleterious effects. In our view, with respect, that is a function that is more properly reserved for s. 1. These are the types of social and economic harms that generally have no place in s. 7.

182 The appellants were correct to criticize the government's attempted wholesale importation of "societal interests" from s. 1 to s. 7 to try to support the constitutional validity of the prohibition. In our view, the appellants should equally be stopped from importing the "salutary/deleterious" effects balance from s. 1 in order to try to justify the opposite conclusion.

183 As, in our view, the appellants have not established an infringement of s. 7, there is no need to call on the government for a s. 1 justification.

F. *Section 15 of the Charter*

184 The appellant Malmo-Levine makes the additional argument that the criminalization of marihuana constitutes a breach of s. 15 of the *Charter*. He posits that marihuana users have a "substance orientation" which is a personal characteristic analogous to other s. 15 grounds such as sexual orientation: *Vriend v. Alberta*, [1998] 1 S.C.R. 493. He further submits that s. 15 is meant to protect individuals who have experienced persecution for activities that are not inherently harmful to society, and in the appellant Malmo-Levine's view, cannabis use is simply "harmless hedonis[m]".

185 A taste for marihuana is not a "personal characteristic" in the sense required to trigger s. 15 protection: *Andrews v. Law Society of British Columbia*, [1989] 1 S.C.R. 143. As Malmo-Levine argues elsewhere, it is a lifestyle choice. It bears no analogy with the personal characteristics listed in s. 15, namely race, national or ethnic origin, colour, religion, sex, age, or mental or physical disability. It would trivialize this list to say that "pot" smoking is analogous to gender or religion as a "deeply personal characteristic that is either unchangeable or changeable only at unacceptable personal costs": *Egan v. Canada*, [1995] 2 S.C.R. 513, at para. 5; *Vriend, supra*, at para. 90. Malmo-Levine's equality claim therefore fails at the first hurdle of the requirements set out in *Law v. Canada (Minister of Employment and Immigration)*, [1999] 1 S.C.R. 497. The true focus of s. 15 is "to remedy or prevent discrimination against groups subject to stereotyping, historical disadvantage and political and social prejudice in Canadian society": *Swain, supra*, at p. 992, *per* Lamer C.J.; and

Rodriguez, supra, at p. 616. To uphold Malmo-Levine's argument for recreational choice (or life-style protection) on the basis of s. 15 of the *Charter* would simply be to create a parody of a noble purpose.

VI. Conclusion

186 For these reasons, it is our view that the *Charter* challenges must fail and that the appeals should be dismissed.

187 The constitutional questions in the *Malmo-Levine* appeal should therefore be answered as follows:

1. Does prohibiting possession of Cannabis (marihuana) for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 7 of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

2. If the answer to Question 1 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: It is unnecessary to answer this question.

3. Does prohibiting possession of Cannabis (marihuana) for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 15(1) of the *Charter* by discriminating against a certain group of persons on the basis of their substance orientation, occupation orientation, or both?

Answer: No.

4. If the answer to Question 3 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: It is unnecessary to answer this question.

188 The constitutional questions in the *Caine* appeal should be answered as follows:

1. Does prohibiting possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 7 of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

2. If the answer to Question 1 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: It is unnecessary to answer this question.

3. Is the prohibition on the possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), within the legislative competence of the Parliament of Canada as being a law enacted for the peace, order and good government of Canada pursuant to s. 91 of the *Constitution Act, 1867*; as being enacted pursuant to the criminal law power in s. 91(27) thereof; or otherwise?

Answer: Yes.

The following are the reasons delivered by

189 ARBOUR J. (dissenting in *Caine*):-- The appeal of the appellant Caine calls into question the constitutionality of the provisions prohibiting possession of cannabis (marihuana) for personal use. The provisions are attacked on the ground that they are not within the legislative competence of the Parliament of Canada and that they infringe s. 7 of the *Canadian Charter of Rights and Freedoms*. In addition to challenging the prohibition on simple possession, the appellant Malmo-Levine also challenges the prohibition of possession of marihuana for the purpose of trafficking on the ground that it infringes ss. 7 and 15 of the *Charter*. The case of the appellant Clay (*R. v. Clay*, [2003] 3 S.C.R. 735, 2003 SCC 75), on appeal from the decision of the Court of Appeal for Ontario ((2000), 49 O.R. (3d) 577), was heard together with the cases of the appellants Caine and Malmo-Levine, on appeal from the decision of the Court of Appeal of British Columbia ((2000), 138 B.C.A.C. 218, 2000 BCCA 335). The *Clay* appeal raises issues identical to the *Caine* appeal and is based on similar findings of fact. Therefore, I will address all three appeals in these reasons and refer to the findings of the courts below in Ontario and in British Columbia.

190 We are asked to address, directly for the first time, whether the *Charter* requires that harm to others or to society be an essential element of an offence punishable by imprisonment. In a landmark 1985 case, Lamer J. (as he then was) said : "A law that has the potential to convict a person who has not really done anything wrong offends the principles of fundamental justice and, if imprisonment is available as a penalty, such a law then violates a person's right to liberty under s. 7 of the *Charter*" (*Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486, at p. 492 ("*Motor Vehicle Reference*")). In my view, a "person who has not really done anything wrong" is a person whose conduct caused little or no reasoned risk of harm or whose harmful conduct was not his or her fault. Therefore, for the reasons that follow, I am of the view that s. 7 of the *Charter* requires not only that some minimal mental element be an essential element of any offence punishable by imprisonment, but also that the prohibited act be harmful or pose a risk of harm to others. A law that has the potential to convict a person whose conduct causes little or no reasoned risk of harm to others offends the principles of fundamental justice and, if imprisonment is available as a penalty, such a law then vio-

lates a person's right to liberty under s. 7 of the *Charter*. Imprisonment can only be used to punish blameworthy conduct that is harmful to others.

I. The Facts and the Proceedings

191 My colleagues Justices Gonthier and Binnie have referred to the salient facts. The adjudicative facts of each case are not in dispute and my colleagues have aptly summarized them. I propose to simply highlight what I consider essential to the disposition of these appeals, most of which is contained in the findings of fact of the trial judges with respect to the harms associated with marihuana use. My colleagues have also referred to recent studies and recent parliamentary reports on the effects of the use of marihuana. The conclusions and recommendations in these new documents are similar to those presented to the trial judges and in my view they add nothing to the full factual record upon which both the trial judges and the courts of appeal in these cases founded their conclusions. In light of this, I do not think that we need to come to our own assessment of the facts. Rather, we should defer to the trial courts absent a patent and overriding error on their part. I am content to rely entirely on the findings of fact below as I see nothing in the new materials introduced before us that suggests that these findings were in error.

192 The findings of fact made by the trial judges in *Caine* and *Clay* are similar in all respects (they are set out in full in para. 40 of the reasons for judgment of Howard Prov. Ct. J. in the *Caine* appeal, and in para. 25 of the reasons for judgment of McCart J. in the *Clay* appeal). In *Clay*, McCart J. made the following findings of fact, which were accepted by Rosenberg J.A. at the Court of Appeal for Ontario (at para. 10):

1. Consumption of marijuana is relatively harmless compared to the so-called hard drugs and including tobacco and alcohol;
2. There exists no hard evidence demonstrating any irreversible organic or mental damage from the consumption of marijuana;
3. That cannabis does cause alteration of mental functions and as such, it would not be prudent to drive a car while intoxicated;
4. There is no hard evidence that cannabis consumption induces psychoses;
5. Cannabis is not an addictive substance;
6. Marijuana is not criminogenic in that there is no evidence of a causal relationship between cannabis use and criminality;
7. That the consumption of marijuana probably does not lead to "hard drug" use for the vast majority of marijuana consumers, although there appears to be a statistical relationship between the use of marijuana and a variety of other psychoactive drugs;
8. Marijuana does not make people more aggressive or violent;
9. There have been no recorded deaths from the consumption of marijuana;
10. There is no evidence that marijuana causes amotivational syndrome;
11. Less than 1% of marijuana consumers are daily users;
12. Consumption in so-called "de-criminalized states" does not increase out of proportion to states where there is no de-criminalization;
13. Health related costs of cannabis use are negligible when compared to the costs attributable to tobacco and alcohol consumption.

193 After having thus established what harms are not associated with marihuana use, McCart J. found, at paras. 26-27:

> Having said all of this, there was also general consensus among the experts who testified that the consumption of marijuana is not completely harmless. While marijuana may not cause schizophrenia, it may trigger it. Bronchial pulmonary damage is at risk of occurring with heavy use. However, to be fair, there is also general agreement among the experts who testified that moderate use of marijuana causes no physical or psychological harm. Field studies in Greece, Costa Rica and Jamaica generally supported the idea that marijuana was a relatively safe drug -- not totally free from potential harm, but unlikely to create serious harm for most individual users or society.
>
> The Le Dain Commission found at least four major grounds for social concern: the probably harmful effect of cannabis on the maturing process in adolescence; the implications for safe driving arising from impairment of cognitive functions and psycho motor abilities, from the additive interaction of cannabis and alcohol and from the difficulties of recognizing or detecting cannabis intoxication; the possibility, suggested by reports in other countries and clinical observations on this continent, that the long term, heavy use of cannabis may result in a significant amount of mental deterioration and disorder; and the role played by cannabis in the development and spread of multi-drug use by stimulating a desire for drug experience and lowering inhibitions about drug experimentation. This report went on to state that it did not yet know enough about cannabis to speak with assurance as to what constitutes moderate as opposed to excessive use.

194 In *Caine*, Howard Prov. Ct. J. found as follows with respect to what harms are not associated with marihuana use (at para. 40):

> 1. the occasional to moderate use of marihuana by a healthy adult is not ordinarily harmful to health, even if used over a long period of time;
> 2. there is no conclusive evidence demonstrating any irreversible organic or mental damage to the user, except in relation to the lungs and then only to those of a chronic, heavy user such as a person who smokes at least 1 and probably 3-5 marihuana joints per day;
> 3. there is no evidence demonstrating irreversible, organic or mental damage from the use of marihuana by an ordinary healthy adult who uses occasionally or moderately;
> 4. marihuana use does cause alteration of mental function and as such should not be used in conjunction with driving, flying or operating complex machinery;
> 5. there is no evidence that marihuana use induces psychosis in ordinary healthy adults who use [marihuana] occasionally or moderately and, in relation to the heavy user, the evidence of marihuana psychosis appears to arise only in those having a predisposition towards such a mental illness;
> 6. marihuana is not addictive;

7. there is a concern over potential dependence in heavy users, but marihuana is not a highly reinforcing type of drug, like heroin or cocaine and consequently physical dependence is not a major problem; psychological dependence may be a problem for the chronic user;
8. there is no causal relationship between marihuana use and criminality;
9. there is no evidence that marihuana is a gateway drug and the vast majority of marihuana users do not go on to try hard drugs; recent animal studies involving the release of dopamine and the release of cortico releasing factor when under stress do not support the gateway theory;
10. marihuana does not make people aggressive or violent, but on the contrary it tends to make them passive and quiet;
11. there have been no deaths from the use of marihuana;
12. there is no evidence of an amotivational syndrome, although chronic use of marihuana could decrease motivation, especially if such a user smokes so often as to be in a state of chronic intoxication;
13. assuming current rates of consumption remain stable, the health related costs of marihuana use are very, very small in comparison with those costs associated with tobacco and alcohol consumption.

195 The trial judge mentioned that these findings were consistent with, *inter alia*, the findings of the Commission of Inquiry into the Non-Medical Use of Drugs, chaired by Gerald Le Dain (later Le Dain J. of this Court). After almost four years of public hearings and research, the majority of the commissioners concluded that simple possession of marihuana should not be a criminal offence. The Commission made the following findings with respect to the harms that are <u>not</u> associated with marihuana use:

1. cannabis is not a "narcotic";
2. few acute physiological effects have been detected from current use in Canada;
3. few users (less than one percent) of cannabis move on to use harder and more dangerous drugs;
4. there is no scientific evidence indicating that cannabis use is responsible for other forms of criminal behaviour;
5. at present levels of use, the risks or harms from consumption of cannabis are much less serious than the risks or harms from alcohol use; and
6. the short term physical effects of cannabis are relatively insignificant and there is no evidence of serious long term physical effects.

(*Cannabis: A Report of the Commission of Inquiry into the Non-Medical Use of Drugs* (1972), at pp. 265-310)

196 Howard Prov. Ct. J. added, however, that marihuana is not a "completely harmless drug for all individual users" (para. 42). She first discussed the health risks for the user and summarized her findings as follows (at para. 39):

> On the question of whether individual marihuana users face any health risks, the distinction between "low/occasional/moderate users" and "chronic users" is of considerable importance. Quite simply, the risk of harm from the use of

> marihuana depends upon which group one is talking about. All of the witnesses from whom I have heard, including Dr. Kalant, appear to agree that there is no evidence to sug[g]est that low/occasional/moderate users assume any significant health risks from smoking marihuana, so long as they are healthy adults and do not fall into one of the vulnerable groups, namely immature youths, pregnant women and the mentally ill. On the other hand, for the chronic user, there is a significant health risk although, this is primarily from the process of smoking, rather than from the chemical make-up of the drug.

Howard Prov. Ct. J. again referred, at para. 42, to the findings of the Le Dain Commission, this time with respect to the harm that may be occasioned by marihuana use. These findings were also referred to in *Clay*, at para. 27, and reproduced above, but I repeat them here for convenience:

1. "the probably harmful effect of cannabis on the maturing process in adolescence;"
2. "the implications for safe driving arising from impairment of cognitive functions and psycho motor abilities ...;"
3. "the possibility, suggested by reports in other countries and clinical observations on this continent, that the long term, heavy use of cannabis may result in a significant amount of mental deterioration and disorder;" and
4. "the role played by cannabis in the development and spread of multi-drug use by stimulating a desire for drug experience and lowering inhibitions about drug experimentation."

197 Howard Prov. Ct. J. also referred to the Hall Report (W. Hall, N. Solowij and J. Lemon, *National Drug Strategy: The health and psychological consequences of cannabis use* (1994), and summarized its conclusions with regard to the "[a]cute effects" of marihuana use, that is, the adverse effects that might occur while actually under the influence (at para. 44):

> Taken as a whole, the findings suggest that: (1) naive users should be careful and if they choose to smoke should do so with experienced users and in an appropriate setting, (2) no one should be studying, writing an exam, or engaging in other complex mental activities while in a state of intoxication induced by cannabis (or alcohol, for that matter); (3) pregnant women should not smoke cannabis (of course, they should not be smoking tobacco or drinking alcohol either); (4) the mentally ill or those with a family history of mental illness should not use cannabis; and (5) as with alcohol, no one should drive, fly or operate complex machinery while under the influence of marihuana.

As to the "chronic effects", that is, the adverse effects that might occur from the chronic use of cannabis (daily use over many years), the Hall Report notes that there is still considerable "uncertainty" and Howard Prov. Ct. J. summarized its findings as follows, at paras. 45-46:

> The "major probable adverse effects" from chronic use appear to be:

-- respiratory diseases associated with smoking as the method of administra-

tion, such as chronic bronchitis, and the occurrence of histo[pa]th[o]logical changes that may be precursors to the development of malignancy;

-- development of a cannabis dependence syndrome, characterized by an inability to abstain from or to control cannabis use;

-- subtle forms of cognitive impairment, most particularly of attention and memory, which persist while the user remains chronically intoxicated, and may or may not be reversible after prolonged abstinence from cannabis.

The "major possible adverse effects" from chronic use (that is, effects which remain to be confirmed by further research) are:

-- an increased risk of developing cancers of the aerodigestive tract, i.e. oral cavity, pharynx, and oesophagus;

-- an increased risk of leukaemia among offspring exposed while in utero; (since disproved)

-- a decline in occupational performance marked by underachievement in adults in occupations requiring high level cognitive skills, and impaired educational attainment in adolescents;

-- birth defects occurring among children of women who used cannabis during pregnancies. (since disproved)

Both Dr. Kalant and Dr. Connolly agreed that research since the publication of the Hall Report (1994) has failed to reveal any foundation for the above-noted concerns regarding (1) leukaemia among off-spring, and (2) birth defects among children of women who used marihuana during pregnancy. These concerns would no longer be considered as "risks" in the scientific community.

Finally, the Hall Report identifies three traditional "high risk groups":

(1) Adolescents with a history of poor school performance whose educational achievements may be further limited by cognitive impairments if chronically intoxicated, or who start using cannabis at an early age

(there being a concern that such youths are at higher risk of becoming chronic users of cannabis as well as other drugs);

(2) Women of childbearing age, because of the concern with the effects of smoking cannabis while pregnant; and

(3) Persons with pre-existing diseases such as cardiovascular diseases, respiratory diseases, schizophrenia or other drug dependencies, all of whom may face a risk of precipitating or exacerbating the symptoms of their d[is]eases.

198 On the basis of this evidence, Howard Prov. Ct. J. concluded as follows with respect to the health risks to the user occasioned by marihuana use (at para. 48):

> There was general agreement among the witnesses who appeared before me (save perhaps for Dr. Morgan) that the conclusions contained in the Hall Report were sound (except for the references to leukemia and birth defects), based on the scientific information available at this time. It should be noted that, apart from the "acute effects", which are rare and transient, none of the above reports raise any significant concerns about the well-being of a healthy adult who is a low/occasional/moderate user of marihuana.

199 Howard Prov. Ct. J. then discussed the risk of harm to others or to society as a whole. She concluded that the only possible harm to individual members of society is related to the fact that an "individual who is in a state of intoxication induced by marihuana poses a risk to the health and safety of others should he or she drive, fly or operate complex machinery" (para. 49). However, Howard Prov. Ct. J. noted that while the state had a legitimate interest in protecting members of society from such conduct, s. 253(*a*) of the *Criminal Code*, R.S.C. 1985, c. C-46, already achieves this purpose. With respect to harm to society as a whole, Howard Prov. Ct. J., at paras. 51-52, concluded that

> [t]he current widespread use of marihuana does not appear to have had any significant impact on the health care system of this province and, more importantly, it has not been perceived by our health care officials as a significant health concern, either provincially or nationally... .
>
> The evidence establishes that any health care concerns (including financial concerns) associated with marihuana use in this country are minor compared to the social, criminal and financial costs associated with the use of alcohol or tobacc[o].

200 Finally, Howard Prov. Ct. J. considered the harm caused by the prohibition of marihuana, which she summarized as follows, at para. 63:

> 1. countless Canadians, mostly adolescents and young adults, are being prosecuted in the "criminal" courts, subjected to the threat of (if not actual) imprisonment, and branded with criminal records for engaging [in] an activity that is remark[a]bly benign (estimates suggest that over 600,000 Ca-

nadians now have criminal records for cannabis related offences); meanwhile others are free to consume society's drugs of choice, alcohol and tobacco, even though these drugs are known killers;

2. disrespect for the law by upwards of one million persons who are prepared to engage in this activity, notwithstanding the legal prohibition;
3. distrust, by users, of health and educational authorities who, in the past, have promoted false and exaggerated allegations about marihuana; the risk is that marihuana users, especially the young, will no longer listen, even to the truth;
4. lack of open communication between young persons and their elders about their use of the drug or any problems they are experiencing with it, given that it is illegal;
5. the risk that our young people will be associating with actual criminals and hard drug users who are the primary suppliers of the drug;
6. the lack of governmental control over the quality of the drug on the market, given that it is available only on the black market;
7. the creation of a lawless sub-culture whose only reason for being is to grow, import and distribute a drug which is not available through lawful means;
8. the enormous financial costs associated with enforcement of the law; and
9. the inability to engage in meaningful research into the properties, effects and dangers of the drug, because possession of the drug is unlawful.

201 We have to analyse the constitutional questions raised in these appeals on the basis of these facts. Although criminalization of marihuana is a sensitive political issue and raises many social policy considerations, our analysis is circumscribed by the findings of fact of the trial judges, which are well supported by an extensive record. These findings are the basis upon which we must decide whether, or to what extent, Parliament may criminalize under threat of imprisonment possession of marihuana for personal use and, alternatively, for the purpose of trafficking. We must determine whether, on the basis of these facts, constitutional requirements are met, with respect to both the division of powers issue and the *Charter* considerations. These cases are not about whether Parliament should or should not prohibit or regulate possession of marihuana, whether the law is fair or unfair to marihuana users, or whether the legislation is effective in reducing the harm occasioned by marihuana use. These cases ask us to determine the limits imposed by the *Charter* upon Parliament to use imprisonment as a sanction for prohibited conduct.

II. Analysis

202 Parliament has full legislative power with respect to the criminal law, including the determination of the essential elements of any given crime. Prior to the enactment of the *Charter*, Parliament could prohibit any act and impose any penal consequences for infringing the prohibition, provided only that the prohibition served "a public purpose which can support it as being in relation to criminal law" (*Reference re Validity of Section 5(a) of the Dairy Industry Act*, [1949] S.C.R. 1 ("*Margarine Reference*"), p. 50; appeal to the Privy Council dismissed, [1951] A.C. 179). Once the legislation was found to have met this test, the courts had virtually no role in reviewing the substance of the legislation. However, with the entrenchment of the *Charter* in the Constitution, courts must now consider not only the *vires* of legislation, but also the compliance of legislation with the

guarantees of the *Charter* (*R. v. Vaillancourt*, [1987] 2 S.C.R. 636, at p. 651; *Motor Vehicle Reference, supra*, at pp. 496-97, *per* Lamer J., at p. 525, *per* Wilson J.).

203 In assessing *Charter* compliance, courts are to look both to the purpose and to the effect of the legislation (*R. v. Smith*, [1987] 1 S.C.R. 1045, at p. 1071, *per* Lamer J.). As Dickson J. said, speaking for the majority of this Court in *R. v. Big M Drug Mart Ltd.*, [1985] 1 S.C.R. 295, at p. 334, "if a law with a valid purpose interferes by its impact, with rights or freedoms, a litigant could still argue the effects of the legislation as a means to defeat its applicability and possibly its validity". Thus, as Lamer J. said in *Smith, supra*, at p. 1071:

> ... even though the pursuit of a constitutionally invalid purpose will result in the invalidity of the impugned legislation irrespective of its effects, a valid purpose does not end the constitutional inquiry. The means chosen by Parliament to achieve that valid purpose may result in effects which deprive Canadians of their rights guaranteed under the *Charter*. In such a case it would then be incumbent upon the authorities to demonstrate under s. 1 that the importance of that valid purpose is such that, irrespective of the effect of the legislation, it is a reasonable limit in a free and democratic society.

Hence, in the cases before this Court, even if Parliament has the legislative power to prohibit and sanction possession of marihuana, i.e. if there is a legitimate legislative purpose falling under a federal head of power, the means chosen by Parliament to achieve this purpose, for example the type of sanction chosen to enforce the prohibition, may infringe the rights to life, liberty or security of the appellants in a manner that is not in accordance with the principles of fundamental justice, as protected by s. 7 of the *Charter*.

204 These cases concern whether the provisions prohibiting possession of marihuana for personal use and, alternatively, for the purpose of trafficking, are within the constitutional legislative power of the Parliament of Canada, either under its general peace, order and good government power ("POGG power"), or under s. 91(27) of the *Constitution Act, 1867* pursuant to its criminal law power. These cases also concern whether the impugned provisions are contrary to s. 7 of the *Charter*. Much confusion has permeated the debate before us and in the courts below regarding these two related but distinct limits imposed upon Parliament's legislative power. Much of the debate thus far has indeed surrounded whether Parliament could "criminalize" possession of marihuana. This issue must be decided according to the division of powers principles, and is but one aspect of the constitutional challenge before us. The *Charter* imposes additional constraints on Parliament when it chooses to provide for deprivation of liberty. I will analyse these two limits on legislative power in turn and endeavour to distinguish the thresholds to be met, as they are in my view distinct and serve different purposes.

A. *The Division of Powers Issue*

205 The appellants Clay and Caine challenge the prohibition against possession of marihuana as being beyond the authority of Parliament under the *Constitution Act, 1867*. My colleagues Gonthier and Binnie JJ. have concluded that the impugned provisions fall under the criminal law head of power. For that reason, they conclude that it is not necessary to revisit the correctness of the conclusion in *R. v. Hauser*, [1979] 1 S.C.R. 984, with respect to Parliament's residual authority to deal with drugs in general or marihuana in particular under the POGG power. I am in general agreement

with the conclusion reached by my colleagues and I will only make a few comments, which will inform the *Charter* analysis.

206 As mentioned above, legislation which properly falls under one of the federal heads of power will pass the division of powers challenge, but may still be found to infringe on a right or freedom protected by the *Charter*. With regard to the federal criminal law power, under s. 91(27) of the *Constitution Act, 1867*, Parliament has been accorded the power to make criminal law in the widest sense (see, *inter alia, RJR-MacDonald Inc. v. Canada (Attorney General)*, [1995] 3 S.C.R. 199, at para. 28; *R. v. Hydro-Québec*, [1997] 3 S.C.R. 213, at para. 118; *Reference re Firearms Act (Can.)*, [2000] 1 S.C.R. 783, 2000 SCC 31, at paras. 28-31). It is entirely within Parliament's discretion to determine what evil it wishes to suppress by penal prohibition and what threatened interest it thereby wishes to safeguard. Apart from the *Charter*, the only qualification attached to Parliament's plenary power over criminal law is that it cannot be employed colourably. Like other legislative powers, the criminal law power does not permit Parliament, simply by legislating in the proper form, colourably to invade areas of exclusively provincial legislative competence. To determine whether such a colourable attempt is made, we must determine whether a legitimate public purpose underlies the criminal prohibition (*Scowby v. Glendinning*, [1986] 2 S.C.R. 226, at p. 237; *Hydro-Québec, supra*, at para. 121).

207 In the *Margarine Reference, supra*, Rand J. drew attention, at pp. 49-50, to the need to identify the evil or injurious effect at which a penal prohibition was directed and explained that a prohibition is not criminal unless it serves "a public purpose which can support it as being in relation to criminal law". Further, he explained that the "ordinary though not exclusive ends" served by the criminal law are "[p]ublic peace, order, security, health, [and] morality" (emphasis added).

208 The main objective of the impugned legislation here is protection from the possible adverse health consequences of marihuana use. The objective of the state in prohibiting marihuana has been summarized by Rosenberg J.A. in *Clay*'s companion case *R. v. Parker* (2000), 146 C.C.C. (3d) 193 (Ont. C.A.), at para. 143:

> First, the state has an interest in protecting against the harmful effects of use of that drug. Those include bronchial pulmonary harm to humans; psychomotor impairment from marihuana use leading to a risk of automobile accidents and no simple screening device for detection; possible precipitation of relapse in persons with schizophrenia; possible negative effects on immune system; possible long-term negative cognitive effects in children whose mothers used marihuana while pregnant; possible long-term negative cognitive effects in long-term users; and some evidence that some heavy users may develop a dependency. The other objectives are: to satisfy Canada's international treaty obligations and to control the domestic and international trade in illicit drugs.

Jurisdiction over health is shared between Parliament and the provincial legislatures; their respective competence depends on the pith and substance of the particular measure at issue.

209 In *RJR-MacDonald, supra*, the issue was whether Parliament could validly employ its criminal law power to prohibit tobacco manufacturers from advertising their products to Canadians, and to increase public awareness concerning the hazards of tobacco use. La Forest J., at para. 32, concluded that the detrimental health effects of tobacco are both dramatic and substantial and that Parliament could validly employ the criminal law:

> Given the "amorphous" nature of health as a constitutional matter, and the resulting fact that Parliament and the provincial legislatures may both validly legislate in this area, it is important to emphasize once again the plenary nature of the criminal law power. In the *Margarine Reference, supra*, at pp. 49-50, Rand J. made it clear that the protection of "health" is one of the "ordinary ends" served by the criminal law, and that the criminal law power may validly be used to safeguard the public from any "injurious or undesirable effect". The scope of the federal power to create criminal legislation with respect to health matters is broad, and is circumscribed only by the requirements that the legislation must contain a prohibition accompanied by a penal sanction and must be directed at a legitimate public health evil. If a given piece of federal legislation contains these features, and if that legislation is not otherwise a "colourable" intrusion upon provincial jurisdiction, then it is valid as criminal law; see *Scowby, supra*, at pp. 237-38. [Emphasis added.]

210 The respondent argues that there is no baseline or threshold level of harm that must be reached before the criminal law power can be invoked. The Crown argues, citing *R. v. Hinchey*, [1996] 3 S.C.R. 1128, at para. 29, and *Hydro-Québec, supra*, at para. 121, that the recognition of a *Charter* principle precluding Parliament from criminalizing conduct unless it can demonstrate a potential for serious or substantial harm would be inconsistent with the well-established constitutional principle that the criminal law can be used to enact legislation to address social, political, or economic interests or "some legitimate public purpose". The respondent submits that even though there would be a rational basis for a statutory or regulatory prohibition, a "harm principle" would call for judicial review of what are essentially policy decisions. The submissions of the Attorney General of Ontario ("AGO") are similar on this respect. The AGO argues that whether a criminal offence is reviewed by way of a *vires* analysis under the division of powers doctrine, or by way of a "harm principle" within the ambit of s. 7, the result will necessarily be the same. The AGO argues that the "harm principle", at least as it has been formulated by Braidwood and Rosenberg JJ.A., does no more than reiterate the threshold test for Parliament's exercise of its criminal law jurisdiction. The AGO further submits that Lamer J.'s analysis in *Motor Vehicle Reference* should not apply to a consideration of the *actus reus* of the offence. The AGO states that consideration of the *actus reus* is precluded because "the decision to criminalize specific types of conduct belongs wholly to Parliament" (AGO's factum, at para. 12).

211 It is not the courts' function to reassess the wisdom of validly enacted legislation. As L'Heureux-Dubé J. said in *Hinchey, supra*, at para. 34, "the judiciary should not rewrite [legislation] to suit its own particular conception of what type of conduct can be considered criminal". And further, at para. 36: "If Parliament chooses to criminalize conduct which, notwithstanding *Charter* scrutiny, appears to be outside of what a judge considers 'criminal', there must be a sense of deference to the legislated authority which has specifically written in these elements."

212 Although courts cannot question the wisdom of legislation, they must assess its constitutionality. There is, as such, no constitutional threshold of harm required for legislative action under the criminal law power. There had been uncertainties in the past in this regard, as some would have required "significant, grave and serious risk of harm to public health, morality, safety or security" before a prohibition could fall within the purview of the criminal law power (see, e.g., *RJR-MacDonald, supra*, at paras. 199-202, *per* Major J.). It is now established that as long as the legisla-

tion is directed at a legitimate public health evil and contains a prohibition accompanied by a penal sanction, and provided that it is not otherwise a "colourable" intrusion upon provincial jurisdiction, Parliament has, under s. 91(27) of the *Constitution Act, 1867*, discretion to determine the extent of the harm it considers sufficient for legislative action (*RJR-MacDonald, supra*, at para. 32; *Reference re Firearms Act (Can.), supra*, at para. 27). Obviously, however, where Parliament relies on the protection of health as its legitimate public purpose, it has to demonstrate the "injurious or undesirable effect" from which it seeks to safeguard the public. This will likely be done by demonstrating the harm to the health of individuals or the public associated with the prohibited conduct. While there is no constitutional threshold level of harm required before Parliament may use its broad criminal law power, conduct with little or no threat of harm is unlikely to qualify as a "public health evil".

213 In *Hydro-Québec, supra*, at para. 120, La Forest J. came to a similar conclusion for the majority of this Court with regard to the mental element dimension of a criminal offence. He held:

> ... under s. 91(27) of the *Constitution Act, 1867*, it is also within the discretion of Parliament to determine the extent of blameworthiness that it wishes to attach to a criminal prohibition... . This flows from the fact that Parliament has been accorded plenary power to make criminal law in the widest sense. This power is, of course, subject to the "fundamental justice" requirements of s. 7 of the *Canadian Charter of Rights and Freedoms*, which may dictate a higher level of *mens rea* for serious or "true" crimes ... .

Just as Parliament may determine the nature of the mental element pertaining to different crimes, it may determine the nature of the "evil or injurious effect" from which it wishes to protect the public. However, while Parliament has the power to define the elements of a crime, the courts have the mandate to review that definition to ensure that it complies with the *Charter* (see, e.g., *Vaillancourt, supra*, at p. 652). As I will discuss below, the "fundamental justice" requirements of s. 7 of the *Charter* may, where imprisonment is available as a punishment, call for an "evil or injurious effect" of a certain nature or degree.

214 The concerns raised by the respondent and the AGO reflect the wrong focus in the courts below as to whether Parliament could "criminalize" possession of marihuana. Indeed, Howard Prov. Ct. J. in *Caine*, in considering the "harm principle", wrote as follows, at paras. 117-20:

> In my view, the proposals that the criminal law be used only to protect against conduct that involves demonstrable harm to another individual or other individuals or to society as a whole or against conduct that is seriously harmful or substantially harmful to society are not "principles of fundamental justice". The case authorities are to the contrary... .
>
> In fact, our Supreme Court has consistently granted Parliament "a broad discretion in proscribing conduct as criminal and in determining proper punishment", *R. v. Hinchey* (1996), 111 C.C.C. (3d) 353 at 369-70. The principles applicable to Parliament's law-making powers in the criminal sphere make clear that Parliament has a broad scope of authority to "criminalize" conduct in order to address any social, political or economic interests... .

> If there was any doubt of how this principle might be applied in the present context, it was resolved when the Supreme Court of Canada indicated, in *RJR-MacDonald Inc. v. Canada*, (*supra*) that Parliament may legislate under the criminal law power to protect Canadians from harmful drugs... .
>
> The correct position is, in my view, that which is set out in *Butler*, (*supra*) at 165. To paraphrase in terms that are applicable to the case before me: Parliament may enact penal legislation prohibiting use of a drug, when it has a reasonable basis for concluding that there is a risk of harm to the health of the user, or a risk of harm to society as a whole. [Emphasis added.]

With respect, the trial judge confused the tests developed by this Court in division of power jurisprudence, which are used to determine whether Parliament has validly used its criminal power in a manner that is not a colourable intrusion upon provincial competences, with the *Charter* constraints imposed upon Parliament when otherwise valid criminal legislation is alleged to infringe on rights protected by the *Charter*. In my respectful view, the same confusion appears in Braidwood J.A.'s analysis.

215 After a thorough review of the common law, leading treatises on the criminal law, law reform commission reports, Canadian federalism cases (addressing the federal criminal law power), and *Charter* jurisprudence, Braidwood J.A. came to the conclusion that the harm principle is indeed a principle of fundamental justice within the meaning of s. 7. After having concluded as to the existence of this principle, Braidwood J.A. set "the appropriate threshold for criminal sanctions" (para. 139) and determined that "[t]he degree of harm must be neither insignificant nor trivial" (para. 138). In determining the appropriate threshold, Braidwood J.A. explained that he had to consider the "relationship, and parallels, between the Criminal Law power of Parliament pursuant to s. 91(27) of the *Constitution Act, 1867* and the test to be applied pursuant to s. 7 of the *Charter*" (para. 139). Braidwood J.A. was thus apparently concerned with affording Parliament the deference it is owed in legislating in criminal matters while at the same time give meaning to the harm principle, because, as he put it: "it is common sense that you don't go to jail unless there is a potential that your activities will cause harm to others" (para. 134). This tension led him to conclude, at paras. 158-60:

> In conclusion, the deprivation of the appellants' liberty caused by the presence of penal provisions in the *NCA* is in accordance with the harm principle. I agree that the evidence shows that the risk posed by marihuana is not large. Yet, it need not be large in order for Parliament to act. It is for Parliament to determine what level of risk is acceptable and what level of risk requires action. The *Charter* only demands that a "reasoned apprehension of harm" that is not [in]significant or trivial. The appellants have not convinced me that such harm is absent in this case.
>
> Therefore, I find that the legal prohibition against the possession of marihuana does not offend the operative principle of fundamental justice in this case.

> Determining whether the *NCA* strikes the "right balance" between the rights of the individual and the interests of the State is more difficult. In the end, I have decided that such matters are best left to Parliament... . I do not feel it is the role of this court to strike down the prohibition on the non-medical use of marihuana possession at this time. [Emphasis added.]

With respect, Braidwood J.A. wrongly focused his analysis on Parliament's power to criminalize possession of marihuana. As I briefly mentioned above, and as my colleagues Gonthier and Binnie JJ. have also reviewed, the principles regarding the scope of Parliament's criminal law power are now well established and harm may not be the sole basis upon which criminal law may be used. Parliament may have the power to prohibit certain conduct, be it under its criminal law power or otherwise, but it must respect minimum *Charter* requirements before it resorts to imprisonment as a sanction. In other words, the harm principle as a principle of fundamental justice operates to prevent restriction of liberty under s. 7 of the *Charter* and not as a constraint inherent in Parliament's criminal law power.

216 The focus must therefore be on the use of imprisonment as a sanction attaching to a prohibited conduct. This becomes obvious upon consideration of the various sources of legislative power under which Parliament may prohibit and sanction certain activities or behaviours. To situate the harm principle within the principles regarding the criminal law power of Parliament would in fact exclude the applicability of this principle of fundamental justice to other prohibitions enforceable by imprisonment and, of course, to the enforcement of provincial statutes. For example, as my colleagues explained, the residual POGG power has application in only three situations: (i) a national emergency; (ii) the federal competence arose because the subject matter did not exist at the time of Confederation and clearly cannot be put into the class of matters of merely local or private nature; and (iii) where the subject matter "goes beyond local or provincial concern or interest and must, from its inherent nature, be the concern of the Dominion as a whole" (*Labatt Breweries of Canada Ltd. v. Attorney General of Canada*, [1980] 1 S.C.R. 914). The determination of whether the impugned legislation meets these criteria thus focuses on characteristics of the legislation that have nothing to do with those falling under the criminal law power, such as the necessity to identify an evil or injurious effect at which the prohibition is directed and a valid criminal law purpose. Needless to say, no harm, be it to identifiable others, to society as a whole, or to self, is required, or even relevant to the determination of whether legislation falls under the POGG power. The harm principle as applied by the courts below would thus be inapplicable to prohibitions enacted under the POGG power, or any other non-criminal fields of federal competence.

217 The use of imprisonment, be it for a criminal offence, a prohibition enacted under the POGG power, or for any other offence created as a means of enforcement of non-criminal legislation, including provincial offences, must be subject to the same *Charter* requirements. The comments of Lamer C.J., in *R. v. Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, at p. 189, are equally applicable here:

> In my view, whether this offence (or the Act generally) is better characterized as "criminal" or "regulatory" is not the issue. The focus of the analysis in *Re B.C. Motor Vehicle Act* and *Vaillancourt* was on the use of imprisonment to enforce the prohibition of certain behaviour or activity. A person whose liberty has been restricted by way of imprisonment has lost no less liberty because he or she is being punished for the commission of a regulatory offence as opposed to a criminal

> offence. Jail is jail, whatever the reason for it. In my view, it is the fact that the state has resorted to the restriction of liberty through imprisonment for enforcement purposes which is determinative of the principles of fundamental justice. [Emphasis in original.]

Similarly here, it is the fact that the state has resorted to the restriction of liberty through imprisonment for enforcement purposes which calls into play the harm principle as a principle of fundamental justice. I note here that the question is not whether imprisonment is used frequently or only in the rarest cases. The mere availability of imprisonment dictates the constitutional test to be applied (*Motor Vehicle Reference, supra*, at p. 515).

218 According to my colleagues' conclusion, the impugned legislation is within Parliament's legislative powers. For my purposes, once it is determined that the legislation falls within one of Parliament's constitutional heads of power, it does not matter whether the legislation falls under the criminal law power or otherwise. The key is indeed whether the approach taken by Parliament to enforce the prohibition of possession of marihuana is in accordance with the prescriptions of the *Charter*. This case is therefore an opportunity for this Court to evaluate the principles developed in *Motor Vehicle Reference* with respect to the *actus reus* of the offence.

B. *The Charter Issues*

219 The appellants Caine and Clay assert that the prohibition of possession of marihuana infringes s. 7 of the *Charter*. The s. 7 analysis requires the appellants to demonstrate a deprivation of liberty that is not in accordance with the principles of fundamental justice. Indeed, as *per* Iacobucci J. in *R. v. White*, [1999] 2 S.C.R. 417, at para. 38, the s. 7 analysis involves three stages:

> The first question to be resolved is whether there exists a real or imminent deprivation of life, liberty, security of the person, or a combination of these interests. The second stage involves identifying and defining the relevant principle or principles of fundamental justice. Finally, it must be determined whether the deprivation has occurred in accordance with the relevant principle ... .

I will now consider each of these three stages. I note that the analysis will concentrate on the challenge of the provisions prohibiting simple possession of marihuana. At the end of the analysis I will address Malmo-Levine's challenge to the prohibition of possession of marihuana for the purpose of trafficking.

(1) Deprivation of Life, Liberty, or Security of the Person

220 The respondent concedes, as the lower courts found, that the possibility of imprisonment under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, engages the s. 7 liberty interest of the appellants. This is consistent with this Court's past holdings: *Motor Vehicle Reference, supra*, at p. 515; *R. v. Heywood*, [1994] 3 S.C.R. 761, at p. 789.

221 The appellants also argue that the right to use marihuana in the privacy of one's home is a fundamental aspect of personal autonomy and dignity. On this issue, I am in complete agreement with my colleagues Gonthier and Binnie JJ. Neither the widest view on liberty, as expressed by La Forest J., writing for himself, L'Heureux-Dubé, Gonthier and McLachlin JJ. on this issue, in *B. (R.) v. Children's Aid Society of Metropolitan Toronto*, [1995] 1 S.C.R. 315, at para. 80, nor the interpretation of security as including a right to personal autonomy, cover the recreational use of marihuana,

even in the privacy of one's home. This use does not qualify as a matter of fundamental importance so as to engage the liberty and security interests under s. 7 of the *Charter*. Put another way:

> ... the autonomy protected by the s. 7 right to liberty encompasses only those matters that can properly be characterized as fundamentally or inherently personal such that, by their very nature, they implicate basic choices going to the core of what it means to enjoy individual dignity and independence.
>
> (*Godbout v. Longueuil (City)*, [1997] 3 S.C.R. 844, at para. 66)

222 The threat of imprisonment clearly engages the s. 7 liberty interest of the appellants; since no one has addressed whether sanctions other than imprisonment could engage the right to liberty or security of the person, I will limit my analysis to the threat of imprisonment. Thus, I need not address here, given the scope of my analysis and the nature of this appeal, whether the imposition of a fine for simple possession of marihuana, or imprisonment as an alternative to the non-payment of a fine, or imposition of a criminal record *simpliciter*, engage the right to security or liberty of the person. Those issues were not addressed by the courts below and it would be both unwise and unnecessary to address them here. As the threat of imprisonment clearly engages the s. 7 liberty interest of the appellants, it is necessary to determine the relevant principles of fundamental justice, to which I now turn.

(2) The Relevant Principles of Fundamental Justice

223 The primary principle of fundamental justice put forth by the appellants is the alleged "harm principle". The British Columbia Court of Appeal in *Caine* recognized the existence of a harm principle as a principle of fundamental justice, although the majority and the minority had different views on which threshold of harm was required by this principle. Rosenberg J.A. of the Court of Appeal for Ontario in *Clay* did not decide the issue but was ready to accept for the purposes of the case at bar that the harm principle was a principle of fundamental justice. The appellants also submit other principles of fundamental justice which they say are applicable to the cases at bar, namely the principle of restraint, the principle precluding irrationality and arbitrariness in the legislative scheme and the principle of overbreadth (see para. 31 of the appellant Caine's factum).

224 Principles of fundamental justice have been defined as follows by Sopinka J. in *Rodriguez v. British Columbia (Attorney General)*, [1993] 3 S.C.R. 519, at pp. 590-91:

> Principles of fundamental justice must not, however, be so broad as to be no more than vague generalizations about what our society considers to be ethical or moral. They must be capable of being identified with some precision and applied to situations in a manner which yields an understandable result. They must also, in my view, be legal principles. The now familiar words of Lamer J. in *Re B.C. Motor Vehicle Act*, [1985] 2 S.C.R. 486, at pp. 512-13, are as follows:
>
> > Consequently, the principles of fundamental justice are to be found in the basic tenets and principles, not only of our judicial process, but also of the other components of our legal system.
> >
> > ...

> Whether any given principle may be said to be a principle of fundamental justice within the meaning of s. 7 will rest upon an analysis of the nature, sources, *rationale* and essential role of that principle within the judicial process and in our legal system, as it evolves.

225 As I mentioned earlier, in determining which principles of fundamental justice are at play here and in assessing their content and their scope, the focus must remain on the choice made by the state to resort to imprisonment to enforce the prohibition of possession of marihuana for personal use and alternatively, of possession of marihuana for the purpose of trafficking (*Wholesale Travel Group Inc., supra*, at p. 189, *per* Lamer C.J.).

(A) *Harm Principle*

226 As Lamer J. recalled in *Motor Vehicle Reference, supra*, at p. 513, "[i]t has from time immemorial been part of our system of laws that the innocent not be punished". This fundamental principle is at the core of his introductory remarks, at p. 492:

> A law that has the potential to convict a person who has not really done anything wrong offends the principles of fundamental justice and, if imprisonment is available as a penalty, such a law then violates a person's right to liberty under s. 7 of the *Charter of Rights and Freedoms* ... .
>
> In other words, absolute liability and imprisonment cannot be combined.

Since this landmark decision, courts have been "'empowered, indeed required, to measure the content of legislation' against the principles of fundamental justice contained in s. 7 of the *Charter*, and specifically, to ensure that the morally innocent not be punished" (*R. v. Creighton*, [1993] 3 S.C.R. 3, at p. 17).

227 It is a fundamental substantive principle of criminal law that there should be no criminal responsibility without an act or omission accompanied by some sort of fault. The Latin phrase is *actus non facit reum, nisi mens sit rea* or "[t]he intent and the [a]ct must both concur to constitute the crime" (*Fowler v. Padget* (1798), 7 T.R. 509, 101 E.R. 1103 (K.B.), at p. 1106; see K. Roach, *Criminal Law* (2nd ed. 2000), at p. 8; D. Stuart, *Canadian Criminal Law: A Treatise* (4th ed. 2001), at p. 359; G. Côté-Harper, P. Rainville and J. Turgeon, *Traité de droit pénal canadien* (4th ed. rev. 1998), at pp. 263-64; J. C. Smith and B. Hogan, *Criminal Law: Cases and Materials* (7th ed. 1999), at p. 27; A. P. Simester and G. R. Sullivan, *Criminal Law: Theory and Doctrine* (2000), at p. 21). Legal causation, which seeks to link the prohibited consequences to a culpable act of the accused, also reflects the fundamental principle that the morally innocent should not be punished (see *R. v. Nette*, [2001] 3 S.C.R. 488, 2001 SCC 78, at para. 45). In determining whether legal causation is established, the inquiry is directed at the question of whether the accused person should be held criminally responsible for the consequences that occurred from his or her conduct. As I said in *Nette, supra*, at para. 47, "[w]hile causation is a distinct issue from *mens rea*, the proper standard of causation expresses an element of fault that is in law sufficient, in addition to the requisite mental element, to base criminal responsibility." This inquiry seeks in fact to determine whether blame can be attributed to the accused and is illustrative of criminal law's preoccupation that both the physical

and mental elements of an offence coincide to reflect the blameworthiness attached to the offence and the offender.

228 In order to determine whether the principle developed in the *Motor Vehicle Reference* may apply to ground an element of fault in the *actus reus*, it is instructive to examine the interaction between the mental and physical elements of an offence and to review how the Court has applied that principle with respect to the *mens rea.* As Lamer J. explained in *Vaillancourt, supra*, at p. 652:

> In effect, *Re B.C. Motor Vehicle Act* acknowledges that, whenever the state resorts to the restriction of liberty, such as imprisonment, to assist in the enforcement of a law, even, as in *Re B.C. Motor Vehicle Act*, a mere provincial regulatory offence, there is, as a principle of fundamental justice, a minimum mental state which is an essential element of the offence... . *Re B.C. Motor Vehicle Act* did not decide what level of *mens rea* was constitutionally required for each type of offence, but inferentially decided that even for a mere provincial regulatory offence at least negligence was required, in that at least a defence of due diligence must always be open to an accused who risks imprisonment upon conviction. [Emphasis in original.]

Further, Lamer J. explained, at p. 653, that

> whatever the minimum *mens rea* for the act or the result may be, there are, though very few in number, certain crimes where, because of the special nature of the stigma attached to a conviction therefor or the available penalties, the principles of fundamental justice require a *mens rea* reflecting the particular nature of that crime. Such is theft, where, in my view, a conviction requires proof of some dishonesty. Murder is another such offence.

The constitutionalization of fault requirements has indeed cast doubt on some *Criminal Code* offences and this Court has, in *Vaillancourt, supra*, and in *R. v. Martineau*, [1990] 2 S.C.R. 633, for example, used the criteria of the stigma and punishment attached to an offence as determinative of the fault level or *mens rea* required for conviction. Specifically, the Court has decided that for murder and theft, principles of fundamental justice guaranteed by s. 7 of the *Charter* demand subjective intent or recklessness. Thus, the constructive murder provisions of the *Code* which required only objective foreseeability of death and in some circumstances, only a causal connection, were held to be unconstitutional.

229 The special mental element required for these offences gives rise to the moral blameworthiness which justifies the stigma and sentence attached to them: *Vaillancourt, supra*, at p. 654; *Martineau, supra*, at p. 646. In *Martineau*, it was decided that the essential role of requiring subjective foresight of death in the context of murder was to "maintain a proportionality between the stigma and punishment attached to a murder conviction and the moral blameworthiness of the offender" (p. 646). The principles of fundamental justice require, because of the special nature of the stigma attached to a murder conviction, and the available penalties, a *mens rea* reflecting the particular nature of the crime. The moral blameworthiness of a particular offender thus stems from the constitutionally required mental element, which is determined by considering the stigma and criminal sanction attaching to prohibited conduct.

230 In my view, the principle that stigma and punishment must be proportionate to the moral blameworthiness of the offender stands only if there is a sufficiently blameworthy element in the *actus reus* itself. A culpable mental state attached to a conduct may only be held "culpable" provided that the offender and his conduct ought to be blamed (see A. von Hirsch and N. Jareborg, "Gauging Criminal Harm: A Living-Standard Analysis" (1991), 11 *Oxford J. Legal Stud.* 1, at p. 6). This was implicitly recognized by this Court in *R. v. DeSousa*, [1992] 2 S.C.R. 944, at pp. 964-65, where Sopinka J. held: "[p]rovided that there is a sufficiently blameworthy element in the *actus reus* to which a culpable mental state is attached, there is no additional requirement that any other element of the *actus reus* be linked to this mental state or a further culpable mental state" (emphasis added). Thus, in my opinion, the principles developed in *Motor Vehicle Reference* mandate a consideration of what is blamable in a specific conduct, i.e., what underlies stigma and punishment. Offences have both a mental and a physical element. An evaluation of the blameworthiness of conduct must take into account both elements so that wrongful conduct will not be held blamable without the necessary mental element and, on the other hand, a deliberate (or reckless or negligent) activity will not be held blamable without the activity being wrongful in the first place. Therefore, in assessing the moral blameworthiness of the offender, the inherent nature of the act committed, or the wrongfulness of the *actus reus*, must be considered.

231 What exactly is wrong or blameworthy in a given criminal offence is rarely an object of debate and is usually described by the harm or risk of harm associated with the conduct. Indeed, harm is so intrinsic to most offences that few would contest, for example, the harm to others associated with murder, assault, or theft. Murder affects the fundamental right to life; assault affects the victim's security and dignity; and theft affects the victim's material comfort and, in certain circumstances, his or her right to security, dignity and privacy. In fact, harm is often central to the requirement that punishment must be proportionate to the moral blameworthiness of the offender; in other words, "the fundamental principle of a morally based system of law [is] that those causing harm intentionally [should] be punished more severely than those causing harm unintentionally" (*Martineau, supra*, at p. 645; *Creighton, supra*, at p. 46; H. L. A. Hart, "Punishment and the Elimination of Responsibility", in *Punishment and Responsibility: Essays in the Philosophy of Law* (1968), at p. 162). Typically, the debate usually does not concern whether the conduct is harmful *per se*, but rather whether the level of harm caused or the inherent gravity of the conduct justify an increase in the harshness of labelling or sentencing.

232 Courts indeed often undertake an evaluation of the level of blameworthiness of the *actus reus*. Identical levels of intent (e.g., the intention to cause death) can lead to different degrees of labelling if the act itself is more deserving of condemnation. For instance, in *R. v. Arkell*, [1990] 2 S.C.R. 695 (released concurrently with *Martineau, supra*), this Court analysed in light of s. 7 whether a sentencing scheme which classified murders done while committing certain underlying offences as more serious, and thereby attaching more serious penalties to them, was unconstitutional. This Court found the increased harshness of labelling and punishment to be constitutionally valid under s. 7. Lamer C.J. came to this by examining the blameworthiness of the offence (at p. 704):

> The section is based on an organizing principle that treats murders committed while the perpetrator is illegally dominating another person as more serious than other murders. Further, the relationship between the classification and the moral blameworthiness of the offender clearly exists... . Parliament's decision to treat

> more seriously murders that have been committed while the offender is exploiting a position of power through illegal domination of the victim accords with the principle that there must be a proportionality between a sentence and the moral blameworthiness of the offender and other considerations such as deterrence and societal condemnation of the acts of the offender. [Emphasis added.]

233 Harm is frequently the determining factor in assessing the severity of an offence and in distinguishing between levels of responsibility for equally mentally blamable acts. For example, under s. 7, this Court, in *DeSousa* (*per* Sopinka J.), held that Parliament could treat crimes that produce certain consequences as more serious than crimes that lack those consequences: "[I]t is acceptable to distinguish between criminal responsibility for equally reprehensible acts on the basis of the harm that is actually caused" (p. 967). See also *R. v. Williams*, [2003] 2 S.C.R. 134, 2003 SCC 41, at paras. 43-46.

234 These principles are also in line with all sentencing principles adopted by this Court. Indeed, harm, or the seriousness of prohibited conduct, along with mental blameworthiness, form the basis for culpability, and go hand in hand to determine the appropriate sentence (see D. E. Scheid, "Constructing a Theory of Punishment, Desert, and the Distribution of Punishments" (1997), 10 Can. J.L. & Juris. 441, at p. 484; von Hirsch and Jareborg, *supra*, at p. 2). It is a fundamental principle of sentencing that both the severity of the offence and the moral blameworthiness of the offender should dictate the quantum of sentence. As Lamer C.J. held in *R. v. M. (C.A.)*, [1996] 1 S.C.R. 500, at para. 36: "For offences where imprisonment is available, the *Code* sets maximum terms of incarceration in accordance with the relative severity of each crime." And further, at para. 40: "It is a well-established tenet of our criminal law that the quantum of sentence imposed should be broadly commensurate with the gravity of the offence committed and the moral blameworthiness of the offender." See also s. 718.1 of the *Criminal Code*, which states that "[a] sentence must be proportionate to the gravity of the offence and the degree of responsibility of the offender": *R. v. Proulx*, [2000] 1 S.C.R. 61, 2000 SCC 5, at para. 82; *R. v. Wust*, [2000] 1 S.C.R. 455, 2000 SCC 18, at para. 18; G. P. Fletcher, *Rethinking Criminal Law* (1978), at pp. 461-62.

235 Hence, harm or the risk of harm is a determinative factor in the assessment of the seriousness or wrongfulness of prohibited conduct. Harm associated with victimizing conduct, i.e., conduct which infringes on the rights and freedoms of identifiable persons, is the most obvious, and the concern usually is with how much the person has been harmed. This, in turn, is likely to dictate the extent of punishment or the difference in the labelling of an offence, as well as the level of *mens rea* necessary to establish culpability. Other forms of conduct cause harm that is more diffuse, where no identifiable persons have had their rights or freedoms infringed by the conduct; the harm there is collective and it is the public interest that is adversely affected. Finally, other conduct is even more distant from this notion of harm, and the prohibition of that conduct is aimed at advancing public interests distinct from the protection of individuals or society.

236 The fundamental question raised in these appeals is whether harm is a constitutionally required component of the *actus reus* of any offence punishable by imprisonment. We have seen above that harm may not be the only basis upon which Parliament may decide to prohibit or regulate a given type of conduct. We must now determine whether the *Charter* requires that harm be the sole basis upon which the state may employ the threat of imprisonment as a sanction against a prohibited conduct.

237 The debate over the harm principle takes place around the traditional confrontation between harm and morality as a basis for restricting an individual's liberty. The liberal view was initially espoused by Victorian philosopher and economist John Stuart Mill in his essay, *On Liberty*. He wrote:

> The object of this Essay is to assert one very simple principle, as entitled to govern absolutely the dealings of society with the individual in the way of compulsion and control, whether the means used be physical force in the form of legal penalties, or the moral coercion of public opinion. That principle is, that the sole end for which mankind are warranted, individually or collectively, in interfering with the liberty of action of any of their number, is self-protection. That the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. He cannot rightfully be compelled to do or forbear because it will be better for him to do so, because it will make him happier, because, in the opinions of others, to do so would be wise, or even right. These are good reasons for remonstrating with him, or reasoning with him, or persuading him, or entreating him, but not for compelling him, or visiting him with any evil in case he do otherwise. To justify that, the conduct from which it is desired to deter him, must be calculated to produce evil to some one else. The only part of the conduct of any one, for which he is amenable to society, is that which concerns others. In the part which merely concerns himself, his independence is, of right, absolute. Over himself, over his own body and mind, the individual is sovereign. [Emphasis added.]
>
> (J.S. Mill, *On Liberty and Considerations on Representative Government* (1946), at pp. 8-9)

Mill's principle was exclusive: "[T]he only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others" (p. 8 (emphasis added)).

238 Mill's assertion was challenged by Sir James Fitzjames Stephen in *Liberty, Equality, Fraternity* (1967), initially published in 1874, who strongly opposed any limitation on the power of the state to enforce morality. Stephen's argument was best captured in a now-famous passage: "there are acts of wickedness so gross and outrageous that, self-protection apart, they must be prevented as far as possible at any cost to the offender, and punished, if they occur, with exemplary severity" (p. 162). This debate between Mill and Stephen was reignited in England by the recommendation in 1957 of the Committee on Homosexual Offences and Prostitution to decriminalize homosexuality on the basis that it is not the duty of the law to concern itself with immorality as such (*The Wolfenden Report* (1963), at paras. 61-62). The reactions to the *Wolfenden Report* have been vehement. Lord Patrick Devlin, in his Maccabaean Lecture delivered at the British Academy in 1959 (later published: P. Devlin, *The Enforcement of Morals* (1965)), argued that purportedly immoral activities, like homosexuality and prostitution, should remain criminal offences and he became associated with the principle of legal moralism -- the principle that moral offences should be regulated because they are immoral (see on this: B. E. Harcourt, "The Collapse of the Harm Principle" (1999), 90 *J. Crim. L. & Criminology* 109, at pp. 111-12; B. Lauzon, *Les champs légitimes du droit criminel et*

leur application aux manipulations génétiques transmissibles aux générations futures (2002), at p. 26).

239 This position is opposed to the liberal view of Professors Hart and Feinberg who reiterated Mill's harm principle. According to J. Feinberg, who adopts a less exclusive view of the harm principle in *The Moral Limits of the Criminal Law* (1984), in the first volume, entitled *Harm to Others*, at p. 26, "[i]t is always a good reason in support of penal legislation that it would probably be effective in preventing ... harm to persons other than the actor." The debate between legal moralism and the harm principle has stimulated academic discussions and much has been written on this topic (see, *inter alia*, in addition to other sources cited throughout these reasons: "Symposium: The Moral Limits of the Criminal Law" (2001), 5 *Buff. Crim. L. Rev.* 1-319; *Mill's On Liberty: Critical Essays* (1997), edited by Gerald Dworkin). Braidwood J.A. referred, at paras. 107-12, to various authors who either adopted the harm principle or incorporated it in their writings. One of the most prominent, H. L. Packer, in his influential *The Limits of the Criminal Sanction* (1968) said, at p. 267, that "harm to others" must be a "limiting criteri[on] for invocation of the criminal sanction". This debate, which has remained focused, as I said earlier, on what should be criminalized, also permeated the work of the Law Reform Commissions in Canada on possible reforms of the *Criminal Code*. I need not expand on their recommendations for my purposes. Suffice it to say that Braidwood J.A. referred to various reports, all of which basically advocated that the criminal law should only be used, save in exceptional circumstances, where conduct causes or risks causing significant or grave harm to others or society (see paras. 113-16).

240 This philosophical and theoretical debate is of great interest and is a useful policy tool for law makers. It may also serve as a guide in the characterization of the harm principle as a principle of fundamental justice. However, as guardians of the constitutional principles of fundamental justice, courts are not expected to merely choose from among the competing theories of harm advanced by criminal law theorists. As Doherty J.A. said in *R. v. Murdock* (2003), 11 C.R. (6th) 43 (Ont. C.A.), at para. 31:

> Nor should the harm principle be taken as an invitation to the judiciary to consecrate a particular theory of criminal liability as a principle of fundamental justice. This is so even if that theory has gained the support of law reformers, some of whom also happen to be judges. Judicial review of the substantive content of criminal legislation under s. 7 should not be confused with law reform. Judicial review tests the validity of legislation against the minimum standards set out in the *Charter*. Law reform tests the legal *status quo* against the law reformer's opinion of what the law should be.

241 This Court has discussed, albeit under s. 1, the interaction between morality and harm as a valid basis to restrict *Charter* rights. In *R. v. Butler*, [1992] 1 S.C.R. 452, at p. 498, Sopinka J., writing for the majority, held that "[t]he objective of maintaining conventional standards of propriety, independently of any harm to society, is no longer justified in light of the values of individual liberty which underlie the *Charter*." Sopinka J. also noted, at pp. 492-93, that "[t]o impose a certain standard of public and sexual morality, solely because it reflects the conventions of a given community, is inimical to the exercise and enjoyment of individual freedoms, which form the basis of our social contract... . The prevention of 'dirt for dirt's sake' is not a legitimate objective which would justify the violation of one of the most fundamental freedoms enshrined in the *Charter*." Sopinka J. however conceded that Parliament had the right to legislate on the basis of some funda-

mental conception of morality for the purposes of safeguarding the values which are integral to a free and democratic society (at p. 493):

> Moral disapprobation is recognized as an appropriate response when it has its basis in *Charter* values.
>
> As the respondent and many of the interveners have pointed out, much of the criminal law is based on moral conceptions of right and wrong and the mere fact that a law is grounded in morality does not automatically render it illegitimate. In this regard, criminalizing the proliferation of materials which undermine another basic *Charter* right may indeed be a legitimate objective.

Sopinka J. found that the overriding objective of the impugned provision was not however moral disapprobation but the avoidance of harm to society, which he considered a substantial concern that justified restriction of the freedom of expression.

242 In a concurring opinion, Gonthier J., writing for himself and L'Heureux-Dubé J., said, at p. 522, that "the avoidance of harm to society is but one instance of a fundamental conception of morality". Speaking about the type of moral claim that could justify an infringement of s. 2(*b*) of the *Charter*, Gonthier J. wrote, at pp. 523-24:

> First of all, the moral claims must be grounded. They must involve concrete problems such as life, harm, well-being, to name a few, and not merely differences of opinion or of taste. Parliament cannot restrict *Charter* rights simply on the basis of dislike; this is what is meant by the expression "substantial and pressing" concern.
>
> Secondly, a consensus must exist among the population on these claims. They must attract the support of more than a simple majority of people. In a pluralistic society like ours, many different conceptions of the good are held by various segments of the population... . In this sense a wide consensus among holders of different conceptions of the good is necessary before the State can intervene in the name of morality.

243 In the present case, the state does not advance morality as a basis for restricting the right to liberty of the appellants, although it appears to have played an important role in the original addition of cannabis to the list of prohibited narcotics (both trial judges put special emphasis on the provocative writings of Edmonton, Alberta Magistrate Emily Murphy, which, according to Howard Prov. Ct. J., "consisted of reckless assertions of fact which were, quite simply, untrue" and which "helped to create a climate of irrational fear which, no doubt, provided some impetus to the movement to prohibit the use of marihuana" (para. 32)) . Had the respondent based its legislation on morality grounds, we would have had to determine the sufficiency of this justification to resort to imprisonment in light of the harm principle as a principle of fundamental justice. However, it is not necessary to comment on the eventual success of such an argument because in any event, here, as in *Butler, supra*, the overriding purpose of the prohibition is not moral disapprobation, but the protection against harm. Therefore, we are not asked in these cases to take side in the "harm vs. morality" de-

bate nor to determine if, and if so in which circumstances, conduct that offends morality could be said to harm others or society as a whole. The state purports to prohibit conduct that it says is directly harmful to the health of individuals, and incidentally to society as a whole.

244 I am of the view that the principles of fundamental justice require that whenever the state resorts to imprisonment, a minimum of harm to others must be an essential part of the offence. The state cannot resort to imprisonment as a punishment for conduct that causes little or no reasoned risk of harm to others. Prohibited conduct punishable by imprisonment cannot be harmless conduct or conduct that only causes harm to the perpetrator. As Braidwood J.A. said in *Caine*, "it is common sense that you don't go to jail unless there is a potential that your activities will cause harm to others" (para. 134).

245 In *Murdock, supra*, Doherty J.A. characterized the harm principle as follows, at para. 33:

> The harm principle, as a principle of fundamental justice, goes only so far as to preclude the criminalization of conduct for which there is no "reasoned apprehension of harm" to any legitimate personal or societal interest. If conduct clears that threshold, it cannot be said that criminalization of such conduct raises the spectre of convicting someone who has not done anything wrong. Difficult questions such as whether the harm justifies the imposition of a criminal prohibition or whether the criminal law is the best way to address the harm are policy questions that are beyond the constitutional competence of the judiciary and the institutional competence of the criminal law adversarial process.

Like Braidwood J.A. in *Caine* and Rosenberg J.A. in *Clay*, Doherty J.A.'s concern was, by his own words, to draw a distinction "between the harm principle as a principle of fundamental justice and closely related, but distinct policy questions surrounding the application of the criminal law" (para. 34). Indeed, he adds in a footnote at para. 33:

> For example, many argue that the criminal sanction should be a last resort employed only if other forms of governmental action cannot adequately address the harm flowing from the conduct. This minimalist approach to criminal law may well be sound criminal law policy. However, it hardly reflects the historical reality of the scope of the criminal law so as to be properly described as a principle of fundamental justice. Any attempt to apply minimalist doctrine to a specific piece of legislation would raise complex questions of social policy which would defy effective resolution in the context of the adversarial criminal law process.

246 As I said before, however, the focus must remain on the choice by the state to resort to imprisonment to sanction conduct that it has decided to prohibit through its criminal law power or otherwise. The power of Parliament to use criminal law is broad and any concern as to what should be criminalized remains in the hands of the elected representatives. However, in my view, be it as a criminal sanction or as a sanction to any other prohibition, imprisonment must, as a constitutional minimum standard, be reserved for those whose conduct causes a reasoned risk of harm to others. "Doing nothing wrong" in that sense means acting in a manner which causes little or no reasoned risk of harm to others or to society. The *Charter* requires that the highest form of restriction of liberty be reserved for those who, at a minimum, infringe on the rights or freedoms of other individuals or otherwise harm society. I note that the notion of harm is not foreign to s. 7. Indeed, in addi-

tion to the cases referred to earlier, McLachlin J. (as she then was), in her dissenting reasons in *Rodriguez, supra*, at p. 618, referred to the notion of harm to others while discussing the scope of the right to security under s. 7:

> Security of the person has an element of personal autonomy, protecting the dignity and privacy of individuals with respect to decisions concerning their own body. It is part of the persona and dignity of the human being that he or she have the autonomy to decide what is best for his or her body. This is in accordance with the fact, alluded to by McEachern C.J.B.C. below, that "s. 7 was enacted for the purpose of ensuring human dignity and individual control, so long as it harms no one else": (1993), 76 B.C.L.R. (2d) 145, at p. 164. [Emphasis added.]

247 Where legislation which may deprive individuals of their liberty is aimed at protecting other individuals or society from the risk of harm caused by the prohibited conduct, courts must scrutinize carefully the harm alleged. In victimizing conduct, the attribution of fault is relatively straightforward because of the close links between the actor's culpable conduct and the resulting harm to the victim. This Court has used principles of interpretation aimed at excluding from the criminal ambit conduct that is tenuously related to the alleged harm. Thus, in *R. v. Sharpe*, [2001] 1 S.C.R. 45, 2001 SCC 2, the accused accepted that harm to children justified criminalizing possession of some forms of child pornography. The fundamental question was rather whether the prohibition went too far by criminalizing possession of an unjustifiable range of material. McLachlin C.J., for the majority of this Court, had this to say on whether the causal link between a specific prohibition and the harm to children was sufficient, at paras. 74, 75 and 95:

> These exclusions support the earlier suggestion that Parliament's goal was to prohibit possession of child pornography that poses a reasoned risk of harm to children. The primary definition of "child pornography" does not embrace every kind of material that might conceivably pose a risk of harm to children, but appears rather to target blatantly pornographic material... .
>
> Yet problems remain. The interpretation of the legislation suggested above reveals that the law may catch some material that particularly engages the value of self-fulfilment and poses little or no risk of harm to children.
>
> ...
>
> If the law is drafted in a way that unnecessarily catches material that has little or nothing to do with the prevention of harm to children, then the justification for overriding freedom of expression is absent. [Emphasis added.]

While these comments were made under s. 1, they illustrate the threshold to be met to establish a sufficient causal link between prohibited conduct and the harm alleged to be caused by such conduct. Thus, for our purposes, if the prohibition of conduct engages a s. 7 interest, as the threat of imprisonment does, while the conduct poses little or no risk of harm to others, then the law is contrary to s. 7.

248 Where harm to society as a whole is alleged, how must such harm be assessed? Harm caused to collective interests, as opposed to harm caused to identifiable individuals, is not easy to quantify and even less easy to impute to a distinguishable activity or actor. In order to determine whether specific conduct, which perhaps only causes direct harm to the actor, or which seems rather benign, causes more than little or no risk of harm to others, courts must assess the interest of society in prohibiting and sanctioning the conduct. "Societal interests" may indeed form part of the s. 7 analysis where the operative principle of fundamental justice necessarily involves issues like the protection of society. McLachlin J., in *Rodriguez, supra*, best summarized this idea. She stated, at p. 622:

> As my colleague Sopinka J. notes, this Court has held that the principles of fundamental justice may in some cases reflect a balance between the interests of the individual and those of the state. This depends upon the character of the principle of fundamental justice at issue. Where, for instance, the Court is considering whether it accords with fundamental justice to permit the fingerprinting of a person who has been arrested but not yet convicted (*R. v. Beare*, [1988] 2 S.C.R. 387), or the propriety of a particular change in correctional law which has the effect of depriving a prisoner of a liberty interest (*Cunningham v. Canada*, [1993] 2 S.C.R. 143), it may be that the alleged principle will be comprehensible only if the state's interest is taken into account at the s. 7 stage.

(See, *inter alia, Cunningham v. Canada*, [1993] 2 S.C.R. 143, at pp. 151-52; *Godbout, supra*, at para. 78: "From the foregoing discussion, it is clear that deciding whether the infringement of a s. 7 right is fundamental[ly] just may, in certain cases, require that the right at issue be weighed against the interests pursued by the state in causing that infringement"; *Parker, supra*, at para. 113; *R. v. Pan* (1999), 134 C.C.C. (3d) 1, at paras. 177-87, appeal dismissed [2001] 2 S.C.R. 344, 2001 SCC 42, at paras. 39-40.) Considering the nature of the harm principle, societal interests will have to be assessed where the harm alleged to be associated with the prohibited conduct affects society as a whole rather than identifiable individuals.

249 Societal interests in prohibiting conduct are evaluated by balancing the harmful effects on society if the conduct in question is not prohibited by law against the effects of prohibiting the conduct in question. It would indeed be misleading to engage in an assessment of the state's interest in prohibiting conduct by evaluating solely the collective harm that the state wishes to prevent without also evaluating the collective costs incurred by preventing such harm (see Packer, *supra*, at p. 267: "[o]ne cannot meaningfully deal with the question of 'harm to others' without weighing benefits against detriments"). The harm or risk of harm to society caused by the prohibited conduct must outweigh any harm that may result from enforcement.

250 The impact conduct has on society will be assessed by gauging the tolerance society has for the negative effects (or harm) occasioned by the conduct in question. Similarly to what Sopinka J. said in *Butler, supra*, at p. 485, the stronger the inference of a risk of harm, the lesser the likelihood of tolerance. Such an assessment is contextual; it cannot be undertaken in a vacuum and must therefore be made *in concreto*, by reference, where possible, to the tolerance society shows to the harm occasioned by comparable conduct. The risk of harm to society occasioned by the conduct must then be balanced against the costs imposed upon society by the prohibition of the conduct in question. The stronger the risk of harm to society caused by the conduct, the greater the costs society will be ready to bear to enforce its prohibition. Here once again, if the prohibition of conduct en-

gages a s. 7 interest, as the threat of imprisonment does, while the conduct poses little or no risk of harm to others, then the law is contrary to s. 7.

251 I stress that where direct harm to identifiable others is caused by conduct, societal interests are easier to identify because of the nature of the relationship between the state, the offender, and the victim. As Doherty J.A. mentioned in *Murdock, supra*, at para. 35, in those circumstances, the state's interest is the protection of individuals in the community from the harm occasioned by the conduct in question. In prohibiting the conduct and in threatening imprisonment for its enforcement, the state restricts the actor's liberty in order to protect the rights or freedoms of others. In circumstances where one's rights and freedoms are directly threatened by another's actions, the state is justified in using imprisonment to sanction the conduct, provided that it causes more than little or no reasoned risk of harm to others. The justification is then grounded in the outer limits of individual freedom which reflect the need to preserve the rights and freedoms of others. In those circumstances, it would be offensive to pursue a further analysis as to whether the costs of enforcement of the offence are such that they outweigh the victim's rights. However, where others' rights and interests are not directly threatened by the prohibited conduct, the justification has a different source. In those circumstances, societal interests, comprising the benefits and detriments of a prohibition, must be such that the restriction of the person's liberty produces a net benefit as a whole.

(b) *Other Principles of Fundamental Justice Involved*

252 The harm principle is dispositive of these appeals. Therefore, I need not discuss whether other principles of fundamental justice are involved and whether the impugned provisions are in accordance with them.

253 We must now determine whether the harm associated with marihuana use justifies the state's decision to use imprisonment as a sanction against the prohibition of its possession.

(3) Has the Deprivation of Liberty Occurred in Accordance with the Principles of Fundamental Justice?

254 It is useful at this stage to briefly revisit the harm caused by marihuana use as found by the trial judges. Although there is no need at this stage to reproduce the findings of the trial judges as to what harms are not associated with marihuana use, remember that these findings displaced many commonly held but entirely erroneous assumptions regarding the effects of marihuana use (see para. 192, above). As to the harmful effects of marihuana use, recall that McCart J. held in *Clay* that the consumption of marihuana is "not completely harmless" but "unlikely to create serious harm for most individual users or society" (para. 26).

255 Howard Prov. Ct. J. in *Caine* summarized her overall findings on harm as follows, at paras. 121-26:

> The evidence before me demonstrates that there is a reasonable basis for believing that the following health risks exist with [marihuana use].
>
> There is a general risk of harm to the users of marihuana from the acute effects of the drug, but these adverse effects are rare and transient. Persons experiencing the acute effects of the drug will be less adept at driving, flying and other

activities involving complex machinery. In this regard they represent a risk of harm to others in society. At current rates of use, accidents caused by users under the influence of marihuana cannot be said to be significant.

There is also a risk that any individual who chooses to become a casual user, may end up being a chronic user of marihuana, or a member of one of the vulnerable persons identified in the materials. It is not possible to identify these persons in advance.

As to the chronic users of marihuana, there are health risks for such persons. The health problems are serious ones but they arise primarily from the act of smoking rather than from the active ingredients in marihuana. Approximately 5% of all marihuana users are chron[i]c users. At current rates of use, this comes to approximately 50,000 persons. There is a risk that, upon legalization, rates of use will increase, and with that the absolute number of chronic users will increase.

In addition, there are health risks for those vulnerable persons identified in the materials. There is no information before me to suggest how many people might fall into this group. Given that it includes young adolescents who may be more prone to becoming chronic users, I would not estimate this group to be min[u]scule.

All of the risks noted above carry with them a cost to society, both to the health care and welfare systems. At current rates of use, these costs are negligible compared to the costs associated with alcohol and drugs [*sic*]. There is a risk that, with legalization, user rates will increase and so will these costs.

256 The inevitable conclusion is that apart from the risks of impairment while driving, flying or operating complex machinery and the impact of marihuana use on the health care and welfare systems, to which I will return, the harms associated with marihuana use are exclusively health risks for the individual user, ranging from almost non-existent for low/occasional/moderate users of marihuana to relatively significant for chronic users. In my view, as I stated above, harm to self does not satisfy the constitutional requirement that whenever the state resorts to imprisonment, there must be a minimum harm to others as an essential part of the offence. The prohibition of conduct that only causes harm to self, regardless of the gravity of the harm, is not in accordance with the principles of fundamental justice and, if imprisonment is available as a means to enforce the prohibition, a breach of s. 7 of the *Charter* will have been established.

257 It is important at this stage to address a specific issue raised by my colleagues. Although they find that the purpose of the impugned legislation is the protection of health and public safety in general (see majority reasons at para. 65), my colleagues put great emphasis on the fact that it also aims at protecting vulnerable groups from self-inflicted harm (see majority reasons at paras. 76, 77, 100, 108, 123-126 and 132). Specifically, they recall the state's interest in acting to protect vulnerable groups, citing *New Brunswick (Minister of Health and Community Services) v. G. (J.)*, [1999] 3

S.C.R. 46, at para. 70; and *B. (R.), supra*, at para. 88. They also claim that the protection of vulnerable groups is a valid exercise of the criminal law power, citing *Rodriguez, supra*, at p. 595; *R. v. Morgentaler*, [1988] 1 S.C.R. 30, at pp. 74-75; *R. v. Keegstra*, [1995] 2 S.C.R. 381; *Sharpe, supra*; and *Butler, supra*. While the cases referred to by my colleagues clearly illustrate the state's interest in the protection of vulnerable groups from others who might harm them, they are far from suggesting that it is the vulnerable ones who should be sent to jail for their self-protection. Implicit in my colleagues' argument is that the state would be justified in threatening with imprisonment adolescents with a history of poor school performance, women of childbearing age and persons with pre-existing diseases such as cardiovascular diseases, respiratory diseases, schizophrenia and other drug dependencies, who are at particular risk of harming themselves by using marihuana. I do not think that an exception to the harm principle is justified to allow the state to threaten with imprisonment vulnerable people in order to prevent them from harming themselves. To this effect, I note Abella J.A.'s sound reasoning (with which the other members of the panel agreed, albeit on narrower grounds), in *R. v. M. (C.)* (1995), 30 C.R.R. (2d) 112 (Ont. C.A.), at pp. 121-23. In that case, the issue was the constitutionality of criminalizing anal intercourse between non-married persons under 18 years of age, regardless of consent:

> The issue then comes down to this: is sending young persons to jail a reasonable way for the state to protect them from any risks associated with consensual anal intercourse?
>
> If the prevention of harm by discouraging the risk is the objective, it is difficult to imagine a more intrusive way to protect an individual from harm than criminal prosecution... . The risk associated with unprotected sexual conduct is a health risk. It strikes me as decidedly inappropriate to deal with minimizing health risks at any age by using the punitive force of the *Criminal Code*, but especially so for young people.
>
> ...
>
> There is no evidence that threatening to send an adolescent to jail will protect him (or her) from the risks of anal intercourse. I can see no rational connection between protecting someone from the potential harm of exercising sexual preferences and imprisoning that individual for exercising them. There is no proportionality between the articulated health objectives and the Draconian criminal means chosen to achieve them.

258 While these comments were made in the analysis of the proportionality test under s. 1, they reflect my view that sending vulnerable people to jail to protect them from self-inflicted harm does not respect the harm principle as a principle of fundamental justice. Similarly, the fact that some vulnerable people may harm themselves by using marihuana is not a sufficient justification to send other members of the population to jail for engaging in that activity. In other words, the state cannot prevent the general population, under threat of imprisonment, from engaging in conduct that is harmless to them, on the basis that other, more vulnerable persons may harm themselves if they engage in it, particularly if one accepts that imprisonment would be inappropriate for the targeted vulnerable groups. I agree with Packer that to justify imprisonment of both vulnerable persons and

other members of the population on that basis would create a society in which "all are safe but none is free" (Packer, *supra*, at p. 65).

259 My colleagues Gonthier and Binnie JJ. have argued that imprisonment for simple possession is not a serious threat upon conviction for possession of marihuana by members of vulnerable groups, since it is only in the presence of "aggravating circumstances" that imprisonment will be a fit sentence. This assertion does not strengthen their position . In fact, it highlights the main difficulty. Imprisonment is an available punishment for simple possession. As demonstrated by the cases cited by my colleagues (at para. 156), imprisonment has been and continues to be employed by Canadian courts in sentencing those convicted of possession *simpliciter*. By definition, the vulnerable groups are the ones whose members are most likely to suffer harm from the use of marihuana. However, by the reasoning of my colleagues, it is those offenders who are not members of vulnerable groups, i.e., those that do not risk anything more than negligible harm to self and others, who will face the threat of imprisonment due to the "presence of aggravating circumstances" (para. 155).

260 The argument of the majority that the availability of imprisonment as a fit sentence in this case is more appropriately approached under s. 12 than under s. 7 is unconvincing. Section 12 of the *Charter* protects against "cruel and unusual treatment or punishment". Although imprisonment is undoubtedly very serious, it is not inherently "cruel and unusual". Section 7 provides the proper scope for considering whether the availability of imprisonment for an offence and the consequent engagement of the liberty interest in s. 7 are in accordance with the principles of fundamental justice. This accords with Lamer J.'s observations in *Motor Vehicle Reference, supra*, at p. 515:

> A law enacting an absolute liability offence will violate s. 7 of the *Charter* only if and to the extent that it has the potential of depriving of life, liberty, or security of the person.
>
> Obviously, imprisonment ... deprives persons of their liberty. An offence has that potential as of the moment it is open to the judge to impose imprisonment. There is no need that imprisonment, as in s. 94(2), be made mandatory. [Emphasis added.]

It is inappropriate to restrict the consideration of the constitutionality of a person's liberty interest to s. 12. Such a stance is counter to the notion that ss. 8 to 14 of the *Charter* are specific illustrations of the principles of fundamental justice in s. 7, as explained by Lamer J. in *Motor Vehicle Reference, supra*, at p. 502. Where, as here, a principle of fundamental justice that is not specifically named in ss. 8 to 12 -- the harm principle -- is invoked, the analysis is appropriately conducted pursuant to s. 7.

261 With respect to the harm to others or to society as a whole occasioned by marihuana use, Howard Prov. Ct. J. (McCart J. came to the same conclusion) identified (i) the risk that persons intoxicated from marihuana may be less adept at driving, flying, or doing other activities involving complex machinery, and (ii) the "cost to society, both to the health care and welfare systems" (para. 126). Regarding the former, she acknowledges that "[a]t current rates of use, accidents caused by users under the influence of marihuana cannot be said to be significant" (para. 122). Regarding the latter, she acknowledged, at para. 52, that "[t]he evidence establishes that any health care concerns (including financial concerns) associated with marihuana use in this country are minor compared to

the social, criminal and financial costs associated with the use of alcohol or tobacc[o]", but considered that "[t]here is a risk that, with legalization, user rates will increase and so will these costs" (para. 126). Hence, describing the two risks of harm to others (from driving and from the burden on the health and welfare systems), Howard Prov. Ct. J. said that at current rates of use, the first risk "cannot be said to be significant", and that the second is "minor".

262 With respect, I can see no difference for the purpose of determining the level of harm to others caused by marihuana use between the terms "insignificant" and "trivial", used by Braidwood J.A. in *Caine* and Rosenberg J.A. in *Clay* to describe the threshold level of harm, and the expressions "cannot be said to be significant" and "negligible", used by Howard Prov. Ct. J. to quantify the level of harm to society. Both Braidwood J.A. and Rosenberg J.A. concluded that the findings of fact of the trial judges show that marihuana indeed poses a risk of harm to others and society that is not insignificant nor trivial (paras. 141-43 in *Caine*; para. 34 in *Clay*). However, Braidwood J.A. came to this conclusion after he quoted in whole the passage from Howard Prov. Ct. J.'s reasons which summarizes all the possible harms associated with marihuana use, including health risks to the user. Rosenberg J.A. apparently did the same since he referred to the findings of McCart J. as a whole and concluded that this showed that "there is some harm associated with marijuana use" (para. 34). Braidwood J.A. and Rosenberg J.A. apparently failed to distinguish between harm caused only to self from harm which puts others or society as a whole at risk. Having made this essential distinction, I conclude that the evidence does not support a conclusion that marihuana use causes a reasoned risk of harm to others or to society that is not insignificant or trivial, to use Braidwood J.A.'s own terms.

263 In any event, in my view, the two spheres of risks to others or society as a whole identified by the trial judges are not sufficient to justify recourse to the most severe penalty imposed by law, a sentence generally viewed as a last resort (see *Motor Vehicle Reference, supra*, at p. 532, *per* Wilson J.). The two risks do not show that marihuana use causes more than little or no harm to others or to society. First, while the risk that persons experiencing the acute effects of the drug may be less adept at driving, flying and engaging in other activities involving complex machinery is indeed a valid concern, the act of driving while under the influence of alcohol or drugs is an activity separate from mere possession and use. Such dangerous driving is already dealt with in the *Criminal Code*, and rightly so, because it is this act which risks victimizing identifiable others as well as society as a whole. In my view, the state cannot rely on this separate offence to justify the prohibition of possession of marihuana *simpliciter*. This is indeed the approach Parliament has adopted regarding alcohol. I note that in *Caine, supra*, Howard Prov. Ct. J. stated explicitly that "[a]part from the above problem [operation of vehicles or other machinery while intoxicated], there is no evidence to suggest that harm of any kind will befall individual members of society as a result of any actions by individual marihuana users" (para. 50).

264 The second negative effect on society as a whole found by the trial judge, i.e., general harm to the health care and welfare systems, is simply too remote and minor to justify the threat of imprisonment for simple possession of marihuana. Much seemingly innocent conduct may have deleterious consequences. In fact, it is not easy to identify conduct which can be said confidently to be without risk of injury in the long run (see, *inter alia*, A. von Hirsch, "Extending the Harm Principle: 'Remote' Harms and Fair Imputation", in A. P. Simester and A. T. H. Smith, eds., *Harm and Culpability* (1996), 259, at p. 260; Harcourt, *supra*). Canadians have a universal health care system to deal with injuries and illnesses, irrespective of fault. Arguments solely based on vague general costs to the health care system cannot justify imprisonment for any kind of risky undertaking. There is

hardly a net benefit to society in imprisoning, on the basis of the costs they impose on the health care and welfare systems, those very persons who may need access to and support from such systems. Canadians do not expect to go to jail whenever they embark on some adventure which involves a possibility of injury to themselves. I see no reason to single out those who may jeopardize their health by smoking marihuana.

265 In the cases before us, the societal interests in prohibiting marihuana possession must take into account, on the one hand, the burden that marihuana use imposes on the health care and welfare systems, and, on the other, the costs incurred by society because of the prohibition. Howard Prov. Ct. J. noted that at current rates of use, the costs imposed upon the health care and welfare systems by marihuana are negligible compared to the costs associated with alcohol and drugs. As I mentioned earlier, society's tolerance for the harmful effects that the conduct may entail must be assessed, where possible, by reference to its tolerance for comparable conduct. I will thus simply take note of the trial judges' findings that the burden that marihuana use imposes on society is "negligible" or "very, very small" compared to the costs imposed by comparable conduct that society tolerates (i.e., alcohol and tobacco use).

266 If there remained any doubt as to whether the harms associated with marihuana use justified the state in using imprisonment as a sanction against its possession, this doubt disappears when the harms caused by the prohibition are put in the balance. The record shows and the trial judges found that the prohibition of simple possession of marihuana attempts to prevent a low quantum of harm to society at a very high cost. A "negligible" burden on the health care and welfare systems, coupled with the many significant negative effects of the prohibition, cannot be said to amount to more than little or no reasoned risk of harm to society. I thus conclude that s. 3(1) and (2) of the *Narcotic Control Act*, as it prohibits the possession of marihuana for personal use under threat of imprisonment, violates the right of the appellants to liberty in a manner that is not in accordance with the harm principle, a principle of fundamental justice, contrary to s. 7 of the *Charter*.

(4) Possession for the Purpose of Trafficking

267 Before moving to the issue of whether the infringement is justified under s. 1 of the *Charter*, I will briefly address the issues raised by the appellant Malmo-Levine. Malmo-Levine argues that the prohibition of possession for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act* infringes ss. 7 and 15 of the *Charter*. My colleagues Gonthier and Binnie JJ. have discussed Malmo-Levine's argument under s. 15, and have concluded that s. 4(2) of the *Narcotic Control Act* does not discriminate against the appellant since the decision to possess and traffic in marihuana is not an immutable personal characteristic, and treating persons who choose to do so in a differential manner in no way infringes human dignity or reinforces prejudicial stereotypes or historical disadvantage. I agree entirely with this conclusion.

268 Considering their conclusion that the prohibition of simple possession of marihuana does not violate s. 7 of the *Charter*, my colleagues Gonthier and Binnie JJ. did not address the issue raised by Malmo-Levine with regard to s. 7 and, for the same reason, neither did the courts below. In fact, Malmo-Levine's challenge at the British Columbia Court of Appeal was restricted to the part of his charge relating to possession (para. 8 of Braidwood J.A.'s reasons). Moreover, the findings of fact of the trial judges in *Clay* and *Caine* concern the harm related to marihuana use, but there is nothing in the factual record concerning the harm associated specifically with the act of trafficking. Most if not all of the arguments before this Court have focussed on possession for personal use. On this re-

cord, it is virtually impossible to determine whether possession of marihuana for the purpose of trafficking causes more than little or no harm to others. I am aware that the health risks associated with marihuana use could be used to demonstrate that the trafficker, involving third parties, puts their health at risk and thus risks causing more than little or no harm to others than himself or herself. However, this obvious argument cannot be properly addressed without consideration of many factors which were not argued by the parties, such as, for instance, the issue of consent (see, e.g., P. Alldridge, "Dealing with Drug Dealing", in *Harm and Culpability, supra*, at p. 239). A conclusion on this issue raised by the appellant Malmo-Levine would be based on pure speculation. On this record, I cannot conclude that the appellant has met his burden and therefore his constitutional challenge fails.

(5) Is the Infringement Justified Under Section 1 of the *Charter*?

269 This Court has explained, in *R. v. Mills*, [1999] 3 S.C.R. 668, the relation between ss. 7 and 1. McLachlin and Iacobucci JJ., writing for the majority, held as follows, at paras. 65-67:

> It is also important to distinguish between balancing the principles of fundamental justice under s. 7 and balancing interests under s. 1 of the *Charter*. The s. 1 jurisprudence that has developed in this Court is in many respects quite similar to the balancing process mandated by s. 7... .
>
> However, there are several important differences between the balancing exercises under ss. 1 and 7. The most important difference is that the issue under s. 7 is the delineation of the boundaries of the rights in question whereas under s. 1 the question is whether the violation of these boundaries may be justified. The different role played by ss. 1 and 7 also has important implications regarding which party bears the burden of proof. If interests are balanced under s. 7 then it is the rights claimant who bears the burden of proving that the balance struck by the impugned legislation violates s. 7. If interests are balanced under s. 1 then it is the state that bears the burden of justifying the infringement of the *Charter* rights.
>
> Because of these differences, the nature of the issues and interests to be balanced is not the same under the two sections. As Lamer J. (as he then was) stated in *Re B.C. Motor Vehicle Act, supra*, at p. 503: "the principles of fundamental justice are to be found in the basic tenets of our legal system". In contrast, s. 1 is concerned with the values underlying a free and democratic society, which are broader in nature. In *R. v. Oakes*, [1986] 1 S.C.R. 103, Dickson C.J. stated, at p. 136, that these values and principles "embody, to name but a few, respect for the inherent dignity of the human person, commitment to social justice and equality, accommodation of a wide variety of beliefs, respect for cultural and group identity, and faith in social and political institutions which enhance the participation of individuals and groups in society". In *R. v. Keegstra*, [1990] 3 S.C.R. 697, at p. 737, Dickson C.J. described such values and principles as "numerous, covering the guarantees enumerated in the *Charter* and more". [Emphasis added.]

270 In the cases before this Court, certain factors would be better evaluated in the analysis under s. 1, where the Crown will bear the burden of proving them, rather than under s. 7. As Rosenberg J.A. held in *Parker, supra,* the companion case of *Clay* at the Court of Appeal for Ontario, at para. 119:

> Thus, the difference between the s. 1 and the s. 7 analysis is important not only because of the different interests to be considered but also because of the shift in the burden of proof. For example, the Crown argued that in considering whether the law struck the right balance between the accused's interests and the interests of the state under s. 7, the court should consider Canada's international treaty obligations. It may be, however, that such interests are more properly a matter for consideration under s. 1, in which case the Crown would bear the onus of demonstrating that the violation of s. 7 was necessary to uphold Canada's treaty obligations. See *R. v. Malmo-Levine*, 2000 BCCA 335, at para. 151, 145 C.C.C. (3d) 225.

Some balancing of societal interests has been done here under s. 7 in ascertaining the existence and the content of the harm principle as a principle of fundamental justice. In many instances, Canada's treaty obligations will be apposite to a s. 7 analysis. Indeed, in some cases an examination of international law will provide indispensable insight into the scope and content to be given to the "principles of fundamental justice" (*Motor Vehicle Reference, supra*, at p. 503; *Suresh v. Canada (Minister of Citizenship and Immigration)*, [2002] 1 S.C.R. 3, 2002 SCC 1, at para. 46; *United States v. Burns*, [2001] 1 S.C.R. 283, 2001 SCC 7, at paras. 79-81). This is not the case here, however. Given the nature of the harm principle, Canada's treaty obligations are not particularly helpful in demonstrating the existence or application of the principle as a principle of fundamental justice. Treaty obligations and international law generally may, of course, also be considered under s. 1 in the determination of whether a violation of s. 7 can be justified (*R. v. Oakes*, [1986] 1 S.C.R. 103, at pp. 140-41; *Mills, supra*, at paras. 65-67).

271 However, while s. 7 violations may be saved by s. 1, this will occur rarely, as was explained by Lamer C.J. in *New Brunswick (Minister of Health and Community Services), supra*, at para. 99:

> Section 7 violations are not easily saved by s. 1... .
>
> ...
>
> This is so for two reasons. First, the rights protected by s. 7 -- life, liberty, and security of the person -- are very significant and cannot ordinarily be overridden by competing social interests. Second, rarely will a violation of the principles of fundamental justice, specifically the right to a fair hearing, be upheld as a reasonable limit demonstrably justified in a free and democratic society.

The general approach in international law is that a state may not invoke its internal law as justification for its failure to perform a treaty (*Vienna Convention on the Law of Treaties*, Can. T.S. 1980 No. 37, Art. 27; *Zingre v. The Queen*, [1981] 2 S.C.R. 392, at p. 410). However, the treaty obligations Canada has undertaken in the war on drugs are subject to, *inter alia*, Canada's "constitutional limitations" (*Single Convention on Narcotic Drugs, 1961*, Can. T.S. 1964 No. 30, Art. 36) and Canada's "constitutional principles and the basic concepts of its legal system" (*Convention against Illicit*

Traffic in Narcotic Drugs and Psychotropic Substances, Can. T.S. 1990 No. 42, Art. 3(2)). The express subordination of these treaties to the requirements of domestic constitutional law suggests that they would not significantly assist an attempt to justify the s. 7 violation in s. 1.

272 The respondent has not made any submissions regarding s. 1, and none of the courts below considered the issue. Given that the burden is on the Crown to establish that the infringement was justified under s. 1, I conclude that it has not met this burden.

III. Conclusion

A. *Malmo-Levine*

273 For the foregoing reasons, in the case of the appellant David Malmo-Levine, I would dismiss the appeal.

274 The constitutional questions in the *Malmo-Levine* appeal should be answered as follows:

1. Does prohibiting possession of Cannabis (marihuana) for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 7 of the *Canadian Charter of Rights and Freedoms*?

Answer: No.

2. If the answer to Question 1 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: It is unnecessary to answer this question.

3. Does prohibiting possession of Cannabis (marihuana) for the purpose of trafficking under s. 4(2) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 15(1) of the *Charter* by discriminating against a certain group of persons on the basis of their substance orientation, occupation orientation, or both?

Answer: No.

4. If the answer to Question 3 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: It is unnecessary to answer this question.

B. *Caine*

275 In the case of the appellant Victor Eugene Caine, I would allow the appeal and set aside the conviction for simple possession.

276 The constitutional questions in the *Caine* appeal should be answered as follows:

1. Does prohibiting possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), infringe s. 7 of the *Canadian Charter of Rights and Freedoms*?

Answer: Yes.

2. If the answer to Question 1 is in the affirmative, is the infringement justified under s. 1 of the *Charter*?

Answer: No.

3. Is the prohibition on the possession of Cannabis (marihuana) for personal use under s. 3(1) of the *Narcotic Control Act*, R.S.C. 1985, c. N-1, by reason of the inclusion of this substance in s. 3 of the Schedule to the Act (now s. 1, Schedule II, *Controlled Drugs and Substances Act*, S.C. 1996, c. 19), within the legislative competence of the Parliament of Canada as being a law enacted for the peace, order and good government of Canada pursuant to s. 91 of the *Constitution Act, 1867*; as being enacted pursuant to the criminal law power in s. 91(27) thereof; or otherwise?

Answer: Yes.

The following are the reasons delivered by

277 LeBEL J. (dissenting in *Caine*):-- I have had the opportunity of reading the joint reasons of Justices Gonthier and Binnie who would dismiss the appeal, and those of Justice Arbour who would allow it. With respect for the other view, I am in agreement with the disposition suggested by Arbour J. and I would answer the constitutional questions as she proposes. Nevertheless, I am not yet convinced that we should raise the harm principle to the level of a principle of fundamental justice within the meaning of s. 7 of the *Canadian Charter of Rights and Freedoms*. On this question, I share the skepticism of my colleagues Binnie and Gonthier JJ. I part company with them, however, at the point where they hold that the prohibition of simple possession of marihuana is not an arbitrary or irrational legislative response. On the evidence which is available to us and which was carefully reviewed by Arbour J., the law, as it stands, is indeed an arbitrary response to social problems. The Crown has failed to properly delineate the societal concerns and individual rights at stake, more particularly the liberty interest involved in this appeal.

278 The process of delineation of rights under s. 7 unavoidably involves balancing competing rights and interests (*R. v. Mills*, [1999] 3 S.C.R. 668, at paras. 65-66). In this respect, concerns about the harm done to society or some of its members or even to the accused themselves must be weighed together with the consequences which flow from the criminalization of simple possession. A balancing of this nature must occur when it is asserted that the liberty interest of the accused has been infringed in a way that is inconsistent with the tenets of fundamental justice under s. 7 of the *Charter*. Such an analysis is not as narrowly focussed as a review of a punishment under s. 12 of the

Charter where courts must determine whether a specific penalty should be considered as cruel and unusual because of its grossly disproportionate nature.

279 In the course of a s. 7 analysis, the inquiry of the Court is more subtle, broader, and more difficult. Although the availability of imprisonment triggers the inquiry into the applicability of s. 7, the investigation must move beyond the sole question of the penalty and the courts must take into account all relevant factors viewed as a whole, in order to determine whether a breach of fundamental rights has been made out. It is made out if and when the response to a societal problem may overreach in such a way as to taint the particular legislative response with arbitrariness. (See for example, *Suresh v. Canada (Minister of Citizenship and Immigration)*, [2002] 1 S.C.R. 3, 2002 SCC 1, at para. 47; *Godbout v. Longueuil (City)*, [1997] 3 S.C.R. 844, at para. 76; *R. v. Seaboyer*, [1991] 2 S.C.R. 577, at pp. 621 and 625.)

280 On the evidence which is available in this appeal, such a legislative overreach happened. I do not need to engage in any additional review of this evidence, given that it was carefully reviewed and discussed by my colleagues. I will not even attempt to summarize it again. In my mind, it cannot be denied that marihuana can cause problems of varying nature and severity to some people or to groups of them. Nevertheless, the harm its consumption may cause seems rather mild on the evidence we have. In contrast, the harm and the problems connected with the form of criminalization chosen by Parliament seem plain and important. Few people appear to be jailed for simple possession but the law remains on the books. The reluctance to enforce it to the extent of actually jailing people for the offence of simple possession seems consistent with the perception that the law, as it stands, amounts to some sort of legislative overreach to the apprehended problems associated with marihuana consumption. Moreover, besides the availability of jail as a punishment, the enforcement of the law has tarred hundreds of thousands of Canadians with the stigma of a criminal record. They have had to bear the burden of the consequences of such criminal records as Arbour J. points out. The fundamental liberty interest has been infringed by the adoption and implementation of a legislative response which is disproportionate to the societal problems at issue. It is thus arbitrary and in breach of s. 7 of the *Charter*. For these reasons, I agree with Arbour J. that fundamental rights are at stake, that they were breached, and that this Court must intervene as part of its duty under the Constitution to uphold the fundamental principles of our constitutional order .

English version of the reasons delivered by

281 DESCHAMPS J. (dissenting in *Caine*):-- The appellants contest Parliament's power to prohibit the simple possession of marihuana. Their challenge is based on two grounds: the division of powers and the *Canadian Charter of Rights and Freedoms*.

282 Like my colleagues, I conclude that, in Canada, the prohibition of the possession of drugs lies within federal jurisdiction. At issue here is Parliament's power to prohibit certain conduct by imposing a sanction of imprisonment, whether pursuant to its jurisdiction over peace, order and good government or under its criminal law power. As the exercise for determining the proper division of powers depends more upon a categorization of the nature of the enactment than on the enactment's legality, which is the focus of a *Charter* challenge, I find that Parliament may validly exercise its coercive power by invoking a ground falling within its criminal law jurisdiction, namely health.

283 There remains the question of conformity with the *Charter*. Four main arguments are raised: Parliament may not use its coercive power to limit an individual's personal freedom to use marihu-

ana; the purpose of the original statute (*The Opium and Narcotic Drug Act, 1923*, S.C. 1923, c. 22) has shifted over time; the prohibition is unconstitutional because marihuana does not harm anyone other than its users; and the prohibition is disproportionate and arbitrary.

284 I agree with the majority of this Court on the arguments relating to the protection of lifestyle and the shifting purpose of the Act. I will limit my comments to the arguments concerning the "harm principle" and the arbitrary nature of the legislation. The latter argument leads me to conclude that the inclusion of cannabis in the schedule to the *Narcotic Control Act*, R.S.C. 1985, c. N-1 (rep. S.C. 1996, c. 19, s. 94), infringes the appellants' right to liberty.

I. The "Harm Principle"

285 The "harm principle", as defined by John Stuart Mill, is cited and interpreted in both the majority opinion and the opinion of Arbour J. I agree with the conclusion of the majority in that I am of the opinion that the "harm principle" is not a principle of fundamental justice *per se*, but I believe it would be useful to focus on one aspect of their reasoning and even elaborate upon it.

286 A vision of the criminal law based on Mill's work, attractive though it may be, leaves the state no room to intervene in order to safeguard the moral values that are fundamental to a free and democratic society: see *R. v. Butler*, [1992] 1 S.C.R. 452, at p. 493. Mill's restrictive position does not fit well with the Canadian reality, in which it is accepted that social morality and criminal law are inextricably linked. Many prohibitions cannot be rationalized under the "harm principle", as emphasized in para. 118 of the majority opinion. Moreover, the state's intervention in punishing a crime is generally the expression of a popular consensus condemning socially reprehensible conduct, such as murder or sexual assault. Thus, reprehension for such conduct must generally be accompanied by the requirement that the individual understand that the conduct is blameworthy, in other words, that the individual have a guilty mind (*mens rea*): see in this regard H. L. Packer, *The Limits of the Criminal Sanction* (1968), at p. 262; V. V. Ramraj, "Freedom of the Person and the Principles of Criminal Fault" (2002), 18 *S. Afr. J. Hum. Rts.* 225. To be sure, morality alone cannot be the sole justification for the state's exercise of its criminal law power. Still, social morality remains an integral part of the justificatory framework for allowing the state to use this power, and its categorical exclusion under the "harm principle" demonstrates the limitations of this concept.

287 Moreover, I believe that restricting criminal law to situations in which harm is caused to others would minimize the role of the state as protector of society. Indeed, the fundamental purpose of criminal justice is the protection of society: see *Report of the Canadian Committee on Corrections -- Toward Unity: Criminal Justice and Corrections* (the Ouimet Report) (1969), at p. 11. The "harm principle" can prove difficult to apply, for example, when the victim is not easily identifiable, as in the case of certain crimes against society as a whole. Mill was himself ambiguous on this point. The state's use of dissuasive sanctions can also help to eliminate conduct where the resulting harm may be difficult to evaluate or prove, such as corruption, in certain cases.

288 The criminal law thus finds its justification in the protection of society, both as a whole and in its individual components. While there can be no doubt that the state is justified in using its criminal law tools to prevent harm to others, this principle is too narrow to encompass all the elements that may place limits on the state's exercise of the criminal law. It cannot validly be characterized as a principle of fundamental justice.

II. Arbitrary Nature of the Inclusion of Marihuana in the Schedule to the *Narcotic Control Act*

289 The criminal law is one of the most aggressive weapons the state has to enforce its dictates. This weapon must be wielded with great care. The courts must intervene when an enactment violates constitutional guarantees. More specifically, and without repeating the detailed comments of my colleagues, the courts must act when the right to liberty is infringed without regard for the principles of fundamental justice. In the present case, I believe Parliament has exercised its power arbitrarily.

290 When the state prohibits socially neutral conduct, that is, conduct that causes no harm, that is not immoral and upon which there is no societal consensus as to its blameworthiness, it cannot do so without raising a problem of legitimacy and, consequently, losing credibility. Citizens become inclined not to take the criminal justice system seriously and lose confidence in the administration of justice. Judges become reluctant to impose the sanctions attached to such laws.

291 Recognizing this chain reaction allows one to grasp the importance of the principle of fundamental justice which holds that for the state to be able to justify limiting an individual's liberty, the legislation upon which it bases its actions must not be arbitrary: see, e.g., *R. v. Arkell*, [1990] 2 S.C.R. 695, at p. 704; *Rodriguez v. British Columbia (Attorney General)*, [1993] 3 S.C.R. 519, at pp. 619-20 (*per* McLachlin J. (as she then was) dissenting); *R. v. Heywood*, [1994] 3 S.C.R. 761, at p. 793. There are several basic tenets of criminal law that can be used to measure the arbitrariness of a prohibition. I shall rely on three of these principles here: the need for the state to protect society from harm, the availability of tools other than criminal law that could adequately control the conduct and the proportionality of the measure to the problem in question. In emphasizing these three rules, I do not mean to suggest that others could not be used to determine if an enactment is arbitrary, nor that these three rules must always be met in a given case. They do, however, serve to delineate the legitimate scope of criminal law. These rules are not new. They were referred to over 35 years ago by the Canadian Committee on Corrections (Ouimet Report, *supra*, at p. 12) in the chapter dealing with the basic principles and goals of criminal justice. I realize that such working groups usually attempt to describe the law as it should be, in a normative sense, but in this chapter, the Committee took care to outline the foundations specific to our criminal law. Those factors are still relevant today.

292 Is the inclusion of marihuana in the schedule to the *Narcotic Control Act* arbitrary?

293 As mentioned by the majority, the reasons for adding marihuana to the schedule to the *Narcotic Control Act* are nebulous, at best. The historical background outlined by the trial judge in the case of the appellant Caine clearly shows that Parliament's decision was made at a time when a climate of irrational fear predominated, owing to a campaign led by Edmonton magistrate Emily Murphy, who claimed that marihuana caused users to lose their minds, along with all sense of moral responsibility, becoming maniacs capable of murder and many other acts of cruelty.

294 Fortunately, the consequences of marihuana use are nothing like those described at that time. Although I do not accept the "harm principle" as an independent principle, I believe that the need for the state to protect society from harm plays an active role in any assessment of the arbitrariness of legislation. As a general rule, the state is justified in using the coercive tools of criminal law in cases where an individual willfully causes harm.

295 Although I do not adopt the approach of my colleague Arbour J., who would limit the sanction of imprisonment to cases where harm is done to others, I agree with her description of the consequences of marihuana use. The inherent risks of marihuana use, apart from those related to the operation of vehicles and the impact on public health care and social assistance systems, affect only the users themselves. These risks can be situated on a spectrum, ranging from no risk for occasional users to more significant risks for frequent users and vulnerable groups. On the whole, with a few exceptions, moderate use of marihuana is harmless. Thus, it seems doubtful that it is appropriate to classify marihuana consumption as conduct giving rise to a legitimate use of the criminal law in light of the *Charter*.

296 An examination of the second criterion, that of the availability of more tailored methods than the criminal law for controlling conduct, is equally perplexing.

297 The criminal law is an indispensable tool, but only in very limited circumstances: when society needs to be protected from an offender, when punishment is required to deter an individual or society in general from committing offences and when corrective measures specific to this field of law are necessary (see s. 718 of the *Criminal Code*, R.S.C. 1985, c. C-46). The minimal harm caused by marihuana does not fit squarely within the categories of conduct usually kept in check by the criminal law.

298 I would refer back to the comments made by Arbour J. (at paras. 192 to 200) concerning the risks identified by the trial judges. Only three groups are traditionally identified as requiring state intervention for their protection: young persons, pregnant women and certain people with medical conditions. This line of reasoning does not have to be pushed very far before it becomes obvious that criminal law is not society's preferred means of controlling the conduct of these groups. The use of imprisonment and all the other aspects of the criminal justice system, including the imposition of a criminal record, to suppress conduct that causes little harm to moderate users or to control high-risk groups for whom the effectiveness of deterrence or correction is highly dubious and seems to me out of keeping with Canadian society's standards of justice.

299 This brings me to the third factor, proportionality. The harmful effects of marihuana use have already been discussed and are highly debatable. The harm caused by its prohibition, however, is clear and significant. For the details, I refer back once again to the effects listed by Arbour J. (para. 200). A balancing of these two factors yields the result that the harm caused by prohibiting marihuana is fundamentally disproportionate to the problems created by its use that the state seeks to suppress.

300 While I am more comfortable using three criteria for evaluating constitutionality rather than just one, I nevertheless agree with LeBel J.'s analysis with regard to proportionality.

301 The harm caused by using the criminal law to punish the simple use of marihuana far outweighs the benefits that its prohibition can bring. LeBel J. notes that the fact that jail sentences are rarely imposed illustrates the perception of judges that imprisonment is not a sanction that befits the inherent dangers of using marihuana. In the case of the appellant Caine, Howard Prov. Ct. J. also observed that the prohibition had brought the law into disrepute in the eyes of over one million people. These are exactly the kinds of reactions that are indicative of the arbitrariness of the impugned provisions. As I have already mentioned, and as Howard Prov. Ct. J. observed, when the state prohibits socially neutral conduct, it exposes itself to the risk of eroding its credibility.

302 Canadian society is changing. Its knowledge base is growing, and its morals are evolving. Even if it was once the case, and in my view it never was, the prohibition against cannabis is no longer defensible. My analysis leads me to conclude that the little harm caused by marihuana casts doubt on the appropriateness of state intervention in this case. When I weigh the prohibition against, first, other available methods for countering the harm that marihuana use presents and, second, the problems caused by marihuana use, I must conclude that the legislation is inconsistent with the constitutional guarantee in s. 7 of the *Charter*.

303 The respondent did not attempt to justify the prohibition under s. 1 of the *Charter*. It has therefore not satisfied its burden.

304 For these reasons, I agree with the disposition proposed by Arbour J.

* * * * *

APPENDIX

Extracts from a document entitled *Cannabis: a health perspective and research agenda*, Division of Mental Health and Prevention of Substance Abuse, World Health Organization (1997), at pp. 30-31:

Chronic health effects of cannabis use

The chronic use of cannabis produces additional health hazards including:

-- selective impairments of cognitive functioning which include the organization and integration of complex information involving various mechanisms of attention and memory processes;

-- prolonged use may lead to greater impairment, which may not recover with cessation of use, and which could affect daily life functions;

-- development of a cannabis dependence syndrome characterized by a loss of control over cannabis use is likely in chronic users;

-- cannabis use can exacerbate schizophrenia in affected individuals;

-- epithelial injury of the trachea and major bronchi is caused by long-term cannabis smoking;

-- airway injury, lung inflammation, and impaired pulmonary defence against infection from persistent cannabis consumption over prolonged periods;

-- heavy cannabis consumption is associated with a higher prevalence of symptoms of chronic bronchitis and a higher incidence of acute bronchitis than in the non-smoking cohort;

-- cannabis use during pregnancy is associated with impairment in fetal development leading to a reduction in birth weight;

-- cannabis use during pregnancy may lead to postnatal risk of rare forms of cancer although more research is needed in this area.

The health consequences of cannabis use in developing countries are largely unknown because of limited and non-systematic research, but there is no reason *a priori* to expect that biological effects on individuals in these populations would be substantially different to what has been observed in developed countries. However, other consequences might be different given the cultural and social differences between countries.

Therapeutic uses of cannabinoids

Several studies have demonstrated the therapeutic effects of cannabinoids for nausea and vomiting in the advanced stages of illnesses such as cancer and AIDS. Dronabinol (tetrahydrocannabinol) has been available by prescription for more than a decade in the USA. Other therapeutic uses of cannabinoids are being demonstrated by controlled studies, including treatment of asthma and glaucoma, as an antidepressant, appetite stimulant, anticonvulsant and anti-spasmodic, research in this area should continue. For example, more basic research on the central and peripheral mechanisms of the effects of cannabinoids on gastrointestinal function may improve the ability to alleviate nausea and emesis. More research is needed on the basic neuropharmacology of THC and other cannabinoids so that better therapeutic agents can be found.

Solicitors:

Solicitors for the appellant Caine: Conroy & Company, Abbotsford.

Solicitor for the respondent: Attorney General of Canada, Vancouver.

Solicitor for the intervener the Attorney General of Ontario: Attorney General of Ontario, Toronto.

Solicitors for the intervener the British Columbia Civil Liberties Association: Arvay Finlay, Victoria.

Solicitors for the intervener the Canadian Civil Liberties Association: Paliare, Roland, Rosenberg, Rothstein, Toronto.

cp/e/qw/qlhbb

Tab 19

Indexed as:

Reference re: Constitutional Creditor Arrangement Act (Canada)

IN THE MATTER OF A Reference concerning the Constitutional validity of the Companies' Creditors Arrangement Act.

[1934] S.C.R. 659

Supreme Court of Canada

1934: March 27, 28, 29 / 1934: June 6.

Present: Duff C.J. and Rinfret, Lamont, Cannon, Crocket and Hughes JJ.

Constitutional law -- The Companies' Creditors Arrangement Act, 1933, 23-24 Geo. V, c. 36 (Dom.) -- Constitutional validity -- "Bankruptcy and Insolvency" (B.N.A. Act, s. 91(21)).

The Companies' Creditors Arrangement Act, 1933, 23-24 Geo. V, c. 36, is intra vires of the Parliament of Canada. The matters dealt with come within the domain of "bankruptcy and insolvency" within the intendment of s. 91(21) of the B.N.A. Act.

The Act discussed with regard to its aim, its features, its comparison with existing bankruptcy or insolvency legislation, and the history of bankruptcy and insolvency law.

REFERENCE to the Supreme Court of Canada for hearing and consideration pursuant to the authority of s. 55 of the Supreme Court Act (R.S.C., 1927, c. 35) of the following question:

Is The Companies' Creditors Arrangement Act, 1933, 23-24 Geo. V, chapter 36, ultra vires of the Parliament of Canada, either in whole or in part, and, if so, in what particular or particulars, or to what extent?

L.E. Beaulieu K.C. and F.P. Varcoe K.C., for the Attorney-General for Canada.
C. Lanctôt K.C. and L. St. Laurent K.C., for the Attorney-General for Quebec.
I.A. Humphries K.C., for the Attorney-General for Ontario.

Solicitor for the Attorney-General of Canada: W. Stuart Edwards.
Solicitor for the Attorney-General of Quebec: Charles Lanctôt.
Solicitor for the Attorney-General of Ontario: I.A. Humphries.

The judgment of Duff C.J. and Rinfret, Crocket and Hughes JJ. was delivered by

DUFF C.J.:-- The history of the law seems to show clearly enough that legislation in respect of compositions and arrangements is a natural and ordinary component of a system of bankruptcy and insolvency law.

Under the Bankruptcy Act, as it now exists, proposals for compositions and arrangements cannot be dealt with before a receiving order or assignment has been made. This, however, was not always the case. Under the Bankruptcy Act of 1919, a proposal for composition or arrangement could be made prior to an assignment or receiving order.

The Winding-up Act contains brief provisions, in sections 65 and 66, which, in substance, differ very little indeed from the legislation now before us; although this, no doubt, is subject to the important qualification, that the provisions of the Winding-up Act apply only in the case of a company which is in course of being wound up. Similar provisions affecting the subject matter of this legislation are to be found in Canadian legislation before and after Confederation.

The powers conferred upon the court under the Companies' Creditors Arrangement Act, 1933, come into operation when a compromise or arrangement is proposed between a "company which is bankrupt or insolvent or which has committed an act of bankruptcy within the meaning of the Bankruptcy Act or which is deemed insolvent within the meaning of the Winding-up Act," and its "unsecured creditors or any class of them." The important difference, as already observed, between the provisions of the Companies' Creditors Arrangement Act and those of the Bankruptcy Act itself in relation to compromises and arrangements is that the powers of the first named Act may be exercised notwithstanding the fact that no proceedings have been taken under the Bankruptcy Act or the Winding-up Act. The Act, however, creates powers, which can be exercised in case, and only in case, of insolvency.

Furthermore, the aim of the Act is to deal with the existing condition of insolvency, in itself, to enable arrangements to be made, in view of the insolvent condition of the company, under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy. Ex facie it would appear that such a scheme in principle does not radically depart from the normal character of bankruptcy legislation. As Lord Cave impliedly states 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."

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.

The argument mainly pressed upon us in opposition to the validity of the legislation was that

> It does not endeavour to treat equally all contracts of debts between the debtor and his creditors but allows the interest of some of them to be sacrificed in the interest of the company and of other classes of creditors.

We think an adequate answer to this objection is put forward in the argument on behalf of the Attorney-General for the Dominion. Apart altogether from the judicial control over the proceedings,

there is the circumstance that the legislation applies to insolvent companies only; and, consequently, that it is within the power of any creditor to apply for a winding-up order or a receiving order. It seems difficult, therefore, to suppose that the purpose of the legislation is to give sanction to arrangements in the exclusive interests of a single creditor or of a single class of creditors and having no relation to the benefit of the creditors as a whole. The ultimate purpose would appear to be enable the court to sanction a compromise which, although binding upon a class of creditors only, would be beneficial to the general body of creditors as well as to the shareholders. We think it is not unimportant to note the circumstance to which our attention was called by counsel for the Attorney-General for the Dominion that the court may order shareholders to be summoned although they are not authorized to vote.

The judgment of Lamont and Cannon JJ. was delivered by

CANNON J.:-- This is a reference by the Governor General in Council submitting for hearing and consideration of this Court the following question:

> Is The Companies' Creditors Arrangement Act, 1933, 23-24 Geo. V, chapter 36, ultra vires of the Parliament of Canada, either in whole or in part, and, if so, in what particular or particulars, or to what extent?

This Act is designed to apply to insolvent or bankrupt companies; and it is contended on behalf of the Dominion that Parliament could pass this legislation under section 91, par. 21, which gives it paramount jurisdiction to make laws concerning bankruptcy and insolvency. The provinces represent that in enacting it Parliament disregarded their exclusive jurisdiction under section 92, par. 13, in relation to property and civil rights in the province.

The whole argument before us was finally directed to one point: Are the proceedings contemplated by the Act, in pith and substance, bankruptcy or insolvency enactments within the fair and ordinary meaning of these words? One of the features which distinguishes this Act from the Bankruptcy Act now in force is that, under the latter, a composition or arrangement cannot be proceeded with before a receiving order or assignment has been made. Another difference is that under the Bankruptcy Act the secured creditor is dealt with on the footing that he may realize his security or value or surrender the same; it is only in respect of what he claims apart from the security that he is affected by the composition or arrangement. It was pointed out also that similar provisions giving binding effect to this approval by a certain majority of creditors are found in our legislation before and after Confederation.

The Insolvent Act of 1864, 27-28 Vict., ch. 17, sec. 9;

The Insolvent Act of 1869, Canada, 32-33 Vict., ch. 16, secs. 94 et seq.;

The Insolvent Act of 1875, Canada, 38 Vict., c. 16, secs. 54 et seq.

As far as Lower Canada is concerned, it may be of interest to note that chapter 87 of the Consolidated Statutes of Lower Canada, 1859, allowed the issue of a capias if the debtor "had refused to compromise or arrange with his creditors, or to make a cession de biens," and provides that the debtor may be discharged if, when the affidavit for capias was made, he had "not refused to compromise or arrange with his creditors."

Moreover, I find that, before and since Confederation, arrangements with the creditors have always been of the very essence of any system of bankruptcy or insolvency legislation. Civil rights

and the sanctity of contracts are certainly affected by clause 5 under which a minority of creditors would be bound by the vote of a majority in number representing three-fourths in value of creditors present and voting, either in person or by proxy, if the agreement or compromise to which they agreed be sanctioned by the court. I find that this feature existed long before Confederation and was at that time generally accepted.

Pardessus, Droit Commercial, vol. 3, Jd. 1843, p. 92, no. 1232, says:

> 1232. Les créanciers d'un failli ont presque toujours intérêt à faire avec lui un arrangement quelconque, plutôt que d'éprouver les lenteurs et les embarrass d'une union qui finit souvent par consumer la fortune du débiteur. Mais, comme rarement tous sont d'accord, et qu'il est naturel de présumer qu'un grand nombre prendra les arrangements les plus convenables a l'intérêt commun, on a cru devoir faire céder la volonté de la minorité à celle de la majorité; les créanciers présents ont donc été admis à décider pour les absents.
>
> Cette minorité, ces absents, doivent au moins avoir l'assurance que de mûres réflexions ont dirigé ceux dont le voeu doit devenir une loi pour eux. Tel est l'objet des règles prescrites pour la validité du concordat.

Under number 1236, classes or categories having different interests are already recognized by this author, and he adds (No. 1237):

> Le concordat est valablement consenti par la majorité des créanciers présents, pourvu que les sommes dues aux personnes qui forment cette majorité égalent les trois quarts de la totalité des créances vérifiées et affirmées, ou admises par provision, dues à des créanciers ayant droit de prendre part à la délibération du concordat.

Therefore, the very clause objected to in our Act of 1933 seems to be copied from the law of bankruptcy as it existed in France in 1843, when this work was published.

Under our system and the English Bankruptcy Act of 1914, bankruptcy legislation deals with the proceedings necessary for the distribution, under judicial authority, of the property of an insolvent person among his creditors. It assumes the commission of an "act of bankruptcy" followed by a petition to the court for a receiving order for the protection of the estate. The property of the debtor then vests in an official receiver. The debtor must submit a statement of affairs to the official receiver who calls a meeting of the creditors. The debtor is examined; and if no composition or scheme of arrangement is approved, he is adjudged bankrupt; and his property becomes divisible among his creditors and vests in a trustee.

Therefore, if the proceedings under this new Act of 1933 are not, strictly speaking, "bankruptcy" proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as "insolvency proceedings" with the object of preventing a declaration of bankruptcy and the sale of these assets, if the creditors directly interested for the time being reach the conclusion that an opportune arrangement to avoid such sale would better protect their interest, as a whole or in part. Provisions for the settlement of the liabilities of the insol-

vent are an essential element of any insolvency legislation and were incorporated in our Insolvent Act of 1864; and such a deed of composition and discharge could be validly made either before, pending or after proceedings upon an assignment, or for the compulsory liquidation of the estate of the insolvent. What was considered as being within the scope of the word "insolvency" when it was used in section 91 of the B.N.A. Act is to be found in the preamble of the 1864 Insolvency Act, which reads:

> Whereas it is expedient that provision be made for the settlement of the estates of insolvent debtors, for giving effect to arrangements between them and their creditors, and for the punishment of fraud.

See also: Cushing v. Dupuy [(1880) 5 App. Cas. 409]; Royal Bank of Canada v. Larue [[1928] A.C. 187].

I therefore reach the conclusion that arrangements as provided for by this Act are and have been, before and since Confederation, an essential component part of any system devised to protect the creditors of insolvents and, at the same time, help the honest debtor to rehabilitate himself and obtain a discharge.

I would, therefore, answer the question submitted to us in the negative.

The question submitted is answered in the negative.

Tab 20

Indexed as:

Royal Bank of Canada v. Fracmaster Ltd.

IN THE MATTER OF The Companies' Creditors Arrangement Act R.S.C. 1985, c. C-36 as amended
AND IN THE MATTER OF Fracmaster Ltd.
Between
Uti Energy Corp., respondent (plaintiff), and
Fracmaster Ltd., respondent (defendant)
And between
Royal Bank of Canada, and
Royal Bank of Canada, as agent for Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Hong Kong Bank of Canada, Banque Nationale de Paris (Canada) and Credit Suisse First Boston Canada, respondents (plaintiffs), and
Fracmaster Ltd., respondent (defendant), and
Uti Energy Corp., appellant
And between
The Janus Corporation, appellant (plaintiff), and
Fracmaster Ltd., respondent (defendant)
And between
Royal Bank of Canada, and Royal Bank of Canada, as agent for Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Hong Kong Bank of Canada, Banque Nationale de Paris (Canada) and Credit Suisse First Boston Canada, respondents (plaintiffs), and
Fracmaster Ltd., respondent (defendant), and
Uti Energy Corp., appellant, and
Calfrac Limited, appellant

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89 A.C.W.S. (3d) 9

Dockets: 99-18326, 99-18327, 99-18331 and 99-18335

Alberta Court of Appeal
Calgary, Alberta

Conrad, O'Leary and Fruman JJ.A.

Heard: June 4 and 7, 1999.
Oral judgment: June 7, 1999. Filed: June 9, 1999.

(10 pp.)

Appeal from the entire order of Paperny J. made May 17, 1999 and entered on May 19, 1999. Appeal from the entire order of Paperny J. made May 21, 1999 and entered on May 25, 1999.

Counsel:

H.A. Gorman, for UTI Energy Corp.
V.P. Lalonde, for The Janus Corporation & Alfred H. Balm.
E.W. Halt and L. Berner, for Calfrac Limited.
T.J. Mallett and A.D. Little, for BJ Services Company.
B.P. O'Leary and A.Z.A. Campbell, for Arthur Andersen Inc. (The Receiver).
F.R. Dearlove, for Royal Bank et al. (The Lending Syndicate).
R. Dudelzak, Q.C., for Global Securities Ltd.
W.E.B. Code, for BNPI.
G.B. Davison, for Fracmaster (for the Corporation).
S.T. Fitzgerald, for TD Asset Finance.

MEMORANDUM OF JUDGMENT
DELIVERED FROM THE BENCH

The judgment of the Court was delivered by Fruman J.A.

1 CONRAD J.A.:-- The decision of the Court is unanimous and will be delivered by Madam Justice Fruman.

2 FRUMAN J.A. (orally):-- Fracmaster Ltd., an oil and gas services company with world-wide operations, encountered serious financial difficulties. With liabilities that greatly exceeded its assets, its inevitable insolvency gave rise to hurried attempts to restructure the company. A series of court proceedings and a court-authorized tender process, all conducted at break neck speed, resulted in a court order approving the sale of Fracmaster's assets to BJ Services Company for $80 million. That order, and the events which led up to it, are the subject of four appeals by prospective purchasers whose bids for Fracmaster were unsuccessful.

3 We make two preliminary observations. First, this is a court of review. It is not our task to reconsider the merits of the various offers and decide which proposal might be best. The decisions made by the chambers judge involve a good measure of discretion, and are owed considerable deference. Whether or not we agree, we will only interfere if we conclude that she acted unreasonably, erred in principle or made a manifest error.

4 Our second observation is that events unfolded rapidly, with short time periods and offers arriving, literally, at the last minute. Parties did not always have time to prepare and file affidavits. On occasion representations of fact were mixed with submissions of law made by counsel to the chambers judge. As a result, our record is not as complete as we might have wished. We imply no criticism. We understand Fracmaster's serious financial jeopardy, the need for haste, and the accommodation by the parties and the court to conclude matters quickly. However, the frailties of the record require that we give considerable deference to fact findings made by the chambers judge and further illustrate why leave is and should be required to appeal proceedings under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (section 13). I will refer to that statute as the "CCAA".

FACTS

5 Fracmaster is an Alberta company. Beginning in the fall of 1998, when its financial condition was precarious, it unsuccessfully attempted to restructure its financial affairs. With the indulgence of a lending syndicate to whom Fracmaster owed $96 million, and whose debt was registered as a first charge on its assets, it subsequently filed a petition under the CCAA. On March 18, 1999, Fracmaster was granted an order imposing a stay of proceedings and appointing Arthur Andersen Inc. as the monitor. Fracmaster then conducted another sale process, in order to restructure the company, inject equity or sell its assets. The sale process was neither supervised nor controlled by the monitor. Several companies submitted offers or proposals, including UTI Energy Corp., Calfrac Limited and The Janus Corporation together with its principal, Alfred H. Balm.

6 When the matter returned to court in May of 1999 four applications were heard:

> First, Fracmaster applied for approval of the sale of its assets to UTI. The members of the lending syndicate supported that application, in accordance with a contractual commitment they had made to UTI.
>
> Second, that same lending syndicate, as an alternative to Fracmaster's application, applied to lift the stay, appoint Arthur Andersen as receiver, direct the receiver to approve the UTI sale and permit the lending syndicate to begin to realize on its security.
>
> Third, Balm/Janus applied to continue the stay, adjourn the other applications, appoint an interim receiver and have the court direct the calling of meetings of secured creditors, unsecured creditors and shareholders, to consider the Balm/Janus plan of arrangement.
>
> Fourth, Calfrac applied for approval and acceptance of its proposal to purchase Fracmaster's assets.

7 In reasons dated May 17, 1999, the chambers judge dismissed the Fracmaster, Balm/Janus and Calfrac applications. She appointed Arthur Andersen as the receiver/manager on certain terms and

conditions, including the power to sell the assets of Fracmaster subject to court approval. She denied the lending syndicate's application to direct the receiver to sell the assets to UTI. Alive to concerns about delay, she asked the receiver to quickly report its recommendations about a sale of assets or other immediate action that the receiver considered appropriate for the benefit of all claimants, including the secured creditors (CCAA A.B. 333). The May 17 order in the CCAA proceedings is the subject of appeals by Balm/Janus and UTI.

8 The next day, May 18, the receiver returned to court with a notice of motion seeking directions for approval of a sale process by way of sealed bids. The process was designed to respond to the principles and objectives established by the chambers judge for a sale of assets. As there had been no independent valuations, the proposed tender process would test the market to determine whether offers were available in excess of the amount of the lending syndicate's secured debt. The process was also designed to maximize the value to the creditors; respond to concerns about delay and the need for finality; provide a process for the benefit of all creditors; and be fundamentally fair by establishing a level playing field for all participants.

9 The proposal was not greeted with unanimous approval by the prospective purchasers, and its terms were the subject of heated debate in court. At the conclusion of the May 18 proceedings, the chambers judge ordered a tender process. The order set out the terms and conditions of offers that would be considered, with final offers to be submitted by 2:00 p.m. on May 20, 1999, by way of sealed bids. The receiver would advise the interested parties of its recommendation by 8:00 p.m. on May 20, and make its recommendation to the court at 10:00 a.m. on May 21. The tender process established in the May 18 order has not been appealed.

10 Offers were submitted by UTI, Calfrac and BJ Services, a company which had previously shown interest in acquiring Fracmaster, but had not participated in the CCAA company-conducted sale process. Balm/Janus did not submit an offer. The lending syndicate continued to support the UTI offer, in accordance with a contractual commitment its members had made to UTI. The receiver recommended acceptance of the BJ Services offer, for a number of reasons, including the fact that it provided the highest cash purchase price, exceeding the Calfrac offer by $13 million and the UTI offer by $19.3 million. The chambers judge, in reasons dated May 21, 1999, approved the BJ Services offer recommended by the receiver. UTI and Calfrac appeal that decision.

THE CCAA APPEALS

11 Balm/Janus appeal the chambers judge's decision in the CCAA proceedings, declining to order a meeting of creditors and shareholders of Fracmaster to consider and implement Balm/Janus' proposed plan of arrangement. The appeal is supported by certain shareholders of Fracmaster and by Banque Nationale de Paris, a subordinated lender.

12 The chambers judge acknowledged that the restructuring proposed by Balm/Janus was a true plan which fit within the CCAA, leaving an after-life for Fracmaster and its shareholders. However, she noted the commercial reality that there was no equity left in Fracmaster, and that the lending syndicate had the only realistic remaining financial interest (CCAA A.B. 329-330). Under the terms of the CCAA and the Balm/Janus proposal, the plan would require the approval of the lending syndicate, which had indicated that it would not support the proposal. The chambers judge found as a fact that the lending syndicate had valid commercial reasons for its refusal (CCAA A.B. 331). She decided that it would be pointless to order meetings of creditors and shareholders and dismissed the Balm/Janus application.

13 There is no requirement under the CCAA that all proposed plans of arrangement be put to meetings of creditors and shareholders for their consideration. Sections 4 and 5 specifically employ the word "may", giving the court discretion. In exercising its discretion, the court must consider whether the proposed plan of arrangement has a reasonable chance of success: Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 10 C.B.R. (3d) 23 (Ont. Gen. Div.), or instead, is doomed to failure: Re Inducon Development Corp. (1991), 8 C.B.R. (3d) 306 (Ont. Gen. Div.). Here it was clear that the lending syndicate did not support the plan. They would be entitled to vote as a class at the meeting and defeat the plan. It was also clear that the Fracmaster situation was urgent, requiring rapid resolution, and that the delays that would be occasioned by calling the meetings would further jeopardize Fracmaster's financial condition and the value of its assets. The chambers judge did not err in concluding that the Balm/Janus plan was doomed to failure. We grant leave to appeal to Balm/Janus, but dismiss their appeal.

14 We wish to make a further observation. Under the CCAA the court has no discretion to sanction a plan unless it has been approved by a vote of a 2/3 majority in value of each class of creditors (section 6). To that extent, each class of creditors has a veto. This procedure is quite different from a court-appointed receivership. In a receivership the desires of the creditors are a significant factor, but the approval by a specific majority of creditors is not a pre-condition to court sanction, and creditors do not have an absolute veto. The difference in the procedures gives rise to different tests and considerations to be applied in each type of proceeding. While in this case the lending syndicate's desires in the CCAA and receivership proceedings were consistent, the chambers judge was not required to give the same weight to their wishes in each proceeding.

15 UTI also appeals the May 17, 1999 order denying Fracmaster's application to approve the sale of its assets to UTI under the CCAA. The chambers judge noted that the proposed sale of assets to UTI did not create any monetary return for the unsecured creditors or shareholders of Fracmaster, nor did it contemplate that they would receive any benefit. The transaction was effectively a sale of assets for the benefit of the lending syndicate, a transaction which she concluded could be accomplished in a manner that did not require the use of the CCAA (CCAA A.B. 331-332). Without deciding whether the UTI offer was commercially provident, she concluded that the sale should not be approved under the CCAA, and dismissed Fracmaster's application.

16 Although there are infrequent situations in which a liquidation of a company's assets has been concluded under the CCAA, the proposed transaction must be in the best interest of the creditors generally: Re Lehndorff General Partner Ltd. (1993), 17 CBR (3d) 24 at 31 (Ont. Gen. Div.). There must be an ongoing business entity that will survive the asset sale. See, for example, Re Canadian Red Cross Society, [1998] O.J. No. 3306 (Ont. Gen. Div.), online: QL (OJ); Re Solv-Ex Corporation and Solv-Ex Canada Limited, (19 November, 1997), (Calgary), 9701-10022 (Alta. Q.B.). A sale of all or substantially all the assets of a company to an entirely different entity, with no continued involvement by former creditors and shareholders, does not meet this requirement. While we do not intend to limit the flexibility of the CCAA, we are concerned about its use to liquidate assets of insolvent companies which are not part of a plan or compromise among creditors and shareholders, resulting in some continuation of a company as a going concern. Generally, such liquidations are inconsistent with the intent of the CCAA and should not be carried out under its protective umbrella. The chambers judge did not err in concluding that the sale of assets to UTI would be an inappropriate use of the CCAA. We grant leave to appeal to UTI, but dismiss its appeal.

RECEIVERSHIP APPEALS

17 Calfrac appeals the May 21 order which approved the sale of Fracmaster's assets to BJ Services. Its primary complaint is that the receiver failed to administer the sale process in strict compliance with the May 18 court ordered procedure. Calfrac's complaints about the process were considered by the chambers judge, and dealt with in her May 21 reasons (Receivership A.B. 119 to 122). She concluded that the terms of the May 18 order had to be read in light of the commercial realities of the business world and the bidding process. She viewed the variations as minor and not problematic and decided that the BJ Services offer was in substantially the same form as the offer proposed by the receiver.

18 A review of Calfrac's offer indicates that it too was not in strict complaince with the terms of the May 18 order. This is not entirely unexpected as the order, tender process and submission of offers came about quickly, without time to contemplate all the intricacies of fine legal drafting. Amendments to the form of agreement were contemplated in paragraph 4. c of the May 18 order. The other paragraphs of section 4, setting out other terms and conditions, did not specifically mention amendments.

19 The tender process in this case was not a distinct and final process designed to provide a complete set of bid documents to the bidders, with no possibility of negotiation or variation, as might be the case in a construction bid. See, for example, M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd., [1999] S.C.J. No. 17 (S.C.C.), online: QL (SCJ). Time did not permit the creation of such definitive conditions. Instead the process was designed to be court supervised. The amendment provisions contained in paragraph 4. c illustrate the intent to build flexibility into the process, rather than requiring strict compliance with the order. All parties were entitled to be present and make representations at the court proceedings to approve an offer, with the court to have ultimate discretion to determine whether the principles and objectives of the sale process had been met. The chambers judge did not act unreasonably in considering the commercial realities and the nature of the variations, and in accepting the form of BJ Services offer. This ground of appeal fails.

20 A second ground of appeal advanced by both Calfrac and UTI, is that the receiver and the chambers judge failed to properly consider the closing risks associated with the BJ Services offer. The chambers judge considered the closing risks in her reasons (Receivership A.B. 112 to 113) and accepted the receiver's conclusion that the closing risks associated with the BJ Services offer were more than the Calfrac offer, no greater than the UTI offer, and more than offset by the BJ Services purchase price.

21 Calfrac is critical of the summary manner in which the receiver communicated its risk assessment, and the lack of detail to back up its analysis. The receiver had 6 hours in which to analyze the offers and indicate its recommendation to the parties. The expedited procedure was set out in the May 18 order which has not been appealed. With the benefit of more time, the receiver undoubtedly would have proffered a more detailed analysis. But one cannot be overly critical of the receiver's work product, given the time constraints.

22 Both UTI and Calfrac contend that the chambers judge erred in her assessment of the closing risks. UTI suggests that she erred in concluding that the closing risks of the BJ Services offer were no greater than the UTI offer. Even if that were so, the chambers judge also concluded that the BJ Services closing risks were more than offset by the greater purchase price. If that was the case for the Calfrac offer, which involved fewer closing risks and a higher purchase price than the UTI offer, it would certainly be the case for the UTI offer, which involved greater closing risks and the lowest

purchase price. We are not satisfied that the chambers judge's conclusions on risks were unreasonable. We defer to her findings and dismiss this ground of appeal.

THE LENDING SYNDICATE'S WISHES

23 UTI's principal ground of appeal is that the chambers judge erred in acting upon the receiver's recommendation and approving the sale of Fracmaster's assets to BJ Services. UTI submits that the prevailing consideration for the receiver should have been the wishes and business decision of the lending syndicate, which supported the UTI offer. UTI's appeal is supported by the lending syndicate and, if the Balm/Janus appeal does not succeed, by Banque Nationale de Paris, the subordinated lender.

24 The facts in this case are unique. After the preliminary stay and CCAA order, Fracmaster conducted a company supervised sale process, which resulted in offers or proposals from several companies, including Balm/Janus, Calfrac and UTI. The lending syndicate considered the proposals, preferred the UTI offer and contractually agreed to support it. An acknowledgment to the April 26 UTI offer, signed by the lending syndicate, stated: "The above Offer is hereby acknowledged by each of the undersigned and each of them agree to support the Offer at the CCAA Proceedings."

25 On April 27, 1999 the lending syndicate signed a side letter which contemplated that the sale of assets might not be completed under the CCAA, but under an alternate transaction, such as the appointment of a receiver and conveyance of assets by the receiver to UTI. The letter stated: "It is agreed that the Term Lenders and the Operating Lender will use their reasonable best efforts to conclude any such alternate transaction so long as they receive the same consideration as they would have received under the Offer."

26 Fracmaster applied for an order approving the sale of its assets to UTI under the provisions of the CCAA. Although the lending syndicate supported that application, in the same proceeding the lending syndicate applied for an alternate order appointing a receiver and directing the receiver to sell the assets to UTI. The chambers judge dismissed Fracmaster's application under the CCAA. She appointed a receiver but refused to direct the receiver to transfer the assets to UTI, concluding that this would fetter the receiver's discretion and largely defeat the purposes of its appointment (CCAA A.B. 333). Although the chambers judge noted that the receiver could have recommended a sale to UTI if it felt comfortable doing so, the receiver instead recommended a new sale process, involving sealed tenders. Both UTI and Calfrac participated in the sealed tender process, repeating their earlier offers. BJ Services, which had not made an offer in the CCAA proceedings, put in a new bid. It offered cash consideration to the lending syndicate of $80 million for Fracmaster's assets, compared to $60.7 million plus warrants offered by UTI and $66 million plus warrants offered by Calfrac. The lending syndicate, which had agreed to support the UTI offer before the BJ Services offer was made, stuck by their commitment and continued to support the UTI offer.

27 In accordance with the May 18 order, the receiver was required to make a recommendation to the court, bearing in mind the interests of all claimants, including the secured creditors. The bid process confirmed that the lending syndicate had the only remaining financial stake in the company. The amount of its secured debt was $96 million, which exceeded the bids. The receiver was aware that the lending syndicate supported UTI's offer, and was also aware of the letter agreement. Nevertheless, the receiver concluded that the BJ Services offer was the best offer, and recommended its acceptance.

28 The chambers judge followed that recommendation and approved the BJ Services offer. There is no suggestion that the BJ Services offer was prejudicial to the lending syndicate. The chambers judge considered the case law and concluded that although the creditors' interests were an important consideration, they were not the only consideration (Receivership A.B. 117). Accepting the principle that the creditors' views should be very seriously considered, she indicated that if she were satisfied that the receiver acted properly and providently, she would be reluctant to withhold approval of a transaction recommended by the receiver. (Receivership A.B. 118)

29 UTI concedes that had the bid process resulted in a bid which exceeded the lending syndicate's secured claim of $96 million, parties other than the lending syndicate would have had a financial interest in the outcome, and different considerations would apply. Because none of the bids exceeded $96 million, only the lending syndicate had a financial interest in the proceeds of sale of assets. UTI submits that the lending syndicate made a bargain with UTI, and that bargain should be the paramount consideration. The thrust of UTI's argument is that its offer should be accepted so long as no one else offered more than $96 million. In effect, it would have a reserve bid.

30 The narrow issue raised in the appeal is the weight to be given to the lending syndicate's wishes to accept the UTI offer. But this appeal raises a competing issue, the integrity of the bid process.

31 Lenders have the ability to appoint private receivers and deal with assets without court approval. In the circumstances of this case, where Fracmaster has many offshore assets, we are told that a private receivership without court involvement would not be expedient. Once a creditor embarks upon a court appointed receivership, the creditor loses an element of control, including the power to dictate the terms of the disposition of assets. Although the lending syndicate's preferences are an important factor to be considered by the court, its preferences do not fetter the court's discretion and are not necessarily determinative.

32 The receiver's role in a liquidation of assets is clear and well defined. Its obligation is to make a sufficient effort to obtain the highest possible sale price for the assets: Salima Investments Ltd. v. Bank of Montreal (1985), 21 D.L.R. (4th) 473 at 476 (Alta. C.A.). In Royal Bank of Canada v. Soundair Corp. (1991), 83 D.L.R. (4th) 76 at 93 (Ont. C.A.), Galligan J.A. set out the principles which govern the function of the court and the exercise of its discretion when considering an application by a receiver for court approval of a sale:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interests of all parties.
3. It should consider the efficacy and integrity of the process by which offers have been obtained.
4. It should consider whether there has been unfairness in the working out of the process.

The chambers judge considered each of these principles in turn, then accepted the receiver's recommendation.

33 Only in rare cases will the receiver's recommendation diverge from the wishes of the only stakeholder, and those cases must be carefully scrutinized by a judge who is asked to approve that recommendation. But we cannot say that the chambers judge acted unreasonably by following the

recommendation of the receiver in this case, because of the unique facts and manner in which events unfolded.

34 After the court learned of the existence of the lending syndicate's contractual commitment to support the UTI offer in a receivership, it nevertheless ordered a sealed tender process. The receiver asked for the sale process in order to determine whether offers might be made which would exceed the amount of the lending syndicate's debt. The receiver also submitted that only a sale process would satisfy the court that it had fulfilled its mandate to maximize recovery and "give everyone a fair and reasonable attempt at bidding on the assets of the company" (Receivership A.B. 56). Once the sale process was engaged, it had to be fundamentally fair, with a level playing field for all participants.

35 The receiver contacted all parties who had previously made an offer for Fracmaster's assets or expressed an interest in making an offer. The receiver also issued a press release outlining the terms of the sale. It was therefore clearly contemplated that the bidding process would not be confined to previous bidders.

36 Some reference to a reserve bid could have been incorporated into the May 18 order indicating, for example, that UTI's offer was to be accepted unless a bid exceeded $96 million. The order was silent. Under the order, UTI was not required to repeat its earlier offer and could have changed the consideration. In fact, it could have made no offer at all. Anyone entering the bidding process might well know, as BJ Services did, that the lending syndicate supported UTI's offer and that this could create some impediments. But they could not know that UTI's offer would have the effect of a reserve bid up to $96 million. To default to the UTI bid without prior notice to the other bidders would undermine the integrity of the independent bidding process.

37 UTI chose to resubmit its earlier offer, but must have been mindful of the risks. Clause 6. (b) of UTI's offer specifically stated that the offer was conditional on court approval.

38 While neither the receiver nor the court had an obligation to sweeten the lending syndicate's negotiated deal, the fact that the effect of the recommended bid was to increase the lending syndicate's cash consideration was not itself a reason to dismiss the receiver's recommendation. Once the court embarked upon a sealed tender process other interests were engaged. The chambers judge considered the interests and desires of the lending syndicate. She also considered the other factors set out in Soundair, including fairness and the efficacy and integrity of the process. She balanced the competing interests, as she was required to do, and we cannot say that her conclusion was unreasonable or that she erred in principle. This ground of appeal fails.

SUMMARY

39 We grant leave to appeal the CCAA orders to Balm/Janus and UTI. The Balm/Janus appeal, Calfrac appeal and two appeals by UTI are dismissed.

FRUMAN J.A.

(DISCUSSION AS TO COSTS)

40 CONRAD J.A.:-- We have concluded that there is no reason to depart from the normal rule that costs follow the success of the appeal. Accordingly, we will order one set of costs to BJ Services to be payable in equal amounts by UTI, Calfrac and Balm/Janus. The costs are to be assessed on Column 5.

CONRAD J.A.

cp/i/kjm

Tab 21

Case Name:

San Francisco Gifts Ltd. (Re)

IN THE MATTER OF The Companies' Creditors Arrangement Act, 1985, C. C-36, as amended AND IN THE MATTER OF a Plan of Compromise or Arrangement of San Francisco Gifts Ltd. ("San Francisco"), San Francisco Retail Gifts Incorporated (previously called San Francisco Gifts Incorporated), San Francisco Gift Stores Limited, San Francisco Gifts (Atlantic) Limited, San Francisco Stores Ltd., San Francisco Gifts & Novelties Inc., San Francisco Gifts & Novelty Merchandising Corporation (previously called San Francisco Gifts and Novelty Corporation), San Francisco (The Rock) Ltd. (previously called San Francisco Newfoundland Ltd.) and San Francisco Retail Gifts & Novelties Limited (previously called San Francisco Gifts & Novelties Limited) (Collectively "The Companies")

[2004] A.J. No. 1062

2004 ABQB 705

42 Alta. L.R. (4th) 352

359 A.R. 71

5 C.B.R. (5th) 92

134 A.C.W.S. (3d) 239

2004 CarswellAlta 1241

Docket No. 0403 00170

Alberta Court of Queen's Bench
Judicial District of Edmonton

Topolniski J.

Heard: September 1, 2004.
Additional submissions: September 21 and 24, 2004.
Judgment: September 28, 2004.
Filed: September 29, 2004.

(53 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Classification of creditors.

Application by six objecting landlords, Oxford Properties Group, Ivanhoe Cambridge 1, 20 Vic Management, Morguard Investments, Morguard Real Estate Investments Trust, RioCan, and 1113443 to reclassify the creditors of San Francisco Gifts for purposes of voting on a proposal and to ban closely related creditors from voting on the plan. The landlords operated retail premises that were leased to the San Francisco group of companies. The companies were owned by a single operating company that was controlled by a single shareholder. Both the operating company and shareholder had made significant loans to the companies. San Francisco had obtained protection under the Companies' Creditors Arrangement Act. It abandoned its leases with the landlords and took assets from the premises. The landlords argued that they should be placed in a separate class because they had distinct legal rights, their claims were difficult to value and they were preferred over other creditors in the class. They also took issue with the operating company and shareholder being classified as unaffected creditors whose claims survived the reorganization despite having the ability to value their security for voting purposes and vote as unsecured creditors for their deficiency claims.

HELD: Application allowed in part. The plan was amended to preserve any cause of action the landlords would have against any party who aided San Francisco in removing assets from their premises. There was sufficient evidence to establish an arguable case that there were arrears of rent owing by San Francisco. The landlords' right to pursue distraint against the companies was unique but this was not sufficient to warrant a separate class. The landlords' claims were not difficult to value. The plan's treatment of the holding company and shareholder was not a reason to segregate the landlords.

Statutes, Regulations and Rules Cited:

1737 Distress for Rent Act of England.

Alberta Rules of Court.

Bankruptcy and Insolvency Act, s. 4.

Companies' Creditors Arrangement Act, 1985, C. C-36.

Statute of George, 11 Geo. II, c. 19

Counsel:

Richard T. G. Reeson, Q.C. and Howard J. Sniderman, Witten LLP, for the Companies

Jeremy H. Hockin, Parlee McLaws LLP, for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc., 20 Vic Management Ltd., Morguard Investments Ltd. Morguard Investments Ltd, Morguard Real Estate Investments Trust, RioCan Property Services, 1113443 Ontario Inc. (the "Objecting Landlords")

Michael J. McCabe , Q.C., Reynolds, Mirth, Richards & Farmer LLP, for the Monitor

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REASONS FOR JUDGMENT

TOPOLNISKI J.:--

INTRODUCTION

1 The San Francisco group of companies (San Francisco) obtained Companies' Creditors Arrangement Act[1] (CCAA) protection on January 7, 2004 under a consolidated Initial Order. The Initial Order has been extended and the companies continue in business. They now propose a compromise of their debt that is spelled out in a plan of arrangement ("Plan") that has been circulated to their creditors. Like all CCAA plans of arrangement, this Plan proposes classes of creditors for voting purposes. Two-thirds in value and a majority in number of the creditors in each class must cast a positive vote for the Plan in order for it to pass muster. If approved, the Plan will then be presented to the Court for sanctioning at what is commonly referred to as a "fairness hearing".[2] These steps have been delayed by the present application.

2 The six applicants are landlords (the "objecting landlords") of retail premises in Ontario, New Brunswick, Nova Scotia and Newfoundland that were leased to San Francisco. The leases were either abandoned by San Francisco before the CCAA proceedings began or were later terminated with court approval. The objecting landlords seek to reclassify the creditors of San Francisco for purposes of voting on the Plan. They rely on three grounds for their application. First, they argue that they should be placed in a separate class because they have distinct legal rights, their claims are difficult to value and they are preferred over other creditors in the class. Second, they believe that their reclassification is warranted as a result of inequitable treatment of certain creditors under the Plan. Third, they seek to ban closely related creditors, or "related persons", as that phrase is defined in s. 4 of the Bankruptcy and Insolvency Act[3] (BIA), from voting on the Plan at all. They submit that, at the very least, related persons should be placed in a separate class to prevent them from controlling the creditor vote.

BACKGROUND

3 San Francisco operates a national chain of novelty goods stores. It currently has 450 employees working from 84 locations. The head office is in Edmonton, Alberta.

4 The group of companies is comprised of the operating company San Francisco Gifts Ltd., and a number of nominee companies. The operating company, which is 100 percent owned by Laurier Investments Corp. ("Laurier"), holds all of the group's assets. In turn, Laurier is 100 percent owned by Barry Slawsky ("Slawsky"), the driving force behind the companies. He is the president and sole director of virtually all of the companies, and is one of the companies' two secured creditors, the

other being Laurier. The nominee companies are hollow shells incorporated for the sole purpose of leasing premises.

5 The Monitor reports that the reviews by its counsel of Slawsky and Laurier's security documents "do not indicate any deficiencies in the security position" and that the combined book value of their loans to the companies is $9,767,000.00. San Francisco's debt at the date of the Initial Order was $5,300,000.00, not including any unsecured deficiency claims by the secured creditors. There are 1183 creditors in total.

6 Like many consolidated CCAA plans of arrangement, this Plan contemplates the compromise of all of the participant companies' debts from one pool of assets. The Plan places all non-governmental unsecured creditors into one class and proposes a compromise payment of roughly $.10 on the dollar by dividing $500,000 between all unsecured creditors in this class on a pro rata basis, after payment of the first $200.00 of each proven claim. The Plan also provides that Slawsky and Laurier's claims will survive the reorganization. They are defined in the Plan as "unaffected creditors" who will not share in the payment to creditors. They may, however, value their security and vote as unsecured creditors for their deficiency claims.

7 There is little common ground between the parties on this application, except for their ready recognition that a separate landlords' class will secure its members the power to veto the creditor vote.

ANALYSIS

Classification of Creditors Generally

8 The CCAA does not direct how creditors should be classified for voting purposes. It does nothing more than define what a secured versus an unsecured creditor is[4] and specify that a plan of arrangement must be approved by the various classes of creditors affected by it.[5] However, a "commonality of interest" test and well-defined guidelines for classification have been set out in the case law.

9 In Sovereign Life Assurance Co. v. Dodd,[6] Lord Esher M.R. articulated the rationale for the commonality of interest test:

> ... It seems plain that we must give such a meaning to the term "class" that will prevent the section being so worked as to prevent a confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

10 The objecting landlords focus their argument on the two themes in this passage: the need for meaningful consultation between class members, something the objecting landlords say will not occur because their rights are different from other creditors in the proposed class; and avoidance of injustice by "confiscation of rights", something the objecting landlords say is preordained if there is no reclassification.

11 The commonality of interest test has evolved over time and now involves application of the following guidelines that were neatly summarized by Paperny J. (as she then was) in Resurgence Asset Management LLS v. Canadian Airlines Corp. ("Canadian Airlines")[7]:

1. Commonality of interest should be viewed based on the non-fragmentation test,[8] not on an identity of interest test .
2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor prior to and under the Plan as well as on liquidation.
3. The commonality of interests should be viewed purposively, bearing in mind that the object of the CCAA, namely to facilitate reorganizations if possible.
4. In placing a broad and purposive interpretation on the CCAA, the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.
5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the Plan in a similar manner.

12 To this pithy list, I would add the following considerations:

(i) Since the CCAA is to be given a liberal and flexible interpretation, classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.[9]

(ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of the plan.[10]

Landlord Classifications Generally

13 The objecting landlords rely on the affidavit of Walter R. Stevenson, a Toronto lawyer who acts for them. I find it odd that counsel for a party would swear an affidavit in support of his client's motion. It is a risky proposition that is strongly discouraged in this Court. In any event, Mr. Stevenson deposes that he has thirteen years of experience representing clients in insolvency matters. He says that he has been involved in nine cases where national tenants abandoned leased premises and their landlords were placed in a separate class. Presumably, all of this information was intended to persuade me that a separate landlord class is now or should be the norm. It does not.

14 Mr. Stevenson's list is not, nor does it purport to be, an exhaustive review of classifications in multi-location CCAA restructurings across Canada. Further, he provides no insight as to whether it was the debtor company or the court which decided that a separate class was appropriate in each of the cases to which he referred. Nor does not provide any information as to why a particular classification decision was made in the first place. There may be valid reasons for a debtor to segregate landlords. For example, in Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce,[11] the court refused to disturb a separate class proposed by the debtor company for 130 landlords. A landlord in that case was funding the Plan.

15 Grafton-Fraser is cited as authority for the general proposition that landlords should be entitled to a separate class. In his brief reasons, Houlden J. indicated that he was allowing the separate class to remain on the basis that, as compared to other creditors, landlords would have difficulty valuing their claims and would be enjoined from exercising the contractual and statutory claims that

they would ordinarily enjoy on a tenant's insolvency. Grafton-Fraser, like all CCAA cases, was doubtless decided on its facts. It was considered, but not applied, in Re Woodward's, a case that brought widespread attention to the non-fragmentation and contextual approach in classification.[12]

16 Landlords are not entitled to a separate class simply because of who they are. There must be sufficient evidence that their claims are materially different from the claims of other creditors in the class to warrant that. To find otherwise would require that I ignore the contextual and non-fragmentation approach (which I observe does not appear to have firmly take hold until after Grafton-Fraser was decided), and give excessive power to one creditor group in relation to a plan of arrangement designed for the benefit of all of the creditors. This concern was expressed by Borins J. in Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia[13] in dismissing a landlord's plea for a separate class so that it's intended negative vote would not be fruitless. A similar caution was voiced by Blair J. in Re Ambro Enterprises Inc.[14]. He too found that a separate class for landlords was unwarranted in that case.

Distinct Legal Rights and Valuation Issues

17 Depending on their particular circumstances, the objecting landlords assert that they have one or more of three distinct legal rights that will be eroded or confiscated if they are unsuccessful in their application: (1) the right to follow and seize assets removed from abandoned premises; (2) the right to claim damages against any person who aided the tenant in clandestinely removing goods from their reach; and (3) the right to terminate a lease for default under what is commonly called an "insolvency clause" in their leases. At the risk of stating the obvious, objecting landlords who had leases terminated with court approval after the Initial Order cannot advance these arguments.

1. Rights Arising from Clandestine Removal of Goods

18 Before applying for CCAA protection, San Francisco removed assets and abandoned 14 of the 16 premises leased from the objecting landlords.

19 Ontario and New Brunswick's legislation allows a landlord the right to follow and seize goods that were fraudulently and clandestinely removed to prevent the landlord from distraining for rental arrears. There is a thirty day time limit on this right to seize. The landlord is also granted a right of action against any person who knowingly aided in the removal or concealment of the goods.[15] These remedies are akin to those provided in the 1737 Distress for Rent Act of England,[16] commonly called The Statute of George, 11 Geo. II, c. 19. Nova Scotia's legislation differs from that in Ontario and New Brunswick in that it does not provide for the third party right of action and the time period for following the goods and seizing is twenty-one rather than thirty days.[17] Newfoundland lacks any specific legislation granting these remedies, and it is questionable if The Statute of George, although incorporated into the laws of Newfoundland before December 31, 1831, remains in effect there.[18]

20 To succeed in an action under these statutory schemes (and perhaps under the common law in Newfoundland), there must be sufficient evidence to establish that: (1) rent payments are in arrears; (2) goods owned by the tenant were removed from the premises; (3) this conduct was clandestine or fraudulent; and (4) the goods were removed for the purpose of preventing the landlord from seizing them for arrears of rent.

21 The issue arises whether the objecting landlords must prove their claims for classification purposes or simply show that they have an arguable case. Clearly, the court is not interested in ruling

on hypothetical matters, but it would be unreasonable at this stage to require an applicant in a re-classification hearing to actually prove their claim. Proof will be required at a later date to establish entitlement to membership in a new class, if one is ordered. What must be presented at this point is sufficient evidence to show that there is an arguable case that would justify a separate class.

22 The objecting landlords rely on two leases, which they say are typical of the leases entered into between them and San Francisco (or its nominee corporations), to demonstrate that there were arrears owing at the date of abandonment. The alleged arrears are comprised of accelerated rent which, under the terms of the leases, became due on termination and are contractually deemed arrears. Without deciding on the correctness of the objecting landlords' assertion, I find that there is sufficient evidence to establish at least an arguable case that there are arrears of rent.

23 Insofar as evidence of clandestine removal is concerned, two landlords depose that, without their knowledge and without notice to them, San Francisco vacated and removed all of its assets from their premises. Although it would have been preferable to have more detail of the circumstances of the alleged removal of assets, this evidence again is sufficient to establish an arguable case. The merits of the objecting landlords' position will be fully aired and determined in quantifying their claims.

24 I have concluded that the objecting landlords have an arguable case. Their rights to pursue distraint and sue a person for aiding in clandestine removal of goods are unique ones. However, the uniqueness of a right is, in and of itself, insufficient to warrant a separate class. The right must be adjudged worthy of a separate class after considering the various factors outlined above. In essence, it must preclude consultation between the creditors.

25 The Initial Order specifically preserved all creditors' rights to take or continue an action against San Francisco if their claims were subject to statutory time limitations.[19] The objecting landlords elected not to pursue their statutorily time limited remedy of following and seizing goods within the time permitted. As a result, it is unreasonable to allow them to now assert that entitlement as the justification for a separate class. Moreover, in the context of a bankruptcy, the remedy is generally academic since there are no goods available for distraint. For these reasons, the inability to follow and seize goods cannot support the ordering of a separate class.

26 The Plan requires that all creditors give up claims against the company, its officers, employees, agents, affiliates, associates and directors. This requirement is subject to the qualification that an action based on allegations of misrepresentations made by a director to creditors or of wrongful or oppressive conduct by a director is preserved (emphasis added).[20] While candidly acknowledging that their best chance of financial recovery on a successful action would be against Slawsky, the objecting landlords contend that preserving their right of action only against him would be insufficient protection given that they do not know at the moment whether he alone was the person who orchestrated or aided in the removal of San Francisco's goods. In view of Slawsky's apparent level of control over the companies, it might be reasonable to conclude that he was involved in the decision to abandon the premises. However, that is speculative at this point and others may well have been involved.

27 Although the Initial Order did not stay actions against San Francisco's employees or agents, the landlords' failure as yet to pursue the employees or agents does not end the matter. This aspect of a removal action is quite different from the statutorily time limited ability of a landlord to follow and seize their tenant's goods, which the objecting landlords chose not to exercise. Only general

limitations legislation and the practical effects of the Releases contained in the Plan affect this aspect of the claim.

28 I find that the Plan does not adequately address the objecting landlords' unique legal entitlement to claim damages against persons who aided their tenant in clandestinely removing goods from the premises. In making this finding, I considered the following to be significant factors:

1. Unlike the ability to follow and seize goods, which has been rendered academic, this right of action is potentially meaningful.
2. The Plan does not offer compensation for deprivation of this right of action, resulting in a "confiscation" of the objecting landlords' right as described in Sovereign Life.
3. Unlike claims that would be extinguished on a bankruptcy of the companies, this right of action would survive since it is against third parties.

29 The CCAA is designed to be fluid and flexible, and the Court is given wide discretion to facilitate that flexibility. Alternatives to establishing a separate voting class should be explored. I can envision at least three other options: (1) direct an amendment to the Plan to compensate the objecting landlords for the loss of their potential rights of action against persons other than Slawsky; (2) direct an amendment to the Plan to expand the survival of actions provision (clause 6.1 (b)) to include potential defendants other than Slawsky; or (3) deal with the matter at the fairness hearing.

30 Ordering a separate class would clearly recognize and protect the objecting landlords' potential causes of action against third parties other than Slawsky. Further, it would overcome potential hurdles in consultation among the unsecured creditors. However, a separate class would give the objecting landlords a veto power over the Plan. This flags the principle that courts should be careful to resist classification approaches that might jeopardize viable plans of arrangement.

31 Directing that the Plan be amended to compensate the objecting landlords for the loss of their potential rights of action is not a viable option. It would require that the Court blindly enter into San Francisco's strategic arena. Such a direction would interfere with the right of the companies to make their own Plan and would purport to cloak the Court with knowledge of the companies' resources, strategies and plans, knowledge which it simply does not posses. Interference of this sort should be avoided.

32 Directing an amendment to the Plan to expand the survival of actions provision to include potential defendants other than Slawsky certainly would be less intrusive than compensating the objecting landlords for the loss of their potential right of action. It would preserve their right to pursue the removal action against persons other than Slawsky and would enhance consultation with other creditors in the class. On the other hand, it would impose an obligation on the companies that they may not have contemplated or may have been unwilling to voluntarily assume.

33 As to dealing with the matter at a fairness hearing, I note that the CCAA does not require that debtors present a guaranteed winner' of a plan to their creditors. Debtors can make any proposal to their creditors and take whatever chances they might consider appropriate. However, to succeed, they must act in good faith and present a plan of arrangement at the end of the day which is fair and reasonable. If they fail to do so, the process is a waste of time and valuable resources. It accomplishes nothing but an erosion of assets that otherwise would be available to creditors on liquida-

tion. This is precisely what Tysoe J. sought to avoid when he ordered a separate class for guarantee holders in Re Woodward's, on being convinced that the plan in that case was unfair to them.[21]

34 The opposite result occurred in Canadian Airlines, where Madam Justice Paperny deferred the classification issue to the fairness hearing. Canadian Airlines presented quite a different scenario to that in Re Woodward's or the one before me. The concern in Canadian Airlines was with Air Canada voting in the same class as other unsecured creditors when it had appointed the board which directed the CCAA proceedings, was funding the Plan, and fears existed about its acquisition of deficiency claims to secure a positive vote. The court was not concerned about a confiscation of legal rights but was attempting to safeguard against "ballot stuffing".[22]

35 In the particular circumstances of the present case, I find it preferable to protect the objecting landlords' remedy by directing that there be an amendment to the Plan to preserve any cause of action they might have against any party who aided San Francisco in clandestinely removing its assets from their premises. This measure balances the need to avoid giving unwarranted power to one creditor group and the need to protect a unique legal entitlement. It avoids the potential of valuable resources being expended on creditors' meetings when the potential exists that at the end of the day I would find the Plan to be unfair on the basis of this aspect of the objecting landlords' argument. Finally, it avoids significant interference with the debtor's financial strategy in formulating its Plan.

2. Loss of Default/Insolvency Clause Remedy

36 Some, if not all, of the leases allow the landlord to terminate the lease in the event of the tenant's insolvency. The objecting landlords argue that this is another unique right which is not compensated for in the Plan.

37 The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to the proceedings in the first place.[23] The objecting landlords complain that their rights are permanently lost because of the Release contained in the Plan. They do not acknowledge that the stay is essential to the longer-term feasibility of the CCAA restructuring and something which courts have granted with increasing regularity to give effect to the remedial nature of the CCAA.[24] Even ignoring this pragmatic consideration, the objecting landlords' argument fails. The contractual right that is affected is neither unique, nor of any practical use. Thirteen other creditors, mainly equipment lessors and utility providers, have similar contractual default provisions. Further, all of the leases have already been terminated.

3. Difficulty in Valuing Claim

38 The objecting landlords rely on Grafton-Fraser for the proposition that landlords' claims are difficult to value and therefore a separate class is warranted. Unfortunately, the brief reasons given by Houlden J. do not provide any insight as to how the company in that case proposed to value the landlords' claims. No doubt, Houlden J. had the specific facts before him clearly in focus as he made his decision. I reject the contention that Grafton-Fraser is a decision of sweeping application, being mindful that rigid rules of general application are to be avoided in CCAA matters.

39 The Claims Procedure Order, issued on June 22, 2004 in this matter, establishes a mechanism for valuing landlords' abandoned premises claims that reflects the methodology established by the

Supreme Court of Canada in Highway Properties Ltd. v. Kelly, Douglas and Co. Ltd.[25] The valuation mechanism, set out in para. 12 of the Order,[26] is straightforward. A claimant simply follows the formula. There is a clear cut-off date for mitigation efforts and a readily calculable present value. The landlords' claims will not be difficult to value.

Inequitable Treatment of Creditors

1. Preferential Treatment of Some Landlords

40 The objecting landlords make the curious complaint that the Plan prefers them to other unsecured creditors in that it contemplates the duty to mitigate, for valuation purposes, ending at the claims bar date.

41 Presumably, the objecting landlords could re-let the premises the following day and still base their claim on the value of unpaid rent for the unexpired portion of the term of their lease. While they might receive a benefit, it is trite that there must always be a cut-off date for mitigation when future losses are the subject of a CCAA creditor claim. San Francisco chose the claims bar date for ease of analyzing claims for voting purposes. Its choice makes practical sense and is not facially offensive. As noted in Re Alternative Fuel Systems Inc.,[27] courts have approved a variety of solutions to quantifying landlords' claims. That approach is in keeping with the distinct purpose of the CCAA. Further, the treatment of landlords' claims under a plan of arrangement is an issue for negotiation and, ultimately, court approval.

42 The objecting landlords also say that they are preferred in that the Plan is a consolidated one that proposes a compromise regardless of whether a landlord's claim against a hollow nominee company would have been worthless outside of the CCAA. This issue will be of interest to other creditors as they consider their vote and position on the fairness hearing. However, it does not warrant creation of a separate class. If anything, it might warrant San Francisco revisiting the Plan, which some of the beneficiaries appear to think is too generous in the circumstances.

2. Preferential Treatment of Slawsky and Laurier

43 The objecting landlords take issue with Slawsky and Laurier being classified as "unaffected creditors" whose claims survive the reorganization despite their ability to value their security for voting purposes and to vote as unsecured creditors for their deficiency claims. Slawsky and Laurier's view is that the Plan does not prefer them because they do not share in the payment available to the general pool of unsecured creditors under the Plan and they are, by deferring payment of their secured claims, effectively funding the Plan.

44 The Plan's treatment of Slawsky and Laurier does not serve as a reason to segregate the landlords. Whether it is a reason to place Slawsky and Laurier into a separate class is discussed under the next heading.

Related Parties

45 The objecting landlords take umbrage with Slawsky, his son Aaron, Laurier, and other corporate entities in which Slawsky has an interest, voting on the Plan. They want to import into the CCAA proceedings the BIA prohibition against "related persons" voting in favour of a proposal, urging that the same policy considerations apply against allowing an insider to control the vote.[28]

46 The Alberta Court of Appeal in Re Alternative Fuel Systems Inc. declined to import BIA landlord claim calculations into a CCAA proceeding. The court found that the section of the CCAA at issue did not mandate importation of BIA provisions and, more significantly, the court found that to do so would not pay sufficient attention to the distinct objectives of the CCAA (remedial) and BIA (largely liquidation). In conducting its contextual analysis, the court acknowledged the need to maintain flexibility in CCAA matters, discouraging importation of any statutory provision that might impede creative use of the CCAA without a demonstrated need or statutory direction. There is no such direction or need in this case.

47 The objecting landlords find support for their position in Re Northland Properties Ltd.[29] Trainor J. in that case refused to allow a subsidiary to vote on its parent's CCAA plan. While care should be exercised to avoid a corporation "stuffing the ballot boxes in its own favour",[30] a blanket ban on insider voting is not always necessary or desirable. Safeguards against potential abuses can be built into a plan and the voting mechanism. For example, the Monitor could procure sworn declarations from insiders as to their direct and indirect shareholdings in order to help track voting. That information, together with proofs of claim, proxies, and ballots, which relate to the insiders' claims could then be presented at the fairness hearing. This type of safeguard was taken in Canadian Airlines. Paperny J. observed in that case that "absent bad faith, who creditors are is irrelevant".[31]

48 Safeguards such as this are applicable only if the court is satisfied that there is sufficient commonality of interest between the insiders and the other creditors to place them in the same class. That was the case in Canadian Airlines. There, all of the creditors in the class were unsecured creditors. They were treated in the same way under the plan, and would have been treated the same way on a bankruptcy. The plan called for the insider, Air Canada, to compromise its claim, just like all of the other creditors.

49 Here, there is no compromise by Slawsky or Laurier. Further, they would, but for a security position shortfall, be unaffected by a bankruptcy of the companies, whereas all of the other creditors in the class would receive nothing. Slawsky has created a Plan which gives him voting rights that he doubtless wants to employ if he senses the need to sway the vote. In return, he gives up nothing. It stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Slawsky and, through him, with Laurier. For that reason, Slawsky and Laurier must be placed in a separate class.

CONCLUSIONS

50 The right of the objecting landlords to pursue distraint is unique as is their right to sue a person for aiding in clandestine removal of goods from the leased premises. For the reasons stated, loss of the objecting landlords' right to follow and seize goods cannot support the ordering of a separate class. However, I find that the Plan does not adequately address their right to claim damages against persons who aided a tenant in clandestinely removing goods from the premises. Rather than create a separate voting class for the objecting landlords, I direct that the Plan be amended to preserve any cause of action the objecting landlords and others in their position might have against any party who aided San Francisco in clandestinely removing its assets from their premises.

51 The right or ability of the objecting landlords to terminate the leases in question in the event of their tenants' insolvency is neither unique nor of any practical effect at this point. It is not a sufficient ground for creation of a separate voting class. Nor have I accepted the argument of the object-

ing landlords that a separate class should be established because their claims will be difficult to value. The Claims Procedure Order provides a mechanism for valuing their claims.

52 I have determined that, to the extent there is preferential treatment of the landlords or of Slawsky and Laurier under the Plan, such preferential treatment does not justify segregating the objecting landlords. However, as Slawsky and Laurier do not share a commonality of interest with other unsecured creditors, they must constitute a separate class for voting purposes.

53 Although success on this application has been somewhat divided, the objecting landlords have enjoyed greater success. There are no provisions in the CCAA dealing with costs, however, the Court has the discretion to award costs under the Rules of Court and its inherent jurisdiction.[32] The nature of the relief granted to the objecting landlords is akin to declaratory relief and accordingly, costs under Column 1 of Schedule C to the Rules of Court are appropriate. The costs are payable forthwith.

TOPOLNISKI J.

cp/e/nc/qw/qlmmm/qlcas/qlfxs

1 R.S.A. 1985, c. C-36, as am.

2 The considerations at this hearing are typically whether there has been strict compliance with statutory requirements, whether any unauthorized acts have occurred, and whether the plan is fair and reasonable: see Re Sammi Atlas Inc. (1998), 3 C.B.R. (4th) 171 (Ont. Ct. (Gen.Div.)).

3 R.S.C. 1985, c. B-3, as am.

4 CCAA, s. 2.

5 CCAA, s. 6.

6 Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573 at 583 (C.A.).

7 Resurgence Asset Management LLS v. Canadian Airlines Corp. (1990), 19 C.B.R. (4th) 12 (Alta. Q.B.), leave to appeal denied (1990) 19 C.B.R. (4th) 33 (Alta. C.A.), cited in the Court of Appeal's subsequent decision in Canadian Airlines (2000), 261 A.R. 120, 2000 ABCA 149 at para. 27: see also Sklar-Peppler Furniture Corp v. Bank of Nova Scotia (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Ct. Gen. Div.)).

8 "Non-fragmentation" means that a multiplicity of classes should be avoided if possible. The notion was first expressed in the Canadian context in Norcen Energy Resources v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.), but does not appear to have gained wide acceptance until 1993 when Re Woodward's Ltd. (1993), 20 C.B.R. (3d) 74 at 81 (B.C.S.C.) was decided. There were five creditor groups in Re Woodward's, including one

group of landlords of abandoned premises and another of creditors holding cross-corporate guarantees or joint covenants, which sought separate classes. The court ruled that, given there was sufficient commonality of interest among the general body of creditors and the applicant landlords, a separate class was unwarranted. Tysoe J. rejected the landlords' proposition that their legal interests differed from that of the other creditors in that repudiation of an anchor tenant's lease would cause the landlord to be in breach of other tenant obligations. He did, however, order a separate class for the holders of cross-corporate guarantees, observing that their unique rights were "confiscated without compensation" under the plan. Interestingly, Tysoe J. rejected the suggestion that the issue be dealt with at the fairness hearing because he was convinced that the scheme was so unfair that he would refuse to sanction a successful outcome, rendering the creditors' vote pointless.

9 Re Fairview Industries Ltd. (1991), 109 N.S.R. (2d) 32, 11 C.B.R. (3d) 71 (S.C.T.D.).

10 Re Woodward's at p. 81.

11 Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce (1992), 90 D.L.R. (4th) 285, 11 C.B.R. (3d) 161 (Ont. Ct. (Gen. Div.)).

12 Peter B. Birkness, "Re Woodward's Limited - The Contextual Commonality of Interest Approach to Classification of Creditors" (1993), 20 C.B.R. (3d) 91 at 92.

13 Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Ct. (Gen. Div.)).

14 Re Ambro Enterprises Inc. (1993), 22 C.B.R. (3d) 80 (Ont. Ct. (Gen. Div.)).

15 Commercial Tenancies Act, R.S.O.1990, c. L-7, ss. 48-50 and Landlord and Tenant Act, R.S.N.B. 1973, c. L-1, ss. 27, 29.

16 Distress for Rent Act 1737, 11 Geo. 2, c. 19, s. 1, which provides: "In case of any tenant or tenants, lessee or lessees ... upon the demise or withholding whereof, any rent is or shall be reserved due or payable, shall fraudulently or clandestinely, convey away, or carry off or from such premises, his or her or their goods or chattels, to prevent the landlord or lessor ... from distraining the same for arrears of rent, it shall or may be lawful for every landlord or lessee ... to take or seize such goods and chattels wherever the same shall be found as distress for the said arrears of rent. "

17 An Act Respecting Tenancies and Distress for Rent, R.S.N.S. 1989, c. 464, ss. 13 and 14.

18 Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd. (1982), 137 D.L.R. (3d) 320 (Nfld. S.C.T.D.), affirmed (1983) 3 D.L.R. (4th) 704 (Nfld. C.A.).

19 The amendment on January 12, 2004 does not affect the issues at bar.

20 Article 6.1 of the Plan provides as follows: "On the Effective Date, and except as provided below, each of the Companies, the Monitor, and the past and present directors, officers, employees, agents, affiliates and associates of each of the foregoing parties (the "Released Parties") shall be released and discharged by all Creditors, including holders of Unsecured Creditor Claims, and Goods and Services Tax Claims from any and all demands, claims, including claims of any past and present officers, directors or employees for contribution and indemnity, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any person may be entitled to assert, including, without limitation, any and all claims in respect of any environmental condition or damage affecting any of the property or assets of the Companies, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Effective Date relating to, arising out of or in connection with any Claims, the business and affairs of the Companies, whenever and however conducted, this Plan and the CCAA Proceedings, and any Claim that has been barred or extinguished by the Claims Procedure Order shall be irrevocably released and discharged, provided that this release shall not affect the rights of any Person to pursue any recoveries for a Claim against a director or the Companies that: (a) relates to contractual rights of one or more creditors against a director; or (b) are based on allegations of misrepresentations made by a director to creditors or of wrongful or oppressive conduct by a director."

21 At para. 11.

22 Re Olympia & York Developments Ltd., [1994] O.J. No. 1335 at para. 24 (Ont. Ct. (Gen. Div.)).

23 See for example: Norcen Energy Resources Ltd., where one of the debtor's joint venture partners was enjoined from relying on an insolvency clause to replace the operator under a petroleum operating agreement.

24 As noted by Spence J. in Re Playdium Entertainment Corp. (2001), 31 C.B.R. (4th) 309 at para. 32 (Ont. Sup. Ct. Just.): "If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the CCAA order could not be asserted by the Famous Players after the stay period. If such an order could not be made the CCAA regime would prospectively be of no value even though a compromise of creditor claims might be worked out in the stay period." See also Luscar Ltd. v. Smoky River Coal Ltd. (1999), 237 A.R. 326 (Alta. C.A.).

25 Highway Properties Ltd. v. Kelly, Douglas and Co. Ltd., [1971] S.C.R. 562.

26 12(a) With respect to Proofs of Claim to be filed with the Monitor by a Landlord of retail premises currently or formerly occupied by the Companies ("Landlord"), a Landlord is to value and calculate its claim ("Landlord's Claim") as being the aggregate of:

(i) Arrears of rent, if any, owing under a lease as at January 7, 2004;

(ii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the value of rent payable under the lease from the date of repudiation to the date of the Proof of Claim (if any) less any revenue received from any reletting of the premises (in whole or in part) as at the date of the Proof of Claim;

(iii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the present value (using an interest factor of 3.65%) of rents payable under the lease as at the date of the Proof of Claim through to the end of the unexpired term of the lease (if any) less any revenue to be received during that time period from any reletting of the premises (in whole or in part) which has occurred prior to the date of the Proof of Claim.

(b) For the purposes of a Landlord's Claim, where a lease contains an option in favour of the Companies authorizing the Companies to treat that lease as terminated and at an end prior to the otherwise stated termination date of that lease, the Companies shall be deemed to have exercised that option and the Landlord's Claim with respect to that lease shall be calculated having regard to the early termination date.

27 Re Alternative Fuel Systems Inc. (2004), 236 D.L.R. (4th) 155 at paras. 64-69, 2004 ABCA 31.

28 The BIA, s. 4(3)(c) definition of "related person" includes a controlling shareholder of a corporation. Section 54(3) provides that a creditor related to the debtor may vote against but not for the acceptance of a proposal.

29 Re Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 166 at 170 (B.C.S.C.). See also: Re The Wellington Bldg. Corp. Ltd., [1934] O.R. 653 (H.C.J.) and Re Dairy Corporation of Canada Limited, [1934] O.R. 436 (C.A.), referred to in Re Northland Properties.

30 Re Olympia & York Developments Ltd. at para. 24, per Farley J.

31 At para. 37.

32 Re Jackpine Forest Products Ltd., [2004] B.C.J. No. 91, 2004 BCSC 20.

Tab 22

Case Name:

San Francisco Gifts Ltd. v. Oxford Properties Group Inc.

Between
San Francisco Gifts Ltd., San Francisco Retail Gifts Incorporated (previously called San Francisco Gifts Incorporated), San Francisco Gift Stores Limited, San Francisco Gifts (Atlantic) Limited, San Francisco Stores Ltd., San Francisco Gifts & Novelties Inc., San Francisco Gifts & Novelty Merchandising Corporation (previously called San Francisco Gifts and Novelty Corporation), San Francisco (The Rock) Ltd. (previously called San Francisco Newfoundland Ltd.) and San Francisco Retail Gifts & Novelties Limited (previously called San Francisco Gifts & Novelties Limited), applicants, and
Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc., 20 Vic Management Ltd., Morguard Investments Ltd., Morguard Real Estate Investments Trust, Riocan Property Services, and 1113443 Ontario Inc., respondents

[2004] A.J. No. 1369

2004 ABCA 386

42 Alta. L.R. (4th) 371

361 A.R. 220

5 C.B.R. (5th) 300

136 A.C.W.S. (3d) 12

2004 CarswellAlta 1607

Docket: 0403-0325-AC

Alberta Court of Appeal
Edmonton, Alberta

Conrad J.A

Heard: November 24, 2004.
Judgment: December 2, 2004.

(18 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Classification of creditors -- Practice -- Appeals -- Leave to appeal -- Grounds for refusal to grant leave.

Application by the San Francisco group of companies for leave to appeal an order. San Francisco was composed of several companies. The operating company in the group held all of its assets and was owned by a company named Laurier Investments. Laurier was owned by an individual named Slawsky. Slawsky and Laurier were San Francisco's only secured creditors. They also had substantial unsecured debt with San Francisco. San Francisco was granted protection under the Companies' Creditors Arrangement Act. It was permitted to file a plan of compromise or arrangement and to submit it to its creditors for consideration and voting. The plan classified Slawsky and Laurier as unaffected creditors. This meant that their claims would survive the reorganization. They would not share in the distribution of $500,000. Six objecting landlords asked the court to create a separate class for landlords and similarly-affected parties. The judge refused this application. The decision removed Slawsky and Laurier from the unsecured creditors class and placed them in a separate class for voting purposes. The judge found that they did not share a common interest with the rest of the unsecured creditors. If the reorganization failed and San Francisco became bankrupt Slawsky and Laurier would be unaffected and the other unsecured creditors would receive nothing. San Francisco objected to this removal.

HELD: Application dismissed. The judge did not err in principle. She did not misunderstand the evidence and her decision to remove Slawsky and Laurier was correct. She was correct in her assessment that there would be no meaningful consultation between shareholders whose debts would not be cancelled and other unsecured creditors whose debts would be. Although the questions of class were important, both to the practice and the parties, there was no merit to this appeal.

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. 13.

Counsel:

R.T.G. Reeson, Q.C. For the Applicants

J.H.H. Hockin for the Respondents

M.J. McCabe, Q.C. For the Court Appointed Monitor

REASONS FOR DECISION

CONRAD J.A.:--

I. Introduction

1 The San Francisco group of companies ("San Francisco") seeks leave to appeal an order finding Barry Slawsky ("Slawsky") and Laurier Investments Corp. ("Laurier") do not share a "commonality of interest" with other unsecured creditors, and placing them in a separate class for purposes of voting on a plan of arrangement under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA").

II. Facts

2 San Francisco is composed of the operating company, San Francisco Gifts Ltd., and several nominee companies. The operating company holds all of San Francisco's assets and is 100% owned by Laurier. Laurier is wholly owned by Slawsky, who is also the president and sole director of nearly all of the San Francisco group of companies. Slawsky and Laurier are San Francisco's only secured creditors. In addition, they have substantial unsecured debt with the company.

3 On January 7, 2004, San Francisco was granted protection under the CCAA. The initial order was extended, and San Francisco remains in business. On June 22, 2004, San Francisco was permitted to file a Plan of Compromise or Arrangement ("Plan") and submit it to its creditors for consideration and voting. The Plan classified Slawsky and Laurier as "unaffected creditors," meaning that their claims survive the reorganization. Slawsky and Laurier would not share in the distribution of $500,000.00; however, they would value their security and vote as unsecured creditors.

4 On July 14, 2004, a group of six objecting landlords asked the Court to create a separate class or classes for landlords and any similarly-affected parties, to assist the Court-appointed monitor in identifying and preserving creditor claims, and to remove any "related parties" from the unsecured creditors class (or, alternatively, deny them a vote).

III. Decision Below

5 The motion was heard on September 1 and 2, 2004. In a reserved written judgment, the supervising chambers justice declined to create a separate class for landlords, but made provision for preserving certain landlords' claims relating to the right to distrain. The decision removed Slawsky and Laurier from the unsecured creditors class, placing them in a separate class for voting purposes, and awarded costs against San Francisco under Column 1. It is the removal of Slawsky and Laurier from the unsecured creditors class for which San Francisco seeks leave to appeal. If granted leave to appeal, San Francisco asks this Court to also review the costs award.

6 The chambers justice focused on the lack of "commonality of interest" between Slawsky and Laurier and the rest of the unsecured creditors. Her concerns centred on the different treatment afforded Slawsky and Laurier. Although Slawsky and Laurier would not share in the $500,000.00 distribution, their debt would not be compromised. If the reorganization failed and San Francisco be-

came bankrupt, Slawsky and Laurier would be unaffected, whereas the rest of the unsecured creditors would receive nothing. The chambers justice concluded at para. 49 of her reasons that in light of their divergent interests, "[i]t stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Barry Slawsky and, through him with Laurier."

IV. Test for Leave to Appeal

7 Any person dissatisfied with an order under the CCAA is permitted an appeal of that order on obtaining leave: CCAA, s. 13. The test for leave to appeal is set out in Re Liberty Oil & Gas Ltd. (2003), 44 C.B.R. (4th) 96, 2003 ABCA 158 at paras. 15 and 16:

> The test for granting leave, as articulated in this Court, involves a single criterion subsuming four factors. The single criterion is that there must be serious and arguable grounds that are of real and significant interest to the parties . . . .
>
> The four factors subsumed in an assessment whether the criterion is present are:
>
> (1) Whether the point on appeal is of significance to the practice;
> (2) Whether the point raised is of significance to the action itself;
> (3) Whether the appeal is prima facie meritorious or, on the other hand, whether it is frivolous; and
> (4) Whether the appeal will unduly hinder the progress of the action . . . .

V. Standard of Review

8 In considering whether the appeal is prima facie meritorious, it is necessary to consider the standard of review the Court would apply if leave was granted. This Court has stated that the supervising chambers justice in a CCAA matter is tasked with an ongoing management process similar to that of a judge in the course of a trial: Re Liberty Oil & Gas Ltd., supra at para. 20. Consequently, the reviewing court will only interfere with the decision where the chambers justice "acted unreasonably, erred in principle or made a manifest error": UTI Energy Corp. v. Fracmaster Ltd. (1999), 244 A.R. 93 at para. 3 (C.A.).

VI. Decision

9 The applicants' main complaints are that the chambers justice erred in her application of the common-law "commonality of interests" test and she misunderstood the facts. The CCAA does not explicitly state what factors differentiate creditors so as to place them in separate classes for voting purposes. But in determining issues relating to class, it is important to recognize that the right to vote as a separate class and thereby defeat a proposed plan of arrangement is the statutory protection provided to the different classes of creditors. While fairness on many issues is assessed again at a later stage, it is the initial placing within a separate class that provides this non-discretionary right to creditors.

10 To give effect to this protection, a "commonality of interests" test was developed. The foundation for the "commonality of interests" test is that the classes must be structured so as to "prevent a confiscation and injustice" and to enable the members to "consult together with a view to their

common interest": Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573 at 583 (C.A.). It follows that it is important to carefully examine classes with a view to protecting against injustice, and not simply rely on fairness being evaluated later.

11 The means of preventing confiscation and injustice raises some very interesting issues when it comes to determining who should be in a separate class for voting purposes. Unlike the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, the CCAA does not specifically provide for treatment of related parties. While unsecured creditors and shareholders have similar legal rights with respect to debts owing, a shareholder qua shareholder has other legal rights that may impact on, or make impossible, the ability of the class to hold a common interest. This is an important issue that has not yet been addressed by this Court. As interesting and important as that issue is, however, it is not the issue on this appeal and resolution of the issue must wait to another day.

12 The chambers judge did not need to, and did not, make her decision on commonality of interest based merely on the fact that Slawsky and Laurier were shareholders. Rather, in arriving at her decision to place the shareholders in a separate class, the chambers judge relied on the different treatment afforded Slawsky and Laurier under the Plan. She stated (at para. 49):

> Here, there is no compromise by Slawsky or Laurier. Further, they would, but for a security position shortfall, be unaffected by a bankruptcy of the companies, whereas all of the other creditors in the class would receive nothing. Slawsky has created a Plan which gives him voting rights that he doubtless wants to employ if he senses the need to sway the vote. In return, he gives up nothing. It stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Slawsky and, through him, with Laurier. For that reason, Slawsky and Laurier must be placed in a separate class.

13 I do not accept the applicants' argument that the chambers judge failed to understand that Slawsky and Laurier had given up something in that the Plan did not provide for their participation in the $500,000.00 available for distribution. This judge was alive to that element of the Plan. When she said that "he gives up nothing," she was referring to the fact that under the Plan the shareholders' debt remains outstanding and is not compromised, unlike the other unsecured creditors' debt. In short, Slawsky and Laurier may be in a position to control the vote and cancel all unsecured creditors' debt but their own. Under these circumstances, there would be no meaningful consultation about the Plan.

14 In my view, the chambers judge was absolutely correct in her assessment that it stretches the imagination to think that there would be meaningful consultation about the Plan between shareholders whose debts would not be cancelled and other unsecured creditors whose debts would be. Certainly, bearing in mind the standard of review, there is absolutely no merit to this appeal.

15 Thus, while I acknowledge that questions of class are important, both to the practice and the parties, this application for leave must fail because it fails to establish that the appeal is prima facie meritorious.

16 In the result, the chambers judge did not err in principle, she did not misunderstand the evidence, and her decision to remove Slawsky and Laurier from the class of unsecured creditors was correct. In my view, any other decision would have resulted in an injustice to the other unsecured

creditors. At a minimum, bearing in mind the standard of review, there is no chance of success on the appeal.

17 Leave to appeal is denied.

(Counsel speaks to costs)

18 Costs are allowed to the Respondent in Column 1 and I allow costs for the filing of their Memorandum, notwithstanding the red stamp.

CONRAD J.A.

cp/e/qw/qlmmm

Tab 23

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 un-

derwriters 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.][1]

(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 indem-

nity. 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.

Tab 24

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 re-

lated-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 Pricewaterhouse-Coopers ("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, 2011 and 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.1 of the *Ontario Securities Act.*

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

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

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

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

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

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 con-

nected 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 chal-

lenges 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 inter-

national 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, Merill-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, Merill, 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, Merill, 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. Determinative Factors

(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) Definition of Class Membership and Definition of Class Period

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 Aetion, 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 amend-

ments are in order to respond to the lessons learned from this carriage motion, and it is not too late to have more representative plaintiffs.

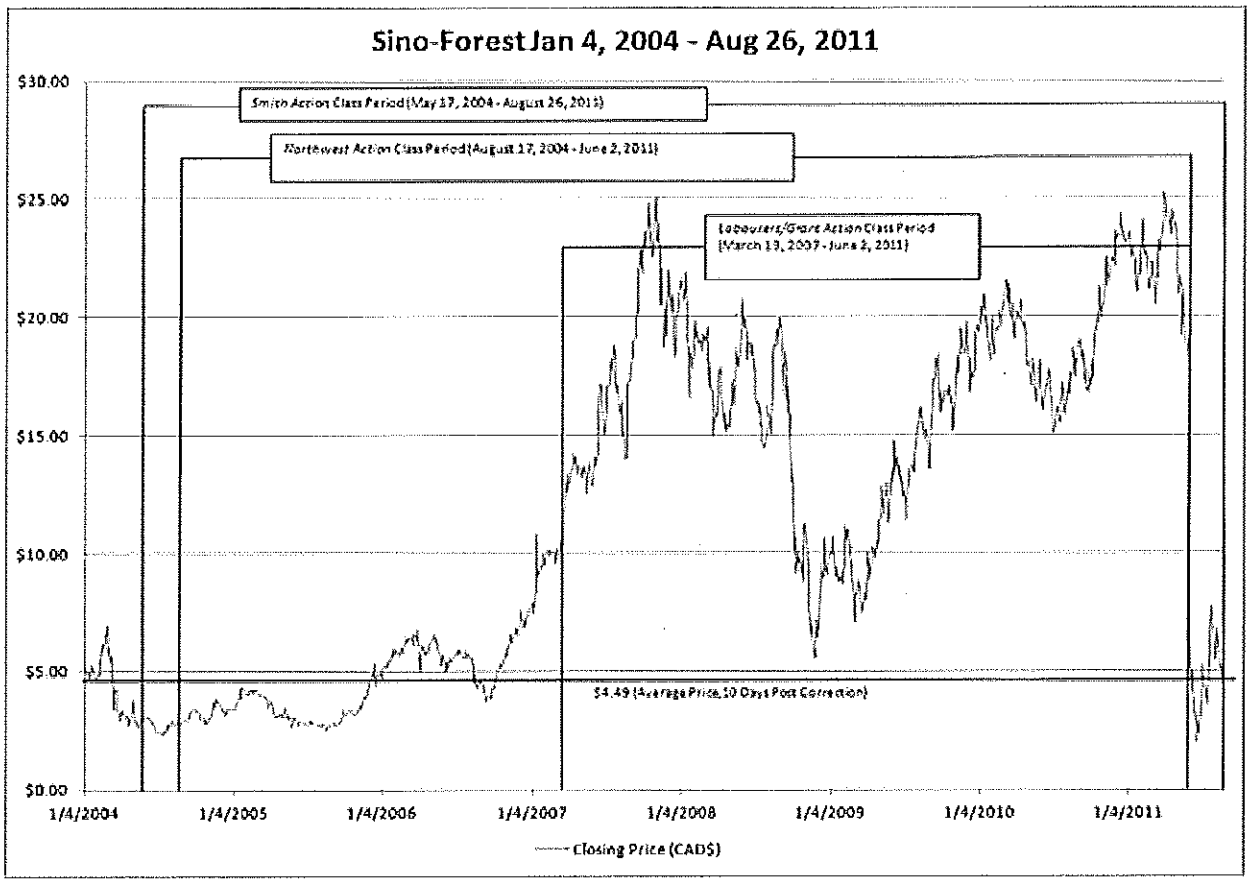
331 I repeat that a carriage motion is without prejudice to the defendants' rights to challenge the pleadings and whether any particular cause of action is legally tenable.

332 I make no order as to costs, which is in the usual course in carriage motions.

P.M. PERELL J.

* * * * *

SCHEDULE "A"



* * * * *

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

Tab 25

Case Name:

Stelco 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 Stelco Inc. and the other applicants listed in Schedule "A"
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, C. c-36, as amended

[2005] O.J. No. 4733

78 O.R. (3d) 254

204 O.A.C. 216

15 C.B.R. (5th) 288

143 A.C.W.S. (3d) 419

2005 CarswellOnt 6283

2005 CanLII 40140

Docket: M33099 (C44332)

Ontario Court of Appeal
Toronto, Ontario

J.I. Laskin, M. Rosenberg and H.S. LaForme JJ.A.

Heard: November 2, 2005.
Judgment: November 4, 2005.

(32 paras.)

Creditors & debtors law -- Legislation -- Debtors' relief -- Companies' Creditors Arrangement Act -- Appeal by debenture holders from orders, reported at [2005] O.J. No. 4309, approving agreements involving steel company in bankruptcy protection, necessary for success of company's plan of

arrangement, dismissed -- Motions judge had jurisdiction to make orders where power of debenture holders to vote down proposal preserved and agreements had support of other stakeholders and Monitor -- Companies' Creditors Arrangement Act, s. 11.

Insolvency law -- Proposals -- Court approval -- Appeal by debenture holders from orders approving agreements involving steel company in bankruptcy protection, necessary for success of company's plan of arrangement, dismissed -- Motions judge had jurisdiction to make orders where orders did not amount to approval of plan of arrangement -- Debentures holders' power to vote down proposed plan not usurped -- Companies' Creditors Arrangement Act, s. 11.

Application by a committee of senior debenture holders for leave to appeal from orders authorizing Stelco to enter into agreements with two stakeholders and a finance provider. A group of equity holders supported the application, while other stakeholders and the Monitor supported the orders. Stelco and its four subsidiaries obtained protection from their creditors in 1994. Stelco's attempts over twenty months to restructure were unsuccessful, in part because certain stakeholders continually exercised veto powers. Stelco's board of directors negotiated agreements with the stakeholders, the Ontario government and the steelworkers union, and Tricap Management, necessary to the success of Stelco's proposed plan of arrangement. The debenture holders objected to terms of the agreements providing for fees payable to Tricap and providing Ontario with power to accept or reject members of Stelco's board of directors. The debenture holders did not propose an alternate plan of arrangement, but made it clear they would not support the one on the table. The motions judge stated in his reasons he was not approving Stelco's plan, but did not think the plan was doomed to fail. He scheduled a meeting of creditors to vote on the plan for November 2005.

HELD: Application allowed. Leave to appeal was granted and the appeal was dismissed. Leave to appeal was granted because the debenture holders raised a novel and important point that was significant to the action. The appeal was prima facie meritorious, and would not unduly interfere with Stelco's continuing negotiations. The appeal was dismissed because the judge had jurisdiction to make the orders approving the agreements, as the orders did not usurp the debenture holders' power to ultimately decide on whether or not to approve Stelco's plan. It was open to the motions judge to find the plan was not doomed to fail, despite the position of the debenture holders, because of the support the plan had from other stakeholders and the Monitor.

Statute, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 6, 11, 11(4), 13

Appeal From:

On appeal from the orders of Justice James M. Farley of the Superior Court of Justice made on October 4, 2005.

Counsel:

Robert W. Staley and Alan P. Gardner for the Informal Committee of Senior Debentureholders, Appellants

Michael E. Barrack and Geoff R. Hall for Stelco Inc., Respondent

Robert I. Thornton and Kyla E.M. Mahar for the Monitor, Respondent

John R. Varley for Salaried Active Employees, Respondents

Michael C.P. McCreary and David P. Jacobs for USW Locals 8782 and 5328, Respondents

George Karayannides for EDS Canada Inc., Respondent

Aubrey E. Kauffman for Tricap Management Ltd., Respondents

Ben Zarnett and Gale Rubenstein for the Province of Ontario, Respondents

Murray Gold for Salaried Retirees, Respondents

Kenneth T. Rosenberg for USW International, Respondents

Robert A. Centa for USWA, Respondents

George Glezos for AGF Management Ltd., Respondents

The judgment of the Court was delivered by

1 **M. ROSENBERG J.A.**:-- This appeal is another chapter in the continuing attempt by Stelco Inc. and four of its wholly-owned subsidiaries to emerge from protection from their creditors under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36. The appellant, an Informal Committee of Senior Debenture Holders who are Stelco's largest creditor, applies for leave to appeal under s. 13 of the CCAA and if leave be granted appeals three orders made by Farley J. on October 4, 2005 in the CCAA proceedings. These orders authorize Stelco to enter into agreements with two of its stakeholders and a finance provider. The appellant submits that the motions judge had no jurisdiction to make these orders and that the effect of these orders is to distort or skew the CCAA process. A group of Stelco's equity holders support the submissions of the appellant. The various other players with a stake in the restructuring and the court-appointed Monitor support the orders made by the motions judge.

2 Given the urgency of the matter it is only possible to give relatively brief reasons for my conclusion that while leave to appeal should be granted, the appeal should be dismissed.

THE FACTS

3 Stelco Inc. and the four wholly-owned subsidiaries obtained protection from their creditors under the CCAA on January 29, 1994. Thus, the CCAA process has been going on for over twenty months, longer than anyone expected. Farley J. has been managing the process throughout. The initial order made under s. 11 of the CCAA gives Stelco sole and exclusive authority to propose and file a plan of arrangement with its creditors. To date, attempts to restructure have been unsuccessful. In particular, a plan put forward by the Senior Debt Holders failed.

4 While there have no doubt been many obstacles to a successful restructuring, the paramount problem appears to be that stakeholders, the Ontario government and Stelco's unions, who do not have a formal veto (i.e. they do not have a right to vote to approve any plan of arrangement and reorganization) have what the parties have referred to as a functional veto. It is unnecessary to set out the reasons for these functional vetoes. Suffice it to say, as did the Monitor in its Thirty-Eighth Re-

port, that each of these stakeholders is "capable of exercising sufficient leverage against Stelco and other stakeholders such that no restructuring could be completed without that stakeholder's support".

5 In an attempt to successfully emerge from CCAA protection with a plan of arrangement, the Stelco board of directors has negotiated with two of these stakeholders and with a finance provider and has reached three agreements: an agreement with the provincial government (the Ontario Agreement), an agreement with The United Steelworkers International and Local 8782 (the USW Agreement), and an agreement with Tricap Management Limited (the Tricap Agreement). Those agreements are intrinsic to the success of the Plan of Arrangement that Stelco proposes. However, the debt holders including this appellant have the ultimate veto. They alone will vote on whether to approve Stelco's Plan. The vote of the affected debt holders is scheduled for November 15, 2005.

6 The three agreements have terms to which the appellant objects. For example, the Tricap Agreement contemplates a break fee of up to $10.75 million depending on the circumstances. Tricap will be entitled to a break fee if the Plan fails to obtain the requisite approvals or if Tricap terminates its obligations to provide financing as a result of the Plan being amended without Tricap's approval. Half of the break fee becomes payable if the Plan is voted down by the creditors. Another example is found in the Ontario Agreement, which provides that the order sanctioning the Final Plan shall name the members of Stelco's board of directors and such members must be acceptable to the province. Consistent with the Order of March 30, 2005 and as required by the terms of the agreements themselves, Stelco sought court authorization to enter into the three agreements. We were told that, in any event, it is common practice to seek court approval of agreements of this importance. The appellant submits that the motions judge had no jurisdiction to make these orders.

7 There are a number of other facts that form part of the context for understanding the issues raised by this appeal. First, on July 18, 2005, the motions judge extended the stay of proceedings until September 9, 2005 and warned the stakeholders that this was a "real and functional deadline". While that date has been extended because Stelco was making progress in its talks with the stakeholders, the urgency of the situation cannot be underestimated. Something will have to happen to either break the impasse or terminate the CCAA process.

8 Second, on October 4, 2005, the motions judge made several orders, not just the orders to authorize Stelco to enter into the three agreements to which the appellant objects. In particular, the motions judge extended the stay to December and made an order convening the creditors meeting on November 15th to approve the Stelco Plan. The appellant does not object to the orders extending the stay or convening the meeting to vote on the Plan.

9 Third, the appellant has not sought permission to prepare and file its own plan of arrangement. At present, the Stelco Board's Plan is the only plan on the table and as the motions judge observed, "one must realistically appreciate that a rival financing arrangement at this stage, starting from essentially a standing start, would take considerable time for due diligence and there is no assurance that the conditions will be any less onerous than those extracted by Tricap".

10 Fourth, in his orders authorizing Stelco to enter into these agreements, the motions judge made it clear that these authorizations, "are not a sanction of the terms of the plan ... and do not prohibit Stelco from continuing discussions in respect of the Plan with the Affected Creditors".

11 Fifth, the independent Monitor has reviewed the Agreements and the Plan and supports Stelco's position.

12 Finally, and importantly, the Senior Debenture Holders that make up the appellant have said unequivocally that they will not approve the Plan. The motions judge recognized this in his reasons:

> The Bondholder group has indicated that it is firmly opposed to the plan as presently constituted. That group also notes that more than half of the creditors by $ value have advised the Monitor that they are opposed to the plan as presently constituted. ... The present plan may be adjusted (with the blessing of others concerned) to the extent that it, in a revised form, is palatable to the creditors (assuming that they do not have a massive change of heart as to the presently proposed plan).

LEAVE TO APPEAL

13 The parties agree on the test for granting leave to appeal under s. 13 of the CCAA. The moving party must show the following:

(a) the point on appeal is of significance to the practice;
(b) the point is of significance to the action;
(c) the appeal is prima facie meritorious; and
(d) the appeal will not unduly hinder the progress of the action.

14 In my view, the appellant has met this test. The point raised is a novel and important one. It concerns the jurisdiction of the supervising judge to make orders that do not merely preserve the status quo but authorize key elements of the proposed plan of arrangement. The point is of obvious significance in this action. If the motions judge's approvals were to be set aside, it is doubtful that the Plan could proceed. On the other hand, the appellant submits that the orders have created a coercive and unfair environment and that the Plan is doomed to fail. It was therefore wrong to authorize Stelco to enter into agreements, especially the Tricap Agreement, that could further deplete the estate. The appeal is prima facie meritorious. The matter appears to be one of first impression. It certainly cannot be said that the appeal is frivolous. Finally, the appeal will not unduly hinder the progress of the action. Because of the speed with which this court is able to deal with the case, the appeal will not unduly interfere with the continuing negotiations prior to the November 15th meeting.

15 For these reasons, I would grant leave to appeal.

ANALYSIS

Jurisdiction generally

16 The thrust of the appellant's submissions is that while the judge supervising a CCAA process has jurisdiction to make orders that preserve the status quo, the judge has no jurisdiction to make an order that, in effect, entrenches elements of the proposed Plan. Rather, the approval of the Plan is a matter solely for the business judgement of the creditors. The appellant submits that the orders made by the motions judge are not authorized by the statute or under the court's inherent jurisdiction and are in fact inconsistent with the scheme and objects of the CCAA. They submit that the orders made in this case have the effect of substituting the court's judgment for that of the debt holders who, under s. 6, have exclusive jurisdiction to approve the plan. Under s. 6, it is only after a majority in number representing two-thirds in value of the creditors vote to approve the plan that the court has a role in deciding whether to sanction the plan.

17 Underlying this argument is a concern on the part of the creditors that the orders are coercive, designed to force the creditors to approve a plan, a plan in which they have had no input and of which they disapprove.

18 In my view, the motions judge had jurisdiction to make the orders he did authorizing Stelco to enter into the agreements. Section 11 of the CCAA provides a broad jurisdiction to impose terms and conditions on the granting of the stay. In my view, s. 11(4) includes the power to vary the stay and allow the company to enter into agreements to facilitate the restructuring, provided that the creditors have the final decision under s. 6 whether or not to approve the Plan. The court's jurisdiction is not limited to preserving the status quo. The point of the CCAA process is not simply to preserve the status quo but to facilitate restructuring so that the company can successfully emerge from the process. This point was made by Gibbs J.A. in Hongkong Bank v. Chef Ready Foods (1990), 4 C.B.R. (3d) 311 (B.C.C.A.) at para. 10:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business activities in Canada that is not a bank, a railway company, a telegraph company, an insurance company, a trust company, or a loan company. When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo *and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure*. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11. [Emphasis added.]

19 In my view, provided the orders do not usurp the right of the creditors to decide whether to approve the Plan the motions judge had the necessary jurisdiction to make them. The orders made in this case do not usurp the s. 6 rights of the creditors and do not unduly interfere with the business judgement of the creditors. The orders move the process along to the point where the creditors are free to exercise their rights at the creditors' meeting.

20 The argument that the orders are coercive and therefore unreasonably interfere with the rights of the creditors turns largely on the potential $10.75 million break fee that may become payable to Tricap. However, the motions judge has found as a fact that the break fee is reasonable. As counsel for Ontario points out, this necessarily entails a finding that the break fee is not coercive even if it could to some extent deplete Stelco's assets.

21 Further, the motions judge both in his reasons and in his orders made it clear that he was not purporting to sanction the Plan. As he said in his reasons, "I wish to be absolutely clear that I am not ruling on or considering in any way the fairness of the plan as presented". The creditors will have the ultimate say on November 15th whether this plan will be approved.

Doomed to fail

22 The appellant submits that the motions judge had no jurisdiction to approve orders that would facilitate a Plan that is doomed to fail. The authorities indicate that a court should not approve a process that will lead to a plan that is doomed to fail. The appellant says that it has made it as clear

as possible that it does not accept the proposed Plan and will vote against it. In Re Inducon Development Corp. (1991), 8 C.B.R. (3d) 306 (Ont. Ct. (Gen. Div.)) at 310 Farley J. said that, "It is of course, ... fruitless to proceed with a plan that is doomed to failure at a further stage."

23 However, it is important to take into account the dynamics of the situation. In fact, it is the appellant's position that nothing will happen until a vote on a Plan is imminent or a proposal from Stelco is voted down; only then will Stelco enter into realistic negotiations with its creditors. It is apparent that the motions judge is of the view that the Plan is not doomed to fail; he would not have approved steps to continue the process if he thought it was. As Austin J. said in Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 7 O.R. (3d) 362 (Div. Ct.) at 369:

> The jurisprudence is clear that if it is obvious that no plan will be found acceptable to the required percentages of creditors, then the application should be refused. *The fact that Paribas, the Royal Bank and K Mart now say there is no plan that they would approve, does not put an end to the inquiry.* All affected constituencies must be considered, including secured, preferred and unsecured creditors, employees, landlords, shareholders, and the public generally ... [Emphasis added.]

24 It must be a matter of judgment for the supervising judge to determine whether the Plan is doomed to fail. This Plan is supported by the other stakeholders and the independent Monitor. It is a product of the business judgment of the Stelco board as a way out of the CCAA process. It was open to the motions judge to conclude that the plan was not doomed to fail and that the process should continue. Despite its opposition to the Plan, the appellant's position inherently concedes the possibility of success, otherwise these creditors would have opposed the extension of the stay, opposed the order setting a date for approval of the plan and sought to terminate the CCAA proceedings.

25 The motions judge said this in his reasons:

> It seems to me that Stelco as an ongoing enterprise is getting a little shop worn/shopped worn. It would not be helpful to once again start a new general process to find the ideal situation [sic solution?]; rather the urgency of the situation requires that a reasonable solution be found.

He went on to state that in the month before the vote there "will be considerable discussion and negotiation as to the plan which will in fact be put to the vote" and that the present Plan may be adjusted. He urged the stakeholders and Stelco to "deal with this question in a positive way" and that "it is better to move forward than backwards, especially where progress is required". It is obvious that the motions judge has brought his judgment to bear and decided that the Plan or some version of it is not doomed to fail. I can see no basis for second-guessing the motions judge on that issue.

26 I should comment on a submission made by the appellant that no deference should be paid to the business judgment of the Stelco board. The appellant submits that the board is entitled to deference for most of the decisions made in the day-to-day operations during the CCAA process except whether a restructuring should proceed or a plan of arrangement should proceed. The appellant submits that those latter decisions are solely the prerogative of the creditors by reason of s. 6. While there is no question that the ultimate decision is for the creditors, the board of directors plays an im-

portant role in the restructuring process. Blair J.A. made this clear in an earlier appeal to this court concerning Stelco reported at (2005), 75 O.R. (3d) 5 at para. 44:

> What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. *The company's role in the restructuring,* and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in Lehndorff, [1993] O.J. No. 14, supra, at para. 5, "to make order[s] so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. *Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance the company's restructuring efforts.* [Emphasis added.]

27 The approvals given by the motions judge in this case are consistent with these principles. Those orders allow the company's restructuring efforts to move forward.

28 The position of the appellant also fails to give any weight to the broad range of interests in play in a CCAA process. Again to quote Blair J.A. in the earlier Stelco case at para. 36:

> In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, *thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders*. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. [Emphasis added.]

29 For these reasons, I would not give effect to the submissions of the appellant.

Submissions of the equity holders

30 The equity holders support the position of the appellant. They point out that the Stelco CCAA situation is somewhat unique. While Stelco entered the process in dire straits, since then almost unprecedented worldwide prices for steel have boosted Stelco's fortunes. In an endorsement of February 28, 2005, the motions judge recognized this unusual state of affairs:

> In most restructurings, on emergence the original shareholder equity, if it has not been legally "evaporated" because the insolvent corporations was so for under water, is very substantially diminished. For example, the old shares may be converted into new emergent shares at a rate of 100 to 1; 1,000 to 1; or even 12,000 to 1. ... Stelco is one of those rare situations in which a change of external cir-

> cumstances ... may result in the original equity having a more substantial "recovery" on emergence than outline above."

31 The equity holders point out that while an earlier plan would have allowed the shareholders to benefit from the continued and anticipated growth in the Stelco equity, the present plan does not include any provision for the existing shareholders. I agree with counsel for Stelco that these arguments are premature. They raise issues for the supervising judge if and when he is called upon to exercise his discretion under s. 6 to sanction the Plan of arrangement.

DISPOSITION

32 Accordingly, I would dismiss the appeal. On behalf of the court, I wish to thank all counsel for their very helpful written and oral submissions that made it possible to deal with this appeal expeditiously.

M. ROSENBERG J.A.
J.I. LASKIN J.A. -- I agree.
H.S. LaFORME J.A. -- I agree.

cp/e/qw/qlsxl/qlkjg/qlgxc

Tab 26

Indexed as:

T. Eaton 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 The T. Eaton Company Limited, applicant

[1999] O.J. No. 5322

15 C.B.R. (4th) 311

95 A.C.W.S. (3d) 219

Court File No. 99-CL-3516

Ontario Superior Court of Justice
Commercial List

Farley J.

Heard: November 23, 1999.
Judgment: November 23, 1999.

(13 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval.

Application for approval for a plan under the Companies' Creditors Arrangement Act. The creditors and the shareholders voted overwhelmingly in favour of the plan. No one presented an alternative plan for the interested parties to vote on.

HELD: Application allowed. The criteria for Court approval were strict compliance with all statutory requirements, that all material filed and procedure carried out had to be examined to determine if anything had been done or purported to be done that was not authorized by the Act, and that the plan be fair and reasonable. Of concern was the size of the pot going to the shareholders. That was a bone of contention amongst the creditors. There was a hierarchy of interest to receive value in a liquidation or liquidation related transaction and the shareholders were at the bottom. The plan was fair and reasonable.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, Ontario Business Corporations Act.

Counsel:

No counsel mentioned.

---

1 **FARLEY J.** (endorsement):-- The criteria that a debtor company must satisfy in seeking the court's approval for a plan under the Companies' Creditors Arrangement Act ("CCAA") are well established:

(a) there must be strict compliance with all statutory requirements;
(b) all material filed and procedure carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
(c) the plan must be fair and reasonable.

See: Re Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.) at pp. 182-3, affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.) and Re Sammi Atlas Inc. (1998), 3 C.B.R. (4th) 171 (Ont.Gen.Div.) at p. 172.

2 In exercising its discretion to approve an arrangement under the Ontario Business Corporations Act ("OBCA"), the court must be satisfied that the arrangement meets the same criteria as set out above for approving a plan under the CCAA. See Olympia & York Developments Ltd. (1993) 18 C.B.R. (3d) 176 (Ont.Gen.Div.) at p. 186.

3 It would appear to be undisputed by anyone (including myself) that items (a) and (b) have been met and complied with. That leaves the question of whether what is advanced is fair and reasonable. The majority can bind the minority in a plan provided that the purchase does not bind the minority to terms that are unfair or unconscionable. See Re Keddy Motor Inns Ltd. (1992), 13 C.B.R. (3d) 245 (N.S.C.A.) at pp. 247-8, 258.

4 In reviewing the fairness and reasonableness of a plan the court does not require perfection; nor will the court second guess the business decisions reached by the stakeholders as a body.

5 In Sammi Atlas, supra, I cited Re Campeau Corp. (1992), 10 C.B.R. (3d) 104 (Ont.Gen.Div.), Re Northland, supra, and Re Olympia & York Developments Ltd. (1993), 12 O.R. (3d) 500 (Gen.Div.) at pp. 173-4 where I observed:

> ... 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 ...
>
> Those voting on the Plan (and I noted 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 Developments Ltd.:
>
> > 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 ...

6 As well there is a heavy onus on parties seeking to upset a plan that the required majority have supported. See Sammi Atlas, supra, at p. 274 citing Re Central Guaranty Trustco Ltd. (1993) 21 C.B.R. (3d) 139 (Ont.Gen.Div.) at p. 141.

7 It is also appropriate to take into consideration the fact that both classes of creditors as well as the shareholders voted overwhelmingly in favour of the Eaton's Plan. In the case of the unsecured creditors this was 99% plus in number and 94% plus in value; the landlords unanimously; and the shareholders 99.5%. This was not a scrape by the minimum requirement situation.

8 The alternative to a favourable vote would be that Eaton's would be in bankruptcy today as per the provisions of last week. Thus there would be some uncertainty as to recoveries - and whether or not a plan could arise from the ashes so as to utilize the tax loss potential. I note specifically that no one presented an alternative plan for the interested parties to vote on.

9 What is of concern is the question of the size of the pot going to the shareholders. That was a bone of contention amongst the various creditors - but as I have observed, no one advanced a competing plan. I would also like to make it clear that I have no doubt that many of the shareholders have suffered significant losses as a result of the demise of Eaton's and I know that it is painful for them. It is not my intention to increase that pain but I do think that it is important for at least future situations that in devising and considering plans persons recognize that there is a natural and legal "hierarchy of interest to receive value in a liquidation or liquidation related transaction" and that in that hierarchy the shareholders are at the bottom. See my endorsement of November 22, 1999 in Re Royal Oak Mines Ltd., [1999] O.J. No. 4848:

> Further in these particular circumstances [here I was talking of Royal Oak, but the same would appear to hold true for Eaton's], there are, in relation to the available tax losses (which is in itself a "conditional" asset), very substantial amounts of unsecured debt standing on the shareholders' shoulders. That is, the shareholders, even assuming an ongoing operation without restructuring, would have to wait a long while before their interests saw the light of day.

10 I think it appropriate to note that in Sammi Atlas, the shareholder got $1.25 million U.S.; in Cadillac Fairview Inc. nothing; and in Royal Oak it is proposed the shareholders be diluted down to 1% equity interest underneath a heavy blanket of other obligations. When viewed in contrast, the Eaton's deal would appear to be on the rich side.

11 I also think it helpful to note my observations in Re A Proposed Arrangement Involving Cadillac Fairview Inc. And Its Shareholders, [1995] O.J. No. 707, released March 7, 1995, at pp. 11-16 and especially the analysis In Re Tea Corporation Limited, Sorsbie v. Same Company, [1904] 1 Ch.D. 12 (C.A.) as well as the other cases referred to therein.

12 I trust that a forward thinking analysis of these views will be of assistance to those involved in future cases.

13 However, in the subject Eaton's case, in the circumstances here prevailing, I find the plan to be fair and reasonable, notwithstanding my concerns that it might well have been appropriately modified to get it closer to perfection. While "perfection" is an impossible goal, "closer to perfection" should always be strived for. The Eaton's plan is approved for both CCAA and OBCA purposes.

FARLEY J.

cp/s/qlala/qlalm

Tab 27

Case Name:

Timminco Ltd. (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 Timminco Limited and Becancour Silicon Inc., Applicants

[2012] O.J. No. 3931

2012 ONCA 552

Docket: M41062 and M41085

Ontario Court of Appeal
Toronto, Ontario

J.M. Simmons, R.G. Juriansz and G.J. Epstein JJ.A.

Heard: By written submissions.
Judgment: July 20, 2012.

(8 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Claims -- Priority -- Application by two unions for leave to appeal from order granting DIP financing provider super priority charge over debtor's assets dismissed -- Debtor would cease operating but for DIP financing -- Financing would only be provided in exchange for super priority charge -- Proceeding with restructuring was in best interests of all parties.

Statutes, Regulations and Rules Cited:

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

Appeal From:

On leave to appeal from the order of Justice Geoffrey B. Morawetz of the Superior Court of Justice, dated February 9, 2012.

Counsel:

Ashley J. Taylor and Erica Tait, for the applicants.

Douglas J. Wray and Jesse Kugler, for the Communications, Energy and Paperworkers Union of Canada.

Charles E. Sinclair, for the United Steelworkers.

ENDORSEMENT

The following judgment was delivered by

1 THE COURT:-- Leave to appeal is denied.

2 In the CCAA context, leave to appeal is to be granted sparingly and only where there are serious and arguable grounds that are of real and significant interest to the parties. In determining whether leave ought to be granted, this Court is required to consider the following four-part inquiry:

* whether the point on the proposed appeal is of significance to the practice;
* whether the point is of significance to the action;
* whether the proposed appeal is *prima facie* meritorious or frivolous; and
* whether the appeal will unduly hinder the progress of the action.

See *Re Stelco* (2005), 78 O.R. (3d) 241

3 In our view, the proposed appeals lack sufficient merit to meet this stringent test.

4 This court's decision in *Indalex Ltd. (Re)* (2011), 104 O.R. (3d) 641, affirms that a CCAA court may invoke the doctrine of paramountcy to override conflicting provisions of provincial statutes where the application of provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy.

5 Here, the motion judge recognized that in the circumstances of this case there was a conflict between the federal CCAA and the provincial PBA and SPPA. He found that, "[i]n the absence of the court granting the requested super priority, the objectives of the CCAA would be frustrated". Further, he concluded that "to ensure that the objectives of the CCAA are fulfilled, it is necessary to invoke the doctrine of paramountcy such that the provisions of the CCAA override those of the QSPPA and the OPBA".

6 We see no basis on which this court could interfere with the motion judge's decision, including his unassailable findings of fact that: (1) without DIP financing, Timminco would be forced to cease operating; (2) bankruptcy would not be in the interests of anyone, including members of the pension plan; (3) if the DIP lender did not get super priority, it would not have agreed to provide financing; and (4) there was insufficient liquidity or unfavourable terms associated with the rejected DIP proposals. In short, he found that there was "no real alternative" to approving the DIP facility and DIP super priority charge.

7 The motion judge also addressed the union's fiduciary arguments, primarily in his earlier reasons released February 2, 2012, that are incorporated by reference into his February 9, 2012 rea-

sons. He concluded that it was in the best interests of all parties to proceed with the restructuring. We see no basis on which this court could interfere with this finding.

8 Costs are to the responding parties on the motions on a partial indemnity scale fixed in the amount of $1,500 per motion inclusive of disbursements and applicable taxes.

J.M. SIMMONS J.A.
R.G. JURIANSZ J.A.
G.J. EPSTEIN J.A.

cp/e/qljel/qlpmg/qlmll

Tab 28

Case Name:

Timminco Ltd. (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 Timminco Limited and Bécancour Silicon Inc., Applicants

[2012] O.J. No. 1949

2012 ONSC 2515

Court File Nos. CV-12-9539-00CL and CV-09-378701-00CP

Ontario Superior Court of Justice
Commercial List

G.B. Morawetz J.

Heard: March 26, 2012.
Judgment: April 27, 2012.

(25 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Stays -- Motion by plaintiff in class proceeding/ creditor of company under CCAA protection to lift stay of proceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Procedure -- Motion by plaintiff in class proceeding/creditor of company under CCAA protection to lift stay of pro-

ceedings allowed in part -- Stay lifted only to permit plaintiff to seek leave to appeal to Supreme Court of Canada procedural judgment about running of limitations period for class proceeding -- TO lift stay entirely would take focus of company's few remaining executives away from restructuring to deal with class proceeding, potentially causing prejudice to other stakeholders.

Motion by Penneyfeather for an order lifting a January 2012 stay of proceedings to permit Penneyfeather to continue a class proceeding against Timminco and others. Timminco was pursuing a restructuring process intended to maximize recovery for stakeholders. It continued to operate as a going concern with a greatly-reduced staff of 10 employees including the president and three executive officers. The class proceeding was commenced in May 2009. Settlement discussions had been terminated and there was a pending motion to strike portions of the statement of claim. Penneyfeather planned to seek leave to appeal to the Supreme Court of Canada an order declaring that the three-year limitation period provided in the Securities Act was not suspended by the operation of the Class Proceedings Act. Timminco consented to lift the stay to permit Penneyfeather to pursue this leave application only. Timminco submitted that key members of its executive team would have to expend considerable time dealing with Penneyfeather's class proceeding if the stay was lifted completely, thereby taking their focus away from the restructuring process.

HELD: Motion allowed in part. If forced to spend significant amounts of time dealing with Penneyfeather's class action in the coming months, the Timminco executive team would be unable to focus on the sales and restructuring process to the potential detriment of Timminco's other stakeholders. A delay in the sales process could have a negative impact on Timminco. It was premature to lift the stay other than with respect to the leave application.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, S.O. 1992, c. 6, s. 12, s. 28

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

Securities Act, R.S.O. 1990, c. S.5, s. 138.14

Counsel:

James C. Orr and N. Mizobuchi, for St. Clair Penneyfeather, Plaintiff in Class Proceeding, *Penneyfeather v. Timminco Limited et al.*

P. O'Kelly and A. Taylor, for the Applicants.

P. LeVay, for the Photon Defendants.

A. Lockhart, for Wacker Chemie AG.

K.D. Kraft, for Chubb Insurance Company of Canada.

D.J. Bell, for John P. Walsh.

A. Hatnay and James Harnum for Mercer Canada, Administrator of the Timminco Haley Plan.

S. Weisz, for FTI Consulting Canada Inc., Monitor.

ENDORSEMENT

1 **G.B. MORAWETZ J.**:-- St. Clair Penneyfeather, the Plaintiff in the *Penneyfeather v. Timminco Limited, et al* action, Court File No. CV-09-378701-00CP (the "Class Action"), brought this motion for an order lifting the stay of proceedings, as provided by the Initial Order of January 3, 2012 and extended by court order dated January 27, 2012, and permitting Mr. Penneyfeather to continue the Class Action against Timminco Limited ("Timminco"), Dr. Heinz Schimmelbusch, Mr. Robert Dietrich, Mr. Rene Boisvert, Mr. Arthur R. Spector, Mr. Jack Messman, Mr. John C. Fox, Mr. Michael D. Winfield, Mr. Mickey M. Yaksich and Mr. John P. Walsh.

2 The Class Action was commenced on May 14, 2009 and has been case managed by Perell J. The following steps have taken place in the litigation:

(a) a carriage motion;
(b) a motion to substitute the Representative Plaintiff;
(c) a motion to force disclosure of insurance policies;
(d) a motion for leave to appeal the result of the insurance motion which was heard by the Divisional Court and dismissed;
(e) settlement discussions;
(f) when settlement discussions were terminated, Perell J. declined an expedited leave hearing and instead declared any limitation period to be stayed;
(g) a motion for particulars; and
(h) a motion served but not heard to strike portions of the Statement of Claim.

3 On February 16, 2012, the Court of Appeal for Ontario set aside the decision of Perell J. declaring that s. 28 of the *Class Proceedings Act* suspended the running of the three-year limitation period under s. 138.14 of the *Securities Act*.

4 The Plaintiffs' counsel received instructions to seek leave to appeal the decision of the Court of Appeal for Ontario to the Supreme Court of Canada. The leave materials were required to be served and filed by April 16, 2012.

5 On April 10, 2012, the following endorsement was released in respect of this motion:

> The portion of the motion dealing with lifting the stay for the Plaintiff to seek leave to appeal the recent decision of the Court of Appeal for Ontario to the Supreme Court of Canada on the limitation period issue was not opposed. This portion of the motion is granted and an order shall issue to give effect to the foregoing. The balance of the requested relief is under reserve.

6 Counsel to Mr. Penneyfeather submits that, apart from the leave to appeal issues, there are steps that may occur before Perell J. as a result of the Court of Appeal ruling. Counsel references that the Defendants may bring motions for partial judgment and the Plaintiff could seek to have the court proceed with leave and certification with any order to be granted *nunc pro tunc* pursuant to s. 12 of the *Class Proceedings Act*.

7 Counsel to Mr. Penneyfeather submits that the three principal objectives of the *Class Proceedings Act* are judicial economy, access to justice and behaviour modification. (See *Western Canadian*

Shopping Centres Inc. v. Dutton, [2001] 2 S.C.R. 534 at paras. 27-29.), and under the *Securities Act*, the deterrent represented by private plaintiffs armed with a realistic remedy is important in ensuring compliance with continuous disclosure rules.

8 Counsel submits that, in this situation, there is only one result that will not do violence to a primary legislative purpose and that is to lift the stay to permit the Class Action to proceed on the condition that any potential execution excludes Timminco's assets. Counsel further submits that, as a practical result, this would limit recovery in the Class Action to the proceeds of the insurance policies, or in the event that the insurers decline coverage because of fraud, to the personal assets of those officers and directors found responsible for the fraud.

9 Counsel to Mr. Penneyfeather takes the position that the requested outcome is consistent with the judicial principal that the CCAA is not meant as a refuge insulating insurers from providing appropriate indemnification. (See *Algoma Steel Corp. v. Royal Bank of Canada*, [1992] O.J. No. 889 at paras. 13-15 (C.A.) and *Re Carey Canada Inc.* [2006] O.J. No. 4905 at paras. 7, 16-17.)

10 In this case, counsel contends that, when examining the relative prejudice to the parties, the examination strongly favours lifting the stay in the manner proposed since the insurance proceeds are not available to other creditors and there would be no financial unfairness caused by lifting the stay.

11 The position put forward by Mr. Penneyfeather must be considered in the context of the CCAA proceedings. As stated in the affidavit of Ms. Konyukhova, the stay of proceedings was put in place in order to allow Timminco and Bécancour Silicon Inc. ("BSI" and, together with Timminco, the "Timminco Entities") to pursue a restructuring and sales process that is intended to maximize recovery for the stakeholders. The Timminco Entities continue to operate as a going concern, but with a substantially reduced management team. The Timminco Entities currently have only ten active employees, including Mr. Kalins, President, General Counsel and Corporate Secretary and three executive officers (the "Executive Team").

12 Counsel to the Timminco Entities submits that, if Mr. Penneyfeather is permitted to pursue further steps in the Class Action, key members of the Executive Team will be required to spend significant amounts of their time dealing with the Class Action in the coming months, which they contend is a key time in the CCAA proceedings. Counsel contends that the executive team is currently focussing on the CCAA proceedings and the sales process.

13 Counsel to the Timminco Entities points out that the Executive Team has been required to direct most of their time to restructuring efforts and the sales process. Currently, the "stalking horse" sales process will continue into June 2012 and I am satisfied that it will require intensive time commitments from management of the Timminco Entities.

14 It is reasonable to assume that, by late June 2012, all parties will have a much better idea as to when the sales process will be complete.

15 The stay of proceedings is one of the main tools available to achieve the purpose of the CCAA. The stay provides the Timminco Entities with a degree of time in which to attempt to arrange an acceptable restructuring plan or sale of assets in order to maximize recovery for stakeholders. The court's jurisdiction in granting a stay extends to both preserving the *status quo* and facilitating a restructuring. See *Re Stelco Inc.*, [2005] O.J. No. 1171 (C.A.) at para. 36.

16 Further, the party seeking to lift a stay bears a heavy onus as the practical effect of lifting a stay is to create a scenario where one stakeholder is placed in a better position than other stakeholders, rather than treating stakeholders equally in accordance with their priorities. See *Canwest Global Communications Corp. (Re)*, [2011] O.J. No. 1590 (S.C.J.) at para. 27.

17 Courts will consider a number of factors in assessing whether it is appropriate to lift a stay, but those factors can generally be grouped under three headings: (a) the relative prejudice to parties; (b) the balance of convenience; and (c) where relevant, the merits (*i.e.* if the matter has little chance of success, there may not be sound reasons for lifting the stay). See *Canwest Global Communications (Re), supra*, at para. 27.

18 Counsel to the Timminco Entities submits that the relative prejudice to the parties and the balance of convenience clearly favours keeping the stay in place, rather than to allow the Plaintiff to proceed with the SCC leave application. As noted above, leave has been granted to allow the Plaintiff to proceed with the SCC leave application. Counsel to the Timminco Entities further submits that, while the merits are vigorously disputed by the Defendants in the context of a Class Action, the Timminco Entities will not ask this court to make any determinations based on the merits of the Plaintiff's claim.

19 I can well recognize why Mr. Penneyfeather wishes to proceed. The objective of the Plaintiff in the Class Action is to access insurance proceeds that are not available to other creditors. However, the reality of the situation is that the operating side of Timminco is but a shadow of its former self. I accept the argument put forth by counsel to the Applicant that, if the Executive Team is required to spend significant amounts of time dealing with the Class Action in the coming months, it will detract from the ability of the Executive Team to focus on the sales process in the CCAA proceeding to the potential detriment of the Timminco Entities' other stakeholders. These are two competing interests. It seems to me, however, that the primary focus has to be on the sales process at this time. It is important that the Executive Team devote its energy to ensuring that the sales process is conducted in accordance with the timeliness previously approved. A delay in the sales process may very well have a negative impact on the creditors of Timminco. Conversely, the time sensitivity of the Class Action has been, to a large extent, alleviated by the lifting of the stay so as to permit the leave application to the Supreme Court of Canada.

20 It is also significant to recognize the submission of counsel on behalf of Mr. Walsh. Counsel to Mr. Walsh takes the position that Mr. Penneyfeather has nothing more than an "equity claim" as defined in the CCAA and, as such, his claim (both against the company and its directors who, in turn, would have an equity claim based on indemnity rights) would be subordinated to any creditor claims. Counsel further submits that of all the potential claims to require adjudication, presumably, equity claims would be the least pressing to be adjudicated and do not become relevant until all secured and unsecured claims have been paid in full.

21 In my view, it is not necessary for me to comment on this submission, other than to observe that to the extent that the claim of Mr. Penneyfeather is intended to access certain insurance proceeds, it seems to me that the prosecution of such claim can be put on hold, for a period of time, so as to permit the Executive Team to concentrate on the sales process.

22 Having considered the relative prejudice to the parties and the balance of convenience, I have concluded that it is premature to lift the stay at this time, with respect to the Timminco Entities, other than with respect to the leave application to the Supreme Court of Canada. It also follows, in

my view, that the stay should be left in place with respect to the claim as against the directors and officers. Certain members of this group are involved in the Executive Team and, for the reasons stated above, I am satisfied that it is not appropriate to lift the stay as against them.

23 With respect to the claim against Photon, as pointed out by their counsel, it makes no sense to lift the stay only as against Photon and leave it in place with respect to the Timminco Entities. As counsel submits, the Timminco Entities have an interest in both the legal issues and the factual issues that may be advanced if Mr. Penneyfeather proceeds as against Photon, as any such issues as are determined in Timminco's absence may cause unfairness to Timminco, particularly, if Mr. Penneyfeather later seeks to rely on those findings as against Timminco. I am in agreement with counsel's submission that to make such an order would be prejudicial to Timminco's business and property. In addition, I accept the submission that it would also be unfair to Photon to require it to answer Mr. Penneyfeather's allegations in the absence of Timminco as counsel has indicated that Photon will necessarily rely on documents and information produced by Timminco as part of its own defence.

24 I am also in agreement with the submission that it would be wasteful of judicial resources to permit the class proceedings to proceed as against Photon but not Timminco as, in addition to the duplicative use of court time, there would be the possibility of inconsistent findings on similar or identical factual issues and legal issues. For these reasons, I have concluded that it is not appropriate to lift the stay as against Photon.

25 In the result, the motion dealing with issues not covered by the April 10, 2012 endorsement is dismissed without prejudice to the rights of the Plaintiff to renew his request no sooner than 75 days after today's date.

G.B. MORAWETZ J.

cp/e/qljel/qlpmg/qlced

Tab 29

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

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.

Tab 30

Case Name:

Western Canadian Shopping Centres Inc. v. Dutton

Bennett Jones Verchere, Garnet Schulhauser, Arthur Andersen & Co., Ernst & Young, Alan Lundell, The Royal Trust Company, William R. MacNeill, R. Byron Henderson, C. Michael Ryer, Gary L. Billingsley, Peter K. Gummer, James G. Engdahl, Jon R. MacNeill,
appellants/respondents on cross-appeal;
v.
Western Canadian Shopping Centres Inc. and Muh-Min Lin and Hoi-Wah Wu, representatives of all holders of Class "A", Class "E" and Class "F" Debentures issued by Western Canadian Shopping Centres Inc.,
respondents/appellants on cross-appeal.

[2000] S.C.J. No. 63

[2000] A.C.S. no 63

2001 SCC 46

2001 CSC 46

[2001] 2 S.C.R. 534

[2001] 2 R.C.S. 534

201 D.L.R. (4th) 385

272 N.R. 135

[2002] 1 W.W.R. 1

J.E. 2001-1430

94 Alta. L.R. (3d) 1

286 A.R. 201

8 C.P.C. (5th) 1

106 A.C.W.S. (3d) 397

File No.: 27138.

Supreme Court of Canada

Hearing and judgment: December 13, 2000.
Reasons delivered: July 13, 2001.

Present: McLachlin C.J. and L'Heureux-Dubé, Gonthier, Iacobucci, Binnie, Arbour and LeBel JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ALBERTA (62 paras.)

Practice -- Class actions -- Plaintiffs suing defendants for breach of fiduciary duties and mismanagement of funds -- Defendants applying for order to strike plaintiffs' claim to sue in representative capacity -- Whether requirements for class action met -- If so, whether class action should be allowed -- Whether defendants entitled to examination and discovery of each class member -- Alberta Rules of Court, Alta. Reg. 390/68, Rule 42.

L and W, together with 229 other investors, became participants in the federal government's Business Immigration Program by purchasing debentures in WCSC, which was incorporated by D, its sole shareholder, for the purpose of helping investor-class immigrants qualify as permanent residents in Canada. WCSC solicited funds through two offerings to invest in income-producing properties. After the investors' funds were deposited, WCSC purchased from CRI, for $5,550,000, the rights to a Crown surface lease and also agreed to commit a further $16.5 million for surface improvements. To finance WCSC's obligations to CRI, D directed that the Series A debentures be issued in an aggregate principal amount of $22,050,000 to some of the investors. D advanced more funds to CRI and corresponding debentures were issued, in particular the Series E and F debentures. Eventually, the debentures were pooled. When CRI announced that it could not pay the interest due on the debentures, L and W, the representative plaintiffs, commenced a class action complaining that D and various affiliates and advisors of WCSC breached fiduciary duties to the investors by mismanaging their funds. The defendants applied to the Court of Queen's Bench for a declaration and order striking that portion of the claim in which the individual plaintiffs purport, pursuant to Rule 42 of the Alberta Rules of Court, to represent a class of 231 investors. The chambers judge denied the application. The majority of the Court of Appeal upheld that decision but granted the defendants the right to discovery from each of the 231 plaintiffs. The defendants appealed to this Court, and the plaintiffs cross-appealed taking issue with the Court of Appeal's allowance of individualized discovery from each class member.

Held: The appeal should be dismissed and the cross-appeal allowed.

In Alberta, class-action practice is governed by Rule 42 of the Alberta Rules of Court but, in the absence of comprehensive legislation, the courts must fill the void under their inherent power to set-

tle the rules of practice and procedure as to disputes brought before them. Class actions should be allowed to proceed under Rule 42 where the following conditions are met: (1) the class is capable of clear definition; (2) there are issues of law or fact common to all class members; (3) success for one class member means success for all; and (4) the proposed representative adequately represents the interests of the class. If these conditions are met the court must also be satisfied, in the exercise of its discretion, that there are no countervailing considerations that outweigh the benefits of allowing the class action to proceed. The court should take into account the benefits the class action offers in the circumstances of the case as well as any unfairness that class proceedings may cause. In the end, the court must strike a balance between efficiency and fairness. The need to strike a balance between efficiency and fairness belies the suggestion that a class action should be struck only where the deficiency is "plain and obvious". On procedural matters, all potential class members should be informed of the existence of the suit, of the common issues that the suit seeks to resolve, and of the right of each class member to opt out. This should be done before any decision is made that purports to prejudice or otherwise affect the interests of class members. The court also retains discretion to determine how the individual issues should be addressed, once common issues have been resolved. In the absence of comprehensive class-action legislation, courts must address procedural complexities on a case-by-case basis in a flexible and liberal manner, seeking a balance between efficiency and fairness.

In this case, the basic conditions for a class action are met and efficiency and fairness favour permitting it to proceed. The defendants' contentions against the suit were unpersuasive. While differences exist among investors, the fact remains that the investors raise essentially the same claims requiring resolution of the same facts. If material differences emerge, the court can deal with them when the time comes. Further, a class action should not be foreclosed on the ground that there is uncertainty as to the resolution of issues common to all class members. If it is determined that the investors must show individual reliance to establish breach of fiduciary duty, the court may then consider whether the class action should continue. The same applies to the contention that different defences will be raised with respect to different class members. Simply asserting this possibility does not negate a class action. If and when different defences are asserted, the court may solve the problem or withdraw leave to proceed as a class.

Finally, to allow individualized discovery at this stage of the proceedings would be premature. The defendants should be allowed to examine the representative plaintiffs as of right but examination of other class members should be available only by order of the court, upon the defendants showing reasonable necessity.

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Distinguished: General Motors of Canada Ltd. v. Naken, [1983] 1 S.C.R. 72; referred to: 353850 Alberta Ltd. v. Horne & Pitfield Foods Ltd., [1989] A.J. No. 652 (QL); Shaw v. Real Estate Board of Greater Vancouver (1972), 29 D.L.R. (3d) 774; Hunt v. Carey Canada Inc., [1990] 2 S.C.R. 959; Korte v. Deloitte, Haskins & Sells (1993), 8 Alta. L.R. (3d) 337; Oregon Jack Creek Indian Band v. Canadian National Railway Co., [1989] 2 S.C.R. 1069; Lac Minerals Ltd. v. International Corona Resources Ltd., [1989] 2 S.C.R. 574; Hodgkinson v. Simms, [1994] 3 S.C.R. 377; Chancey v. May (1722), Prec. Ch. 592, 24 E.R. 265; City of London v. Richmond (1701), 2 Vern. 421, 23 E.R. 870; Wallworth v. Holt (1841), 4 My. & Cr. 619, 41 E.R. 238; Duke of Bedford v. Ellis, [1901] A.C. 1; Taff Vale Railway Co. v. Amalgamated Society of Railway Servants, [1901] A.C. 426; Markt & Co. v. Knight Steamship Co., [1910] 2 K.B. 1021; Bell v. Wood, [1927] 1 W.W.R. 580; Langley v.

North West Water Authority, [1991] 3 All E.R. 610, leave denied [1991] 1 W.L.R. 711n; Newfoundland Association of Public Employees v. Newfoundland (1995), 132 Nfld. & P.E.I.R. 205; Ranjoy Sales and Leasing Ltd. v. Deloitte, Haskins and Sells, [1984] 4 W.W.R. 706; International Capital Corp. v. Schafer (1995), 130 Sask. R. 23; Guarantee Co. of North America v. Caisse populaire de Shippagan Ltée (1988), 86 N.B.R. (2d) 342; Lee v. OCCO Developments Ltd. (1994), 148 N.B.R. (2d) 321; Van Audenhove v. Nova Scotia (Attorney General) (1994), 134 N.S.R. (2d) 294; Horne v. Canada (Attorney General) (1995), 129 Nfld. & P.E.I.R. 109; Bywater v. Toronto Transit Commission (1998), 27 C.P.C. (4th) 172; Drummond-Jackson v. British Medical Association, [1970] 1 All E.R. 1094.

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Class Proceedings Act, R.S.B.C. 1996, c. 50, ss. 4(1), 7, 27.
Class Proceedings Act, 1992, S.O. 1992, c. 6, ss. 5(1), 6, 25.

Code of Civil Procedure, R.S.Q., c. C-25, Book IX, arts. 1003, 1039.
Federal Rules of Civil Procedure, 28 U.S.C.A. para. 23.
Supreme Court of Judicature Act, 1873 (U.K.), 36 & 37 Vict., c. 66, Sch., r. 10.

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APPEAL and CROSS-APPEAL from a judgment of the Alberta Court of Appeal (1998), 73 Alta. L.R. (3d) 227, 228 A.R. 188, 188 W.A.C. 188, 30 C.P.C. (4th) 1, [1998] A.J. No. 1364 (QL), 1998 ABCA 392, dismissing an appeal from a decision of the Court of Queen's Bench (1996), 41 Alta. L.R. (3d) 412, 191 A.R. 265, 3 C.P.C. (4th) 329, [1996] A.J. No. 1165 (QL). Appeal dismissed and cross-appeal allowed.

Barry R. Crump, Brian Beck and David C. Bishop, for the appellants/respondents on cross-appeal.
Hervé H. Durocher and Eugene J. Erler, for the respondents/appellants on cross-appeal.

[Quicklaw note: Please see complete list of solicitors appended at the end of the judgment.]

The judgment of the Court was delivered by

1 **McLACHLIN C.J.**-- This appeal requires us to decide when a class action may be brought. While the class action has existed in one form or another for hundreds of years, its importance has increased of late. Particularly in complicated cases implicating the interests of many people, the class action may provide the best means of fair and efficient resolution. Yet absent legislative direction, there remains considerable uncertainty as to the conditions under which a court should permit a class action to be maintained.

2 The claimants wanted to immigrate to Canada. To qualify, they invested money in Western Canadian Shopping Centres Inc. ("WCSC"), under the Canadian government's Business Immigration Program. They lost money and brought a class action. The defendants (appellants) claim the class action is inappropriate and ask the Court to strike it out. For the following reasons, I conclude that the claimants may proceed as a class.

I. Facts

3 The representative plaintiffs Muh-Min Lin and Hoi-Wah Wu, together with 229 other investors, became participants in the government's Business Immigration Program of Employment and Immigration Canada by purchasing debentures in WCSC. WCSC was incorporated by Joseph Dutton, its

sole shareholder, for the purpose of "facilitat[ing] the qualification of the Investors, their spouses, and their never-married children as Canadian permanent residents."

4 WCSC solicited funds through two offerings "to invest in land located in the Province of Saskatchewan for the purpose of developing commercial, non-residential, income-producing properties". The offering memoranda provided that the subscription proceeds would be deposited with an escrow agent, later designated as The Royal Trust Company ("Royal Trust"), and would be released to WCSC upon conditions, subsequently amended.

5 The dispute arises from events after the investors' funds had been deposited with Royal Trust. In May 1990, WCSC entered into a Purchase and Development Agreement ("PDA") with Claude Resources Inc. ("Claude") under which WCSC purchased from Claude, for $5,550,000, the rights to a Crown surface lease adjacent to Claude's "Seabee" gold deposits in northern Saskatchewan. WCSC also agreed to commit a further $16.5 million for surface improvements and for the construction of a gold mill, which would be owned by WCSC. A lease agreement executed in tandem with the PDA leased the not-yet-constructed gold mill and related facilities, together with the surface lands, back to Claude. The payments required of Claude under that lease agreement matched the semi-annual interest payments required of WCSC with respect to the investors.

6 To finance WCSC's obligations under the PDA with Claude, Dutton directed Royal Trust to issue debentures in an aggregate principal amount of $22,050,000 to a subset of the investors who had subscribed by that point. Royal Trust did so by issuing "Series A" debentures to 142 investors. After the debentures were issued, WCSC distributed an update letter to its investors, describing the investment in Claude.

7 In a separate series of transactions executed around the same time, Dutton and Claude entered into an agreement by which (1) Dutton effectively conveyed to Claude 49 percent of his shares in WCSC; (2) Claude paid Dutton $1.6 million in cash; (3) Claude advanced Dutton a $1.6 million non-recourse loan; (4) Dutton entered into an employment contract with Claude for a salary of $50,000 per year; and (5) Claude and Dutton's management company, J.M.D. Management Ltd., entered into a management contract for $200,000 per year. It appears that WCSC did not distribute an update letter to its investors describing this series of transactions.

8 Over the next months, Dutton advanced more funds to Claude and directed Royal Trust to issue corresponding debentures. Of particular relevance to the instant dispute are the Series E debentures issued in December 1990 (aggregate principal of $2.56 million), and the Series F debentures issued in May 1991 (aggregate principal of $9.45 million). When the Series E debentures were issued, the Series A and E debentures were pooled, so that investors in those series became entitled to a pro rata claim on the total security pledged with respect to the two series. When the Series F debentures were issued, the security for that series was pooled with the security that had been pledged with respect to the Series A and E debentures. WCSC apparently distributed investor update letters after the issuance of the Series E and F debentures, just as it had done after the issuance of the Series A debentures.

9 In December 1991, Claude announced that it could not pay the interest due on the Series A, E, and F debentures and Muh-Min Lin and Hoi-Wah Wu commenced this action. The gravamen of the complaint is that Dutton and various affiliates and advisors of WCSC breached fiduciary duties to the investors by mismanaging or misdirecting their funds.

II. Statutory Provisions

10 Alberta Rules of Court, Alta. Reg. 390/68

> 42 Where numerous persons have a common interest in the subject of an intended action, one or more of those persons may sue or be sued or may be authorized by the Court to defend on behalf of or for the benefit of all.
>
> 129(1) The court may at any stage of the proceedings order to be struck out or amended any pleading in the action, on the ground that
>
> (a) it discloses no cause of action or defence, as the case may be, or
> (b) it is scandalous, frivolous or vexatious, or
> (c) it may prejudice, embarrass or delay the fair trial of the action, or
> (d) it is otherwise an abuse of the process of the court,
>
> and may order the action to be stayed or dismissed or judgment to be entered accordingly.
>
> (2) No evidence shall be admissible on an application under clause (a) of subrule (1).
> (3) This Rule, so far as applicable, applies to an originating notice and a petition.
>
> 187 A person for whose benefit an action is prosecuted or defended or the assignor of a chose in action upon which the action is brought, shall be regarded as a party thereto for the purposes of discovery of documents.
>
> 201 A member of a firm which is a party and a person for whose benefit an action is prosecuted or defended shall be regarded as a party for the purposes of examination.

III. Decisions

11 The appellants applied to the Court of Queen's Bench of Alberta (1996), 41 Alta. L.R. (3d) 412 for a declaration and order striking that portion of the Amended Statement of Claim in which the individual plaintiffs purport, pursuant to Rule 42 of the Alberta Rules of Court, to represent a class of 231 investors. The chambers judge identified four issues: (1) whether the court had the power under Rule 42 to strike the investors' claim to sue in a representative capacity; (2) whether the court was restricted to considering only the Amended Statement of Claim filed; (3) the standard of proof required to compel the court to exercise its discretion to strike the representative claim; and (4) whether, in this case, this standard was met.

12 On the first issue, the chambers judge relied on the decision of Master Funduk in 353850 Alberta Ltd. v. Horne & Pitfield Foods Ltd., [1989] A.J. No. 652 (QL), to conclude that the court has the power, under Rule 42, to strike a claim made by plaintiffs to sue in a representative capacity.

13 On the second issue, the chambers judge held that the court need not limit its inquiry to the pleadings, relying on 353850 Alberta, supra, and on the decision of the British Columbia Supreme Court in Shaw v. Real Estate Board of Greater Vancouver (1972), 29 D.L.R. (3d) 774. He con-

cluded, however, that resolution of the case before him did not require resort to the affidavit evidence.

14 On the third issue, the chambers judge concluded that the court should strike a representative claim under Rule 42 only if it is "entirely clear" or "beyond doubt" or "plain and obvious" that the claim is deficient -- the standard applied to applications to strike pleadings for disclosing no reasonable claim: Hunt v. Carey Canada Inc., [1990] 2 S.C.R. 959.

15 On the final issue, the chambers judge, applying the "plain and obvious" rule, concluded that the Amended Statement of Claim was not deficient under Rule 42 and met the requirements set out in Korte v. Deloitte, Haskins & Sells (1993), 8 Alta. L.R. (3d) 337 (C.A.): (1) that the class be capable of clear and definite definition; (2) that the principal issues of law and fact be the same; (3) that one plaintiff's success would necessarily mean success for all members of the plaintiff class; and (4) that the resolution of the dispute not require any individual assessment of the claims of individual class members. However, he left the matter open to review by the trial judge.

16 The Alberta Court of Appeal, per Russell J.A. (for the majority), dismissed the appeal, Picard J.A., dissenting: (1998), 73 Alta. L.R. (3d) 227. The majority rejected the argument that the chambers judge should have conclusively resolved the Rule 42 issue rather than left it open to the trial judge, citing Oregon Jack Creek Indian Band v. Canadian National Railway Co., [1989] 2 S.C.R. 1069, in which this Court left to the trial judge the issue of whether the plaintiffs were authorized to sue on behalf of a broader class. The majority also rejected the argument that the investors must show individual reliance to succeed. However, it granted the defendants the right to discovery from each of the 231 plaintiffs on the grounds that Rule 201, read with Rule 187, allows discovery from any person for whose benefit an action is prosecuted or defended and that the defendants should not be barred from developing an argument based on actual reliance merely because it was speculative.

17 Picard J.A., would have allowed the appeal. In her view, the Chambers judge erred in deferring the matter to the trial judge because, unlike Oregon Jack Creek, the case was narrow and "a great deal of relevant evidence was available to the court to allow it to make a decision" (p. 235). The need to show individual reliance was only one of many problems that the investors would face if allowed to proceed as a class. Citing this Court's decisions in Lac Minerals Ltd. v. International Corona Resources Ltd., [1989] 2 S.C.R. 574, and Hodgkinson v. Simms, [1994] 3 S.C.R. 377, she concluded that "[t]he extent of fiduciary duties in a particular case requires a meticulous examination of the facts, particularly of any contract between the parties" (p. 237). She concluded that "[t]his responsibility of proof by the [investors] cannot possibly be met by a representative action nor by giving a right of discovery of the 229 other parties to the action" (p. 237).

IV. Issues

18 1. Did the courts below apply the proper standard in determining whether the investors had satisfied the requirements for a class action under Rule 42?

2. Did the courts below err in denying defendants' motion to strike under Rule 42?
3. If the class action is allowed, should the defendants have the right to full oral and documentary discovery of all class members?

V. Analysis

A. The History and Functions of Class Actions

19 The class action originated in the English courts of equity in the late seventeenth and early eighteenth centuries. The courts of law focussed on individual questions between the plaintiff and the defendant. The courts of equity, by contrast, applied a rule of compulsory joinder, requiring all those interested in the subject matter of the dispute to be made parties. The aim of the courts of equity was to render "complete justice" -- that is, to "arrang[e] all the rights, which the decision immediately affects": F. Calvert, A Treatise Upon the Law Respecting Parties to Suits in Equity (2nd ed. 1847), at p. 3; see also C. A. Wright, A. R. Miller and M. K. Kane, Federal Practice and Procedure (2nd ed. 1986), at s. 1751; J. Story, Equity Pleadings (10th ed. 1892), at s. 76a. The compulsory-joinder rule "allowed the Court to examine every facet of the dispute and thereby ensure that no one was adversely affected by its decision without first having had an opportunity to be heard": J. A. Kazanjian, "Class Actions in Canada" (1973), 11 Osgoode Hall L.J. 397, at p. 400. The rule possessed the additional advantage of preventing a multiplicity of duplicative proceedings.

20 The compulsory-joinder rule eventually proved inadequate. Applied to conflicts between tenants and manorial lords or between parsons and parishioners, it closed the door to the courts where interested parties in such cases were too numerous to be joined. The courts of equity responded by relaxing the compulsory-joinder rule where strict adherence would work injustice. The result was the representative action. For example, in Chancey v. May (1722), Prec. Ch. 592, 24 E.R. 265, members of a partnership were permitted to sue on behalf of themselves and some 800 other partners for misapplication and embezzlement of funds by the partnership's former treasurer and manager. The court allowed the action because "it was in behalf of themselves, and all others the proprietors of the same undertaking, except the defendants, and so all the rest were in effect parties," and because "it would be impracticable to make them all parties by name, and there would be continual abatements by death and otherwise, and no coming at justice, if all were to be made parties" (p. 265); see also Kazanjian, supra, at p. 401; G. T. Bispham, The Principles of Equity (9th ed. 1916), at para. 415; S. C. Yeazell, "Group Litigation and Social Context: Toward a History of the Class Action" (1977), 77 Colum. L. Rev. 866, at pp. 867 and 872; J. K. Bankier, "Class Actions for Monetary Relief in Canada: Formalism or Function?" (1984), 4 Windsor Y.B. Access Just. 229, at p. 236.

21 The representative or class action proved useful in pre-industrial English commercial litigation. The modern limited-liability company had yet to develop, and collectives of business people had no independent legal existence. Satisfying the compulsory-joinder rule would have required a complainant to bring before the court each member of the collective. The representative action provided the solution to this difficulty: see Kazanjian, supra, at p. 401; Yeazell, supra, at p. 867; City of London v. Richmond (1701), 2 Vern. 421, 23 E.R. 870 (allowing the plaintiff to sue trustees for rent owed, though the beneficiaries of the trust were not joined).

22 The class action required a common interest between the class members. Many of the early representative actions were brought in the form of "bills of peace", which could be maintained where the interested individuals were numerous, all members of the group possessed a common interest in the question to be adjudicated, and the representatives could be expected fairly to advocate the interests of all members of the group: see Wright, Miller and Kane, supra, at para. 1751; Z. Chafee, Some Problems of Equity (1950), at p. 201, T. A. Roberts, The Principles of Equity (3rd ed. 1877), at pp. 389-92; Bispham, supra, at para. 417.

23 The courts of equity applied a liberal and flexible approach to whether a class action could proceed. They "continually sought a proper balance between the interests of fairness and effi-

ciency": Kazanjian, supra, at p. 411. As stated in Wallworth v. Holt (1841), 4 My. & Cr. 619, 41 E.R. 238, at p. 244, "it [is] the duty of this Court to adapt its practice and course of proceeding to the existing state of society, and not by too strict an adherence to forms and rules, established under different circumstances, to decline to administer justice, and to enforce rights for which there is no other remedy".

24 This flexible and generous approach to class actions prevailed until the fusion of law and equity under the Supreme Court of Judicature Act, 1873 (U.K.), 36 & 37 Vict., c. 66, and the adoption of Rule 10 of the Rules of Procedure:

> 10. Where there are numerous parties having the same interest in one action, one or more of such parties may sue or be sued, or may be authorised by the Court to defend in such action, on behalf or for the benefit of all parties so interested.

While early cases under the new rules maintained a liberal approach to class actions (see, e.g., Duke of Bedford v. Ellis, [1901] A.C. 1 (H.L.); Taff Vale Railway Co. v. Amalgamated Society of Railway Servants, [1901] A.C. 426 (H.L.)), later cases sometimes took a restrictive approach (see, e.g., Markt & Co. v. Knight Steamship Co., [1910] 2 K.B. 1021 (C.A.)). This, combined with the widespread use of limited-liability companies, resulted in fewer class actions being brought.

25 The class action did not forever languish, however. Conditions emerged in the latter part of the twentieth century that once again invoked its utility. Mass production and consumption revived the problem that had motivated the development of the class action in the eighteenth century -- the problem of many suitors with the same grievance. As in the eighteenth century, insistence on individual representation would often have precluded effective litigation. And, as in the eighteenth century, the class action provided the solution.

26 The class action plays an important role in today's world. The rise of mass production, the diversification of corporate ownership, the advent of the mega-corporation, and the recognition of environmental wrongs have all contributed to its growth. A faulty product may be sold to numerous consumers. Corporate mismanagement may bring loss to a large number of shareholders. Discriminatory policies may affect entire categories of employees. Environmental pollution may have consequences for citizens all over the country. Conflicts like these pit a large group of complainants against the alleged wrongdoer. Sometimes, the complainants are identically situated vis-à-vis the defendants. In other cases, an important aspect of their claim is common to all complainants. The class action offers a means of efficiently resolving such disputes in a manner that is fair to all parties.

27 Class actions offer three important advantages over a multiplicity of individual suits. First, by aggregating similar individual actions, class actions serve judicial economy by avoiding unnecessary duplication in fact-finding and legal analysis. The efficiencies thus generated free judicial resources that can be directed at resolving other conflicts, and can also reduce the costs of litigation both for plaintiffs (who can share litigation costs) and for defendants (who need litigate the disputed issue only once, rather than numerous times): see W. K. Branch, Class Actions in Canada (1998), at para. 3.30; M. A. Eizenga, M. J. Peerless and C. M. Wright, Class Actions Law and Practice (1999), at para. 1.6; Bankier, supra, at pp. 230-31; Ontario Law Reform Commission, Report on Class Actions (1982), at pp. 118-19.

28 Second, by allowing fixed litigation costs to be divided over a large number of plaintiffs, class actions improve access to justice by making economical the prosecution of claims that would otherwise be too costly to prosecute individually. Without class actions, the doors of justice remain closed to some plaintiffs, however strong their legal claims. Sharing costs ensures that injuries are not left unremedied: see Branch, supra, at para. 3.40; Eizenga, Peerless and Wright, supra, at para. 1.7; Bankier, supra, at pp. 231-32; Ontario Law Reform Commission, supra, at pp. 119-22.

29 Third, class actions serve efficiency and justice by ensuring that actual and potential wrongdoers do not ignore their obligations to the public. Without class actions, those who cause widespread but individually minimal harm might not take into account the full costs of their conduct, because for any one plaintiff the expense of bringing suit would far exceed the likely recovery. Cost-sharing decreases the expense of pursuing legal recourse and accordingly deters potential defendants who might otherwise assume that minor wrongs would not result in litigation: see "Developments in the Law -- The Paths of Civil Litigation: IV. Class Action Reform: An Assessment of Recent Judicial Decisions and Legislative Initiatives" (2000), 113 Harv. L. Rev. 1806, at pp. 1809-10; see Branch, supra, at para. 3.50; Eizenga, Peerless and Wright, supra, at para. 1.8; Bankier, supra, at p. 232; Ontario Law Reform Commission, supra, at pp. 11 and 140-46.

B. The Test for Class Actions

30 In recognition of the modern importance of representative litigation, many jurisdictions have enacted comprehensive class action legislation. In the United States, Federal Rules of Civil Procedure, 28 U.S.C.A. para. 23 (introduced in 1938 and substantially amended in 1966) addressed aspects of class action practice, including certification of litigant classes, notice, and settlement. The English procedural rules of 1999 include detailed provisions governing "Group Litigation": United Kingdom, Civil Procedure Rules 1998, SI 1998/3132, rr. 19.10-19.15. And in Canada, the provinces of British Columbia, Ontario, and Quebec have enacted comprehensive statutory schemes to govern class action practice: see British Columbia Class Proceedings Act, R.S.B.C. 1996, c. 50; Ontario Class Proceedings Act, 1992, S.O. 1992, c. 6; Quebec Code of Civil Procedure, R.S.Q., c. C-25, Book IX. Yet other Canadian provinces, including Alberta and Manitoba, are considering enacting such legislation: see Manitoba Law Reform Commission, Report #100, Class Proceedings (January 1999); Alberta Law Reform Institute, Final Report No. 85, Class Actions (December 2000); see also R. Rogers, "A Uniform Class Actions Statute", Appendix O to the Proceedings of the 1995 Meeting of The Uniform Law Conference of Canada.

31 Absent comprehensive codes of class action procedure, provincial rules based on Rule 10, Schedule, of the English Supreme Court of Judicature Act, 1873 govern. This is the case in Alberta, where class action practice is governed by Rule 42 of the Alberta Rules of Court:

> 42 Where numerous persons have a common interest in the subject of an intended action, one or more of those persons may sue or be sued or may be authorized by the Court to defend on behalf of or for the benefit of all.

The intention of the Alberta legislature is clear. Class actions may be brought. Details of class action practice, however, are largely left to the courts.

32 Alberta's Rule 42 does not specify what is meant by "numerous" or by "common interest". It does not say when discovery may be made of class members other than the representative. Nor does it specify how notice of the suit should be conveyed to potential class members, or how a court

should deal with the possibility that some potential class members may desire to "opt out" of the class. And it does not provide for costs, or for the distribution of the fund should an action for money damages be successful.

33 Clearly, it would be advantageous if there existed a legislative framework addressing these issues. The absence of comprehensive legislation means that courts are forced to rely heavily on individual case management to structure class proceedings. This taxes judicial resources and denies the parties ex ante certainty as to their procedural rights. One of the main weaknesses of the current Alberta regime is the absence of a threshold "certification" provision. In British Columbia, Ontario, and Quebec, a class action may proceed only after the court certifies that the class and representative meet certain requirements. In Alberta, by contrast, courts effectively certify ex post, only after the opposing party files a motion to strike. It would be preferable if the appropriateness of the class action could be determined at the outset by certification.

34 Absent comprehensive legislation, the courts must fill the void under their inherent power to settle the rules of practice and procedure as to disputes brought before them: Bell v. Wood, [1927] 1 W.W.R. 580 (B.C.S.C.), at pp. 581-82; Langley v. North West Water Authority, [1991] 3 All E.R. 610 (C.A.), leave denied [1991] 1 W.L.R. 711n (H.L.); Newfoundland Association of Public Employees v. Newfoundland (1995), 132 Nfld. & P.E.I.R. 205 (Nfld. S.C.T.D.); W. A. Stevenson and J. E. Côté, Civil Procedure Guide, 1996, at p. 4. However desirable comprehensive legislation on class action practice may be, if such legislation has not been enacted, the courts must determine the availability of the class action and the mechanics of class action practice.

35 Alberta courts moved to fill the procedural vacuum in Korte, supra. Korte prescribed four conditions for a class action: (1) the class must be capable of clear and definite definition; (2) the principal issues of fact and law must be the same; (3) success for one of the plaintiffs must mean success for all; and (4) no individual assessment of the claims of individual plaintiffs need be made.

36 The Korte criteria loosely parallel the criteria applied in other Canadian jurisdictions in which comprehensive class-action legislation has yet to be enacted: see, e.g., Ranjoy Sales and Leasing Ltd. v. Deloitte, Haskins and Sells, [1984] 4 W.W.R. 706 (Man. Q.B.); International Capital Corp. v. Schafer (1995), 130 Sask. R. 23 (Q.B.); Guarantee Co. of North America v. Caisse populaire de Shippagan Ltée (1988), 86 N.B.R. (2d) 342 (Q.B.); Lee v. OCCO Developments Ltd. (1994), 148 N.B.R. (2d) 321 (Q.B.); Van Audenhove v. Nova Scotia (Attorney General) (1994), 134 N.S.R. (2d) 294 (S.C.), at para. 7; Horne v. Canada (Attorney General) (1995), 129 Nfld. & P.E.I.R. 109 (P.E.I.S.C.), at para. 24.

37 The Korte criteria also bear resemblance to the class-certification criteria in the British Columbia, Ontario, and Quebec class action statutes. Under the British Columbia and Ontario statutes, an action will be certified as a class proceeding if (1) the pleadings or the notice of application disclose a cause of action; (2) there is an identifiable class of two or more persons that would be represented by the class representative; (3) the claims or defences of the class members raise common issues (in British Columbia, "whether or not those common issues predominate over issues affecting only individual members"); (4) a class proceeding would be the preferable procedure for the resolution of common issues; and (5) the class representative would fairly represent the interests of the class, has advanced a workable method of advancing the proceeding and notifying class members, and does not have, on the common issues for the class, an interest in conflict with other class members: see Ontario Class Proceedings Act, 1992, s. 5(1); British Columbia Class Proceedings Act, s. 4(1). Under the Quebec statute, an action will be certified as a class proceeding if (1) the recourses

of the class members raise identical, similar, or related questions of law or fact; (2) the alleged facts appear to warrant the conclusions sought; (3) the composition of the group makes joinder impracticable; and (4) the representative is in a position to adequately represent the interests of the class members: see Quebec Code of Civil Procedure, art. 1003.

38 While there are differences between the tests, four conditions emerge as necessary to a class action. First, the class must be capable of clear definition. Class definition is critical because it identifies the individuals entitled to notice, entitled to relief (if relief is awarded), and bound by the judgment. It is essential, therefore, that the class be defined clearly at the outset of the litigation. The definition should state objective criteria by which members of the class can be identified. While the criteria should bear a rational relationship to the common issues asserted by all class members, the criteria should not depend on the outcome of the litigation. It is not necessary that every class member be named or known. It is necessary, however, that any particular person's claim to membership in the class be determinable by stated, objective criteria: see Branch, supra, at paras. 4.190-4.207; Friedenthal, Kane and Miller, Civil Procedure (2nd ed. 1993), at pp. 726-27; Bywater v. Toronto Transit Commission (1998), 27 C.P.C. (4th) 172 (Ont. Ct. (Gen. Div.)), at paras. 10-11.

39 Second, there must be issues of fact or law common to all class members. Commonality tests have been a source of confusion in the courts. The commonality question should be approached purposively. The underlying question is whether allowing the suit to proceed as a representative one will avoid duplication of fact-finding or legal analysis. Thus an issue will be "common" only where its resolution is necessary to the resolution of each class member's claim. It is not essential that the class members be identically situated vis-à-vis the opposing party. Nor is it necessary that common issues predominate over non-common issues or that the resolution of the common issues would be determinative of each class member's claim. However, the class members' claims must share a substantial common ingredient to justify a class action. Determining whether the common issues justify a class action may require the court to examine the significance of the common issues in relation to individual issues. In doing so, the court should remember that it may not always be possible for a representative party to plead the claims of each class member with the same particularity as would be required in an individual suit.

40 Third, with regard to the common issues, success for one class 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. A class action should not be allowed if class members have conflicting interests.

41 Fourth, the class representative must adequately represent the class. In assessing whether the proposed representative is adequate, the court may look to the motivation of the representative, the competence of the representative's counsel, and the capacity of the representative to bear any costs that may be incurred by the representative in particular (as opposed to by counsel or by the class members generally). The proposed representative need not be "typical" of the class, nor the "best" possible representative. The court should be satisfied, however, that the proposed representative will vigorously and capably prosecute the interests of the class: see Branch, supra, at paras. 4.210-4.490; Friedenthal, Kane and Miller, supra, at pp. 729-32.

42 While the four factors outlined must be met for a class action to proceed, their satisfaction does not mean that the court must allow the action to proceed. Other factors may weigh against allowing the action to proceed in representative form. The defendant may wish to raise different defences with respect to different groups of plaintiffs. It may be necessary to examine each class

member in discovery. Class members may raise important issues not shared by all members of the class. Or the proposed class may be so small that joinder would be a better solution. Where such countervailing factors exist, the court has discretion to decide whether the class action should be permitted to proceed, notwithstanding that the essential conditions for the maintenance of a class action have been satisfied.

43 The class action codes that have been adopted by British Columbia and Ontario offer some guidance as to factors that would generally not constitute arguments against allowing an action to proceed as a representative one. Both state that certification should not be denied on the grounds that: (1) the relief claimed includes a demand for money damages that would require individual assessment after determination of the common issues; (2) the relief claimed relates to separate contracts involving different members of the class; (3) different class members seek different remedies; (4) the number of class members or the identity of every class member is unknown; or (5) the class includes subgroups that have claims or defences that raise common issues not shared by all members of the class: see Ontario Class Proceedings Act, 1992, s. 6; British Columbia Class Proceedings Act, s. 7; see also Alberta Law Reform Institute, supra, at pp. 75-76. Common sense suggests that these factors should no more bar a class action suit in Alberta than in Ontario or British Columbia.

44 Where the conditions for a class action are met, the court should exercise its discretion to disallow it for negative reasons in a liberal and flexible manner, like the courts of equity of old. The court should take into account the benefits the class action offers in the circumstances of the case as well as any unfairness that class proceedings may cause. In the end, the court must strike a balance between efficiency and fairness.

45 The need to strike a balance between efficiency and fairness belies the suggestion that a class action should be struck only where the deficiency is "plain and obvious", as the Chambers judge held. Unlike Rule 129, which is directed at the question of whether the claim should be prosecuted at all, Rule 42 is directed at the question of how the claim should be prosecuted. The "plain and obvious" standard is appropriate where the result of striking is to forever end the action. It recognizes that a plaintiff "should not be 'driven from the judgment seat' at this very early stage unless it is quite plain that his alleged cause of action has no chance of success": Drummond-Jackson v. British Medical Association, [1970] 1 All E.R. 1094 (C.A.), at p. 1102 (quoted in Hunt, supra, at pp. 974-75). Denial of class status under Rule 42, by contrast, does not defeat the claim. It merely places the plaintiffs in the position of any litigant who comes before the court in his or her individual capacity. Moreover, nothing in Alberta's rules suggests that class actions should be disallowed only where it is plain and obvious that the action should not proceed as a representative one. Rule 42 and the analogous rules in other provinces merely state that a representative may maintain a class action if certain conditions are met.

46 The need to strike a balance between efficiency and fairness also belies the suggestion that class actions should be approached restrictively. The defendants argue that General Motors of Canada Ltd. v. Naken, [1983] 1 S.C.R. 72, precludes a generous approach to class actions. I respectfully disagree. First, when Naken was decided, the modern class action was very much an untested procedure in Canada. In the intervening years, the importance of the class action as a procedural tool in modern litigation has become manifest. Indeed, the reform that has been effected since Naken has been motivated in large part by the recognition of the benefits that class actions can offer the parties, the court system, and society: see, e.g., Ontario Law Reform Commission, supra, at pp. 3-4.

47 Second, Naken on its facts invited caution. The action was brought on behalf of all persons who purchased new 1971 or 1972 Firenza motor vehicles in Ontario. The complaint was that General Motors had misrepresented the quality of the vehicles and that the vehicles "were not reasonably fit for use" (p. 76). The statement of claim alleged breach of warranty and breach of representation, and sought $1,000 in damages for each of approximately 4,600 plaintiffs. Estey J., writing for a unanimous Court, disallowed the class action. While each plaintiff raised the same claims against the defendant, the resolution of those claims would have required particularized evidence and fact-finding at both the liability and damages stages of the litigation. Far from avoiding needless duplication, a class action would have unnecessarily complicated the resolution of what amounted to 4,600 individual claims.

48 To summarize, class actions should be allowed to proceed under Alberta's Rule 42 where the following conditions are met: (1) the class is capable of clear definition; (2) there are issues of fact or law common to all class members; (3) success for one class member means success for all; and (4) the proposed representative adequately represents the interests of the class. If these conditions are met the court must also be satisfied, in the exercise of its discretion, that there are no countervailing considerations that outweigh the benefits of allowing the class action to proceed.

49 Other procedural issues may arise. One is notice. A judgment is binding on a class member only if the class member is notified of the suit and is given an opportunity to exclude himself or herself from the proceeding. This case does not raise the issue of what constitutes sufficient notice. However, prudence suggests that all potential class members be informed of the existence of the suit, of the common issues that the suit seeks to resolve, and of the right of each class member to opt out, and that this be done before any decision is made that purports to prejudice or otherwise affect the interests of class members.

50 Another procedural issue that may arise is how to deal with non-common issues. The court retains discretion to determine how the individual issues should be addressed, once common issues have been resolved: see Branch, supra, at para. 18.10. Generally, individual issues will be resolved in individual proceedings. However, as under the legislation of British Columbia, Ontario, and Quebec, a court may specify special procedures that it considers necessary or useful: see Ontario Class Proceedings Act, 1992, s. 25; British Columbia Class Proceedings Act, s. 27; Quebec Code of Civil Procedure, art. 1039.

51 The diversity of class actions makes it difficult to anticipate all of the procedural complexities that may arise. In the absence of comprehensive class-action legislation, courts must address procedural complexities on a case-by-case basis. Courts should approach these issues as they do the question of whether a class action should be allowed: in a flexible and liberal manner, seeking a balance between efficiency and fairness.

C. Whether the Investors Have Satisfied Rule 42

52 The four conditions to the maintenance of a class action are satisfied here. First, the class is clearly defined. The respondents Lin and Wu represent themselves and "[229 other] immigrant investors ... who each invested at least the sum of $150,000.00 into a fund totalling $34,065,000.00, the said sum to be managed, administered and secured by ... Western Canadian Shopping Centres Inc.". Who falls within the class can be ascertained on the basis of documentary evidence that the parties have put before the court. Second, common issues of fact and law unite all members of the class. The essence of the investors' complaint is that the defendants owed them fiduciary duties

which they breached. While the investors' Amended Statement of Claim alludes to claims in negligence and misrepresentation, counsel for the investors undertook in argument before this Court to abandon all but the fiduciary duty claims. Third, at this stage of the proceedings, it appears that resolving one class member's breach of fiduciary claim would effectively resolve the claims of every class member. As a result of security-pooling agreements effected by WCSC, each investor now has an interest, proportional to his or her investment, in the same underlying security. Finally, the representative plaintiffs are appropriate.

53 The defendants argue that the proposed suit is not amenable to prosecution as a class action because: (1) there are in fact multiple classes of plaintiffs; (2) the defendants will raise multiple defences to different causes of action advanced against different defendants; and (3) in order to prevail, the investors must show actual reliance on the part of each class member. I find these arguments unpersuasive.

54 The defendants' contention that there are multiple classes of plaintiffs is unconvincing. No doubt, differences exist. Different investors invested at different times, in different jurisdictions, on the basis of different offering memoranda, through different agents, in different series of debentures, and learned about the underlying events through different disclosure documents. Some investors may possess rescissionary rights that others do not. The fact remains, however, that the investors raise essentially the same claims requiring resolution of the same facts. While it may eventually emerge that different subgroups of investors have different rights against the defendants, this possibility does not necessarily defeat the investors' right to proceed as a class. If material differences emerge, the court can deal with them when the time comes.

55 The defendants' contention that the investors should not be permitted to sue as a class because each must show actual reliance to establish breach of fiduciary duty also fails to convince. In recent decades fiduciary obligations have been applied in new contexts, and the full scope of their application remains to be precisely defined. The fiduciary duty issues raised here are common to all the investors. A class action should not be foreclosed on the ground that there is uncertainty as to the resolution of issues common to all class members. If it is determined that the investors must show individual reliance, the court may then consider whether the class action should continue.

56 The same applies to the contention that different defences will be raised with respect to different class members. Simply asserting this possibility does not negate a class action. If and when different defences are asserted, the court may solve the problem or withdraw leave to proceed as a class.

57 I conclude that the basic conditions for a class action are met and that efficiency and fairness favour permitting it to proceed.

D. Cross-Appeal

58 The investors take issue on cross-appeal with the Court of Appeal's allowance of individualized discovery from each class member. The Court of Appeal held that the defendants are entitled, under Rules 187 and 201, to examination and discovery of each member of the class. The investors argue that the question of whether discovery should be allowed from each class member is a question best left to a case management judge appointed pursuant to the Alberta Rules of Court Binder, Practice Note No. 7.

59 I agree that allowing individualized discovery at this stage of the proceedings would be premature. One of the benefits of a class action is that discovery of the class representatives will usually suffice and make unnecessary discovery of each individual class member. Cases where individual discovery is required of all class members are the exception rather than the rule. Indeed, the necessity of individual discovery may be a factor weighing against allowing the action to proceed in representative form.

60 I would allow the defendants to examine the representative plaintiffs as of right. Thereafter, examination of other class members should be available only by order of the court, upon the defendants showing reasonable necessity.

VI. Conclusion

61 For the foregoing reasons, I would dismiss the appeal and allow the investors to proceed as a class. I would allow the cross-appeal.

62 Costs of the appeal and cross-appeal are to the respondents.

Solicitors for the appellant/respondent on cross-appeal The Royal Trust Company: Burnet, Duckworth & Palmer, Calgary.
Solicitors for the appellants/respondents on cross-appeal James G. Engdahl, William R. MacNeill, Jon R. MacNeill, Gary L. Billingsley, R. Byron Henderson: McLennan Ross, Edmonton.
Solicitors for the appellant/respondent on cross-appeal C. Michael Ryer: Peacock Linder & Halt, Calgary.
Solicitors for the appellant/respondent on cross-appeal Peter K. Gummer: Brownlee Fryett, Edmonton.
Solicitors for the appellants/respondents on cross-appeal Ernst & Young and Alan Lundell: Parlee McLaws, Edmonton.

Solicitors for the appellants/respondents on cross-appeal Bennett Jones Verchere and Garnet Schulhauser: Gowling Lafleur Henderson, Calgary.
Solicitors for the appellant/respondent on cross-appeal Arthur Andersen & Co.: Lucas Bowker & White, Edmonton.
Solicitors for the respondents/appellants on cross-appeal: Durocher Simpson, Edmonton.

cp/e/qllls

Tab 31

BETTER LATE THAN NEVER: NOTICE AND OPT OUT AT THE SETTLEMENT STAGE OF CLASS ACTIONS

GEORGE RUTHERGLEN*

Whether the Due Process Clause requires individual notice to class action members has not yet been resolved by the Supreme Court. Under the literal terms of Rule 23, however, courts currently require early individual notice in (b)(3) class actions, while leaving notice to the discretion of the trial court in (b)(1) and (b)(2) actions. In this Article, Professor Rutherglen questions the difference in procedural protections afforded to (b)(3) class members, on the one hand, and (b)(1) and (b)(2) class members, on the other. Arguing that effective notice need not meet the rigorous standard of early individual notice in (b)(3) class actions, Professor Rutherglen suggests a new rule that would give class members the right to receive individual notice later in the proceeding, and, at least for (b)(3) class members, the right to opt out at the settlement stage. Such a rule would better protect class members because it would provide notice at a time when information about the merits of the claim is more readily available. It also would empower class members to register their dissatisfaction with the performance of the class attorney by opting out. Where previous scholarship emphasizes the procedural dimensions of notice and the right to opt out under the Due Process Clause, Professor Rutherglen emphasizes the substantive aspects of the right to opt out. He stresses the importance of making substantive changes in the law that would provide for better management of both large class actions and related individual claims.

INTRODUCTION

Almost all class actions sooner or later result in notice to the class. If notice is not given sooner, as it is in class actions certified under Rule 23(b)(3), then it must be given later, at least before approval of a settlement under Rule 23(e) or at the remedy stage to distribute compensatory relief to members of the class. Notice early in the class action, of course, has been controversial, particularly on the issue of whether it serves any purpose at all. What can we learn from notice later in the class action, at the settlement or remedy stage? I will argue that we can learn three things.

First, effective notice need not meet the rigorous standard of "individual notice to all members who can be identified through reason-

* O.M. Vicars Professor of Law and F. Palmer Weber Research Professor, University of Virginia. A.B., 1971, J.D., 1974, University of California, Berkeley. I would like to thank participants at a conference on class actions at New York University School of Law and at a workshop at University of Virginia School of Law for their comments on an earlier draft of this Article.

able effort," as required in (b)(3) class actions.[1] Practice in (b)(1) and (b)(2) class actions reveals that less expensive forms of notice, most often by publication targeted at the plaintiff class, can be effective in giving most class members an opportunity to object to the terms of settlement or to obtain individual relief.

Second, procedures designed to protect the class must be distinguished from procedures designed to protect the opponent of the class. Notice and the right to opt out are designed to protect the rights of class members. Yet these procedural requirements have been invoked most often by defendants in order to defeat any attempt to certify a class at all. It is both odd and ironic that the defendant has become the principal advocate of the class members' rights. Surely a better means of protecting the interests of the class can be found than by relying upon the interests of its adversary.

This problem leads to the third lesson to be learned from notice at the settlement or remedy stage of a class action. Through the rules on preclusion of class members' claims, the class members' right to notice and to opt out has been conflated with the defendant's right to obtain a judgment binding on the class. Under present law, early notice to class members in (b)(3) class actions is justified principally as a condition for making any judgment in favor of the defendant binding upon the class. Rule 23 does not have to operate this way, and indeed, in its original version, it did not. Rule 23 originally allowed one-way intervention: giving notice to class members and binding them by the judgment in a class action only if the judgment was rendered in favor of the class.[2] This procedure left class members with the option of benefiting from the class action if the class prevailed but escaping the effects of preclusion if it did not. The 1966 amendments to Rule 23 were an attempt to eliminate one-way intervention by requiring an early decision on certification of a class action followed by either of two procedures: early individual notice and the right to opt out (in (b)(3) class actions) or no early notice and no right to opt out (in (b)(1) and (b)(2) class actions).[3] If the original version of Rule 23 went too far in allowing one-way intervention, the 1966 amendments

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[1] Fed. R. Civ. P. 23(c)(2) ("In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort.").

[2] 7A Charles A. Wright et al., Federal Practice and Procedure § 1752, at 31, 32-33, 40-41 (2d ed. 1986).

[3] See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 99, 105-06 (1966).

perhaps went too far in eliminating any procedure that even resembled one-way intervention.

The 1966 amendments were the last systematic revision of Rule 23, and, indeed, the last significant amendments of any kind. As has become increasingly apparent since 1966, these amendments created an awkward mismatch between the subdivisions under which class actions are certified and the procedural protections to which a class is entitled.[4] They also have created a more widespread, and more pernicious, problem: a built-in conflict of interest for the class attorney, who can obtain a generous award of attorney's fees, and perhaps equally generous relief for a few named plaintiffs and members of the class, by compromising the interests of absent class members through preclusion of their claims. Settlements that blatantly sell out the interests of the class are not likely to receive judicial approval under Rule 23(e). Nevertheless, they represent only the most extreme examples of potential conflicts between the class attorney and the class, not to mention conflicts within the class or among various attorneys seeking to represent the class.[5] These conflicts of interest are all the more severe because class members usually do not have a sufficient stake in the class action to protect themselves. They are thus faced with the grim prospect of having the performance of their representative monitored mainly by their adversary.

There is no point in going back to one-way intervention as it was practiced under the original version of Rule 23.[6] That version of the Rule has been superseded in many other respects.[7] Much can be said, however, in favor of allowing class members to opt out of a class action if they are dissatisfied with the settlement obtained by the class attorney. Much also can be said in favor of limiting the preclusive effect of the class action in other ways. This Article examines a few of these alternatives to the existing procedures under Rule 23.

Part I begins with a brief discussion of two related issues: the availability of "fluid class" recoveries and other forms of approximate relief for the class; and the constitutional basis for the decision in

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[4] See, e.g., Kenneth W. Dam, Class Action Notice: Who Needs It?, 1974 Sup. Ct. Rev. 97, 115-16.

[5] See John C. Coffee, Jr., Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions, 86 Colum. L. Rev. 669, 677 (1986); Jack B. Weinstein, Ethical Dilemmas in Mass Tort Litigation, 88 Nw. U. L. Rev. 469, 502-06, 532-33 (1994).

[6] For an argument to the contrary, see Mark C. Weber, Preclusion and Procedural Due Process in Rule 23(b)(2) Class Actions, 21 U. Mich. J.L. Ref. 347, 400-13 (1988).

[7] See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 98-99 (1966).

Eisen v. Carlisle & Jacquelin.[8] Part II then proceeds to a discussion of notice and preclusion in the two major types of class actions after *Eisen*: those certified under subdivision (b)(3), in which individual notice to class members is required; and those certified under either subdivision (b)(1) or (b)(2), in which such notice generally is not required. Part III turns from notice to the right to opt out and examines three aspects of this right: its effects on settlement; its substantive character; and its consequences for preclusion and the statute of limitations. I conclude that the current structure of Rule 23 should be revised to give greater rights to class members: in particular, to give them the right to receive effective notice later in the proceedings and the right to opt out at the settlement stage of class actions in order to register their dissatisfaction with the performance of the class attorney.

I
Two Related Problems

Before I examine the procedures at the remedy stage of class actions, I would like to distinguish two related problems: the use of approximate remedies in class actions and the constitutional right of class members to individual notice. These problems are not entirely independent of the procedural issues at the remedy stage discussed in this Article. Nevertheless, they are complicated enough in their own right to deserve separate treatment. I will discuss them only insofar as they bear upon the appropriate procedures for notice and opt out at the settlement and remedy stages of class actions.

A. Approximate Remedies

The relationship between remedies and the procedures in class actions is a complicated one, made more complicated by the variety of remedies available in class actions. Approximate remedies, in particular, come in many different forms, from simplifying assumptions that are used to calculate the recoveries of individual class members to "fluid class" recoveries that expand the beneficiaries of a judgment to persons other than proven victims of wrongdoing.[9] At one extreme, the use of simplifying assumptions, such as presumptions about which individual class members are entitled to relief, does not dispense with

[8] 417 U.S. 156 (1974).

[9] See, e.g., Kenneth S. Abraham & Glen O. Robinson, Aggregative Valuation of Mass Tort Claims, Law & Contemp. Probs., Autumn 1990, at 137, 140; Anna L. Durand, Note, An Economic Analysis of Fluid Class Recovery Mechanisms, 34 Stan. L. Rev. 173, 173-82 (1981).

the need for individual notice to class members. If they are to receive any benefits at all, they must at least come forward and identify themselves as members of the class and provide an address or some other means by which a recovery can be sent to them.[10] At the other extreme, a fluid class recovery might provide relief to future customers or employees of the defendant, instead of providing compensation only to past victims of wrongdoing.[11] A fluid class recovery dispenses with the need for notice by expanding the award of compensatory relief to those who are not victims of wrongdoing in the traditional sense. Some individuals receive the benefit of the judgment without proving that they are victims of wrongdoing. It follows that they do not need any kind of notice at all in order to benefit from the judgment.

Different remedial principles can combine features from both of these extremes, so that an approximate form of individual relief can gradually be transformed by degrees to a form of fluid class recovery. The approximation simply shifts from the issue of how much relief to give to the issue of which individuals are entitled to relief. When it is put in these terms, even the most common forms of relief embody some approximations. For instance, under Title VII, if the court finds that an employer has engaged in discrimination, say in promotions, then every class member who applied for a promotion and was denied one is presumed to be entitled to individual relief.[12] This presumption is rebuttable by the employer, but in theory it can, and undoubtedly sometimes does, result in compensation to individuals who are not really victims of discrimination. Even an ordinary finding that an individual class member is a victim of discrimination can depend upon approximations similar to those underlying fluid class recoveries. Novel remedial principles about who is entitled to relief, and in what amount, differ only in degree from more familiar presumptions frequently invoked at the remedy stage of litigation.

This is not to say that differences of degree do not matter. Of course they do. But it is the similarities in degree that are crucial because they reveal the substantive character of all remedial presumptions, whether or not they are invoked in class actions. Remedial presumptions have both deterrent and compensatory consequences: if they increase the probability of sanctions for conduct in violation of

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[10] See Thomas R. Meites & Sargent L. Aborn, Distributing the Settlement Fund in a Class Action, Litig., Summer 1981, at 33, 34.

[11] See Gail Hillebrand & Daniel Torrence, Claims Procedures in Large Consumer Class Actions and Equitable Distribution of Benefits, 28 Santa Clara L. Rev. 747, 761-73 (1988).

[12] See, e.g., International Bhd. of Teamsters v. United States, 431 U.S. 324, 361-62 (1977).

the law, then they increase its deterrent effect; if they redistribute awards of relief from one set of class members to another, then they affect the compensation available to victims of illegal conduct. Neither of these consequences easily can be confined solely to procedure, and thus to the kind of legal rules that can be determined by Rule 23.

This limitation on the scope of Rule 23 follows from the prohibition in the Rules Enabling Act against any rule that would "abridge, enlarge, or modify any substantive right."[13] This prohibition operates mainly to restrict the powers of the rulemakers, as I will argue in some detail later. It does not, however, restrict federal judges in applying and interpreting substantive law. Although Rule 23 cannot affect the substantive rights reflected in remedial presumptions, it still provides the procedural background against which courts must decide what those substantive rights are. A court that makes this judgment does not exercise any power under Rule 23, but instead exercises the broader power to adjust substantive rules of law to changed procedural rules.[14]

For this reason, a single-minded insistence on the limited scope of Rule 23 only succeeds in transforming many of the problems that commonly arise in class actions into problems in other areas of law, without really contributing to their solution. For instance, fluid recoveries could be viewed as solely a subject for the law of remedies, or tolling of the limitation period for class members could be viewed as solely a matter of interpreting the statute of limitations. These questions cannot be solved by Rule 23 itself, but they can be addressed from the substantive side by interpreting the law that gives rise to the plaintiffs' claims and determines the remedies to which they are entitled.

From the procedural side, Rule 23 must only remain flexible enough to accommodate whatever the substantive law is. In the case of remedial presumptions, it must provide the procedures by which these presumptions can be invoked or rebutted in class actions. Sometimes, notice and the right to opt out will be necessary to implement these presumptions; sometimes they will not. Whatever simplifying assumptions are made about calculating individual relief or about fluid class recoveries, Rule 23 must provide the procedural mechanism for implementing the resulting principles of substantive law. Unless the law wholly abandons any attempt to compensate vic-

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[13] 28 U.S.C. § 2072(b) (1994).

[14] See, e.g., Hal S. Scott, Comment, The Impact of Class Actions on Rule 10b-5, 38 U. Chi. L. Rev. 337, 367-68 (1971).

tims of past wrongdoing, the procedures under Rule 23 must contemplate some form of notice to individual class members.

B. Notice Under the Due Process Clause

The notice required at any stage in a class action must meet the minimum requirements of the Due Process Clause. If it fails to do so, and the class action goes forward, any resulting judgment is not binding on the class, or at least not on those class members who failed to receive notice.[15] The absence of a judgment binding on the class, in turn, leaves the defendant exposed to the dangers of one-way intervention: if the class wins, then individual class members can obtain relief from the defendant, but if the class loses, they can bring independent individual actions.

It remains uncertain, however, exactly what kind of notice the Due Process Clause requires. Ever since *Eisen v. Carlisle & Jacquelin*,[16] the question whether unnamed class members have a constitutional right to notice has been much discussed and analyzed by legal commentators and much avoided by the Supreme Court.[17] *Eisen*, of course, held that Rule 23 required individual notice to be mailed to all class members who could reasonably be identified.[18] This holding was based on the literal terms of subdivision (c)(2) which, in turn, applies only to class actions, usually for damages, certified under subdivision (b)(3). Subdivision (c)(2) requires "the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort."[19] In *Eisen*, the Court interpreted this provision literally, and, with some justification, read the qualifying clause, "through reasonable effort," to apply only to the process of identifying class members, not to the process of giving individual notice.[20] The result was a nearly absolute rule requiring individual notice.

The leading case on notice under the Due Process Clause, *Mullane v. Central Hanover Bank & Trust Co.*,[21] imposes no such rigid rule. Under *Mullane*, the constitutional requirement is "notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity

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15 See Hansberry v. Lee, 311 U.S. 32, 40-41 (1940).

16 417 U.S. 156 (1974).

17 The seminal work is Dam, supra note 4, at 109-16.

18 *Eisen*, 417 U.S. at 173.

19 Fed. R. Civ. P. 23(c)(2).

20 See *Eisen*, 417 U.S. at 173.

21 339 U.S. 306 (1950).

to present their objections."[22] The qualifying phrase, "reasonably calculated" applies to "all the circumstances." The Court went on to hold that notice was not required to parties, essentially class members, who were not known in the ordinary course of business or whose interests were "either conjectural or future."[23] As to these parties, adequate representation by parties who did receive individual notice was sufficient. The Supreme Court has adhered to this flexible constitutional standard for notice in class actions in all but one narrow fact situation.[24]

Despite this limited support in opinions of the Supreme Court, the lower federal courts have frequently read a constitutional basis into the holding of *Eisen*, partly because that decision itself relied upon *Mullane*.[25] For instance, in *Johnson v. General Motors Corp.*,[26] the Fifth Circuit required individual notice to class members for whom monetary relief in the form of backpay was sought in a class action under Title VII of the Civil Rights Act of 1964. This decision went beyond *Eisen* itself because the class action had been certified under subdivision (b)(2),[27] as most employment discrimination class actions are, and so notice was not required by the literal terms of Rule 23, as it would have been for a class action certified under subdivision (b)(3). Sensibly enough, the court held that the request for backpay resembled a claim for damages, which would have required certification under subdivision (b)(3), so that individual notice was constitutionally required.[28] Other circuits have followed this approach, most recently the Ninth Circuit in *Brown v. Ticor Title Insurance Co.*,[29] a case in which the Supreme Court tried, but failed, to reach the constitutional question. Some circuits have rejected this holding and none has extended it to all class actions; in particular, no circuit has ex-

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22 Id. at 314.

23 Id. at 317.

24 In Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985), the Court required individual notice to class members who resided outside the forum state, but the case was brought in state court on state claims, so that the issue of adequate notice was tied up with the issue of personal jurisdiction over members of the class. See id. at 806-14. The statements in the opinion endorsing individual mailed notice as a constitutional requirement must be interpreted in this light.

25 *Eisen*, 417 U.S. at 174.

26 598 F.2d 432, 433 (5th Cir. 1979).

27 Id. at 436.

28 See id. at 437-38.

29 982 F.2d 386 (9th Cir. 1992), cert. dismissed as improvidently granted, 114 S. Ct. 1359 (1994).

tended the holding to class actions in which only general injunctive relief is sought on behalf of the class.[30]

The exact dimensions of the constitutional requirement of individual notice remain uncertain, as the flexible standard articulated in *Mullane* would lead one to expect. As a result, Rule 23 has had a far greater practical impact upon the notice given in class actions than has the Due Process Clause. In particular, the notice given early in a class action, immediately after certification, depends primarily on the subdivision under which the class action is certified. With only a few exceptions, like that recognized in *Johnson*, courts routinely require individual notice soon after certification in (b)(3) class actions and routinely exercise their discretion to give less demanding forms of notice later in (b)(1) and (b)(2) class actions.[31] This familiar pattern of litigation under Rule 23 presupposes that the Constitution requires early notice mainly in some subset of class actions certified under subdivision (b)(3), but not in most class actions certified under subdivisions (b)(1) and (b)(2).

Whether or not this presupposition eventually proves to be justified, the rulemakers can do little to alter constitutional law. On the other hand, they need not do very much to conform to it. The Due Process Clause requires notice only as the condition for a binding judgment. Class members who do not receive adequate notice are not bound by the resulting judgment. This was the procedure in spurious class actions for damages under the old version of Rule 23. Class members were allowed to engage in "one-way intervention": they could benefit from a favorable judgment but escape the preclusive effect of an unfavorable judgment. As a result, the party opposing the class could lose with respect to the entire class, but could win only with respect to the named plaintiffs.[32] This procedure was attacked as unfair to the party opposing the class, but far from being constitutionally questionable, one-way intervention is precisely what the Due Process Clause condones.[33] No one argued then, and no one argues now, that this procedure denied class members their right to due process. Even under the current version of Rule 23, if class members do not receive constitutionally adequate notice, they can benefit from a favorable judgment and avoid an unfavorable judgment.[34] Whatever

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[30] See 2 Herbert B. Newberg & Alba Conte, Newberg on Class Actions § 8.05, at 8-18 (3d ed. 1992).

[31] See generally 2 id. §§ 8.15-.16.

[32] See supra note 2 and accompanying text.

[33] See Dam, supra note 4, at 117.

[34] Note, Collateral Attack on the Binding Effect of Class Action Judgments, 87 Harv. L. Rev. 589, 601 (1974).

the scope of the constitutional requirement of individual notice, it can be met in either of two ways: by giving more notice to the class or by giving less preclusive effect to the resulting judgment.

The close relationship between notice and preclusion does not mean that the rulemakers are free to disregard the Due Process Clause. It does mean that they have a wide range of choices in deciding how to comply with it. Individual notice to all identifiable class members early in the proceedings, before a judgment on the merits, is only one way of providing due process. Different forms of notice at different stages in the proceedings can also satisfy due process if the preclusive effects of the resulting judgment are suitably limited. Several of these alternatives have been tried after *Eisen* as a way of adjusting to, and even avoiding, the consequences of that decision.

II

NOTICE AND PRECLUSION AFTER *Eisen*

A. Class Actions Certified Under Subdivision (b)(3)

Under the current version of Rule 23, individual notice is required only under narrowly defined conditions that have separate rationales. These conditions and rationales, however, bear no necessary relationship to one another, so that when they are pulled apart, the case for individual notice starts to unravel. Class members are entitled to individual notice only in class actions certified under subdivision (b)(3). The right to notice follows from the right to opt out, which class members again only possess in class actions certified under subdivision (b)(3).[35] In order to avoid the dangers of one-way intervention, however, a class action must be certified, notice must be given, and the right to opt out must be exercised before any judgment on the merits.[36] Each of these steps might be individually justifiable, but collectively they lead from procedures designed to protect members of the class—notice and the right to opt out—to procedures designed to protect the party opposing the class—early certification and notice.

What gets lost in the transition between protecting the class and protecting the party opposing the class is the question—really two questions—of cost: is early individual notice worth the cost? And if so, who bears the cost? The great defect of the procedures approved in *Eisen* is that they require notice at a time when it is least likely to be effective: early in the proceedings when class members are not

[35] See Fed. R. Civ. P. 23(c)(2)-(3).

[36] See Fed. R. Civ. P. 23(c)(1); Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 173-74 (1974).

likely to know either the value of their claims or the adequacy of class representation. Moreover, because notice must be given before any adjudication on the merits, the cost of notice rests initially upon the named plaintiffs or their attorneys.[37] Individual notice might offer theoretical protection to the class, but it functions in practice as an obstacle to maintenance of class actions, as the dismissal of the class action as originally defined in *Eisen* revealed.[38]

These criticisms of existing procedures in (b)(3) class actions are usually framed in terms of efficiency, or, more precisely, inefficiency: the overall cost of individual notice far exceeds the overall benefits.[39] Although this global perspective has its advantages—who is in favor of inefficiency?—it does not respond directly to the need to protect individual rights, either procedural rights under the Due Process Clause or substantive rights under the Rules Enabling Act. Any attempt to maximize overall efficiency inevitably requires trade-offs between individual rights and the general interests of society as a whole.[40] Yet rights generally operate as constraints on achieving overall efficiency. In particular, the Due Process Clause and the Rules Enabling Act forbid exactly the kinds of trade-offs that any serious attempt to maximize overall efficiency requires. In analyzing Rule 23, it is therefore necessary to focus on individual rights, either of class members or of the party opposing the class.

Individual notice protects the rights of class members only if it gives them some informed basis for deciding whether or not to opt out of the class action. The later the notice is, the more likely it is to provide class members with the information necessary to make this decision. Class members need to know whether their claims are more valuable when asserted within the class action or when asserted outside it. Taken to its extreme, this reasoning leads directly back to one-way intervention: giving class members individual notice and the right to opt out only after judgment. This extreme solution, of course, favors class members at the expense of the party opposing the class.[41]

The present version of Rule 23 has rejected this extreme solution only to favor a solution at the opposite extreme: certification of a class action "[a]s soon as practicable after the commencement of an action brought as a class action" and individual notice before any deci-

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[37] 2 Newberg & Conte, supra note 30, § 8.06, at 8-20 to 8-21.

[38] *Eisen*, 417 U.S. at 179 & n.16.

[39] See, e.g., Jonathan R. Macey & Geoffrey P. Miller, The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform, 58 U. Chi. L. Rev. 1, 27-28 (1991).

[40] See Ronald Dworkin, Taking Rights Seriously 92 (1977).

[41] See supra note 15 and accompanying text.

sion on the merits.[42] It is not necessary, however, to choose only between these extremes. And, indeed, emphasizing one-way intervention as the particular evil addressed by the 1966 amendments to Rule 23 greatly overstates the extent of this practice under the original Rule. The Advisory Committee Note to the 1966 amendments itself cites only "a few actions" in which courts "have held or intimated" that one-way intervention is possible and then goes on to cite conflicting authority as well.[43] These cases only established that one-way intervention was a *possibility* under the original version of Rule 23, not that it was standard practice.[44] One-way intervention was not even mentioned in the text of the original Rule, but was a consequence of judicial and scholarly interpretation of the Rule.[45] The 1966 amendments to Rule 23 focussed on the uncertainty of the procedures under the original Rule.[46] One purpose of the amendments was to clarify the preclusive effect of a judgment in a class action. Although the rulemakers were remarkably ambivalent about their power to make rules of preclusion,[47] their concern was mainly with the absence of definite rules of preclusion under the original Rule. They were less concerned with the precise means by which a class was defined, so long as it was defined before judgment so that it determined who was bound by the judgment. Indeed, a distinguished critic of one-way in-

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[42] Fed. R. Civ. P. 23(c)(1)-(2).

[43] See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 105 (1966).

[44] The cases as a whole were conflicting on the question. See 7B Wright et al., supra note 2, § 1800, at 450 n.2, 451 nn.3 & 5.

[45] The principal case, and indeed, one of the few square holdings allowing one-way intervention, was Union Carbide & Carbon Corp. v. Nisley, 300 F.2d 561, 589 (10th Cir. 1961), cert. dismissed, 371 U.S. 801 (1962). The principal academic commentary was Harry Kalven, Jr. & Maurice Rosenfield, The Contemporary Function of the Class Suit, 8 U. Chi. L. Rev. 684, 712-14 (1941).

[46] The focus then, as now, was on the division of class actions into different categories with different procedural consequences. See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 98-99 (1966).

[47] As the Advisory Committee Note states, "[a]lthough thus declaring that the judgment in a class action includes the class, as defined, subdivision (c)(3) does not disturb the recognized principle that the court conducting the action cannot predetermine the *res judicata* effect of the judgment; this can be tested only in a subsequent action." Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 106 (1966). In a contemporaneous article, the reporter to the Advisory Committee also expressed concern about the substantive nature of preclusion. See Benjamin Kaplan, Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure (pt. 1), 81 Harv. L. Rev. 356, 378 & nn.79-80, 393 (1967). Similar concerns were expressed by the drafters of the original version of Rule 23. See Kalven & Rosenfield, supra note 45, at 705-06.

tervention, Zechariah Chafee, favored a flexible rule allowing class members to opt out at any time before judgment.[48]

Because most class actions are settled before trial, as is most litigation, it might make sense to require individual notice when a settlement is proposed or immediately before trial, whichever occurs earlier. Notice after a proposed settlement would allow class members to evaluate the settlement for themselves when they decide to opt out. Notice and the right to opt out before trial would allow the party opposing the class to gain the preclusive effect of a judgment in its favor. Unlike the question of whether to give individual notice at all, the question of when to give notice is inevitably a question of degree—whether to give it sooner or later in the action.

The practice of conditionally certifying settlement classes and simultaneously giving notice of a proposed settlement supports this reform.[49] Such delayed certification is at odds with the requirement under subdivision (c)(1) of certification "[a]s soon as practicable" after commencement of the action, but it is consistent with the further provision that certification "may be conditional, and may be altered or amended before the decision on the merits."[50] For example, in the pending class action for exposure to asbestos, *Georgine v. Amchem Products, Inc.*,[51] a class had been conditionally certified for settlement negotiations and then finally certified only when the settlement was approved. In such cases, as part of the settlement negotiations, the parties agree on a definition of the class and on a proposed settlement on the merits. The court then gives combined notice both of certification of the class and of the settlement, which is independently required before the settlement can be approved under subdivision (e).[52] If the class is certified under subdivision (b)(3), class members also have the right to opt out.

Because simultaneous certification and settlement now depends entirely upon the agreement of the parties, the defendant can force the additional cost of individual notice onto the class representative

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[48] See Zechariah Chafee, Jr., Some Problems of Equity 284-85 (1950). So, too, then-Professor Jack Weinstein favored development of nonmutual assertion of collateral estoppel as an alternative to class actions with one-way intervention. See Jack B. Weinstein, Revision of Procedure: Some Problems in Class Actions, 9 Buff. L. Rev. 433, 448-54, 468-69 (1960).

[49] See 2 Newberg & Conte, supra note 30, § 8.21.

[50] Fed. R. Civ. P. 23(c)(1).

[51] 157 F.R.D. 246, 257, 261 (E.D. Pa. 1994), vacated and remanded, Nos. 94-1925 et al., 1996 U.S. App. LEXIS 11191 (3d Cir. May 10, 1996).

[52] See 2 Newberg & Conte, supra note 30, § 8.21. Courts have expressed reluctance about the practice of consolidated notice only to the extent of refusing to include opt-out forms on the ground that such forms might be confusing to class members. 2 Id. § 8.20, at 8-70.

(or more plausibly, the class attorney) simply by insisting upon certification before agreeing to any settlement on the merits. Under existing law, the cost of individual notice is a bargaining chip that is held by the party opposing the class. If the Rule were changed so that notice of certification and settlement were combined, the party opposing the class could insist on separate notice of certification only if it were prepared to undertake the additional expense of going to trial. If it instead agreed to a settlement before trial, then two sets of notices would be replaced by one. The cost of the combined notice would be itself a subject of negotiations, but it would eliminate a set of notices that must be financed initially by the class representative. Moreover, under existing practice, a settlement usually shifts the cost of notice to the defendant, assuming that the class recovers any relief at all, whether monetary or injunctive.[53]

No doubt there are other procedures for making individual notice to class members less a ritual and more a realistic means of protecting their rights. Settlement classes, with all their disadvantages,[54] are not a necessary condition for giving class members notice and the right to opt out at the settlement or remedy stage of a class action. In any class action in which individual relief is distributed to members of the class, it is necessary to give them effective notice, usually individual notice, at some point. This notice becomes far more valuable, and far easier to finance, after some recovery has been obtained for the class. The various forms that this notice can take, and the time at which it should be issued, have been more thoroughly explored in class actions certified under subdivisions (b)(1) and (b)(2). Because *Eisen* does not apply to these class actions, they have occasioned closer examination of different forms of notice and whether these forms of notice comply with the Due Process Clause.

B. Class Actions Under Subdivisions (b)(1) and (b)(2)

Nothing has stimulated certification of (b)(1) and (b)(2) class actions as much as the strict requirements of individual notice in (b)(3) class actions. This strategy for evading the requirements of *Eisen* reveals the mismatch between the distinctions among different class actions in subdivision (b) and the procedures in subdivision (c).[55] The

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[53] See 2 id. § 8.20.

[54] For a decision disapproving the use of a settlement class, see In re General Motors Corp. Pick-Up Truck Fuel Tank Prods. Liab. Litig., 55 F.3d 768, 786-804 (3d Cir.), cert. denied, 116 S. Ct. 88 (1995).

[55] A revision of Rule 23 proposed by the Advisory Committee dissolves the different categories of class actions now found in subdivision (b) but replaces them with greater reliance on the district court's discretion, for instance, on the issue of notice and the right

different categories of class actions correspond only loosely to the need for individual notice, although the existing categories do provide a closer fit with the right to opt out. Class actions under subdivision (b)(1) are mandatory joinder devices, fully analogous and similar in wording to the provisions on necessary and indispensable parties under Rule 19.[56] Allowing class members to opt out of (b)(1) actions would defeat the purpose of certifying them in the first place. These class actions are necessary either to protect the party opposing the class from inconsistent judgments in individual actions or to protect class members from judgments in individual actions that would adversely affect their interests. Class actions for injunctive and declaratory relief under subdivision (b)(2), at least when they conform to the literal requirement of relief "with respect to the class as a whole," also do not easily admit the right to opt out.[57] Class members who opt out would essentially create exceptions to what would otherwise be a general injunction or declaratory judgment applicable to the entire class.

In neither (b)(1) nor (b)(2) class actions, however, do these arguments against the right to opt out amount to arguments against individual notice. This would be the case only if the sole purpose served by individual notice is to allow class members to opt out. But individual notice can plainly serve other purposes: when exit is not a possibility, the choice between voice and loyalty becomes all the more important.[58] Class members are entitled to notice so that they have an opportunity to object to the class attorney's performance. This form of protest is the only alternative to acquiescence in the decisions of the class attorneys when exit is foreclosed, as it must be in (b)(1) and (b)(2) class actions.

The reason originally given for denying individual notice in these class actions—that the classes are more cohesive than in (b)(3) class actions—simply begs the question at issue.[59] Whether the class is co-

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to opt out. See Robert G. Bone, Rule 23 Redux: Empowering the Federal Class Action, 14 Rev. Litig. 79, 109-12 (1994).

[56] See Fed. R. Civ. P. 19(a).

[57] See Fed. R. Civ. P. 23(b)(2).

[58] Albert O. Hirschman, Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States (1970).

[59] See 7B Wright et al., supra note 2, § 1786, at 194-95; Stephen C. Yeazell, From Group Litigation to Class Action Part II: Interest, Class, and Representation, 27 UCLA L. Rev. 1067, 1110-15 (1980).

In this respect, the Advisory Committee's treatment of (b)(3) class actions appears to be a disturbing holdover of the special treatment of "spurious" class actions under the original version of Rule 23. The latter were cases in which class members were not united by some common pre-existing legal relationship and therefore were not bound by the resulting judgment unless they joined as parties in the class action. Absence of cohesiveness in (b)(3) class actions addresses the same concerns with diverging interests. As the Advi-

hesive depends upon the interests of the class members, which can only be ascertained by their response to notice of the class action. Nothing in the present requirements for certification under subdivision (b)(1) or (b)(2) assures any degree of cohesiveness among class members. To the contrary, in one type of class action, for damages against a limited fund under subdivision (b)(1)(B), class members must have antagonistic interests under the terms of the Rule itself. Class actions can be maintained under this subdivision only when the interests of class members are antagonistic, because recovery by one class member would impede the ability of others to recover.[60]

These (b)(1) class actions, such as those covering the many claims arising from use of the Dalkon Shield in *In re A.H. Robins Co.*[61] and from exposure to asbestos in *In re Joint Eastern and Southern District Asbestos Litigation (Johns-Manville)*,[62] resemble bankruptcy proceedings more closely than they do any kind of device for permissive joinder of claims. And, indeed, in both *A.H. Robins* and *Johns-Manville*, class actions were merged and conducted simultaneously with reorganization proceedings filed by the debtor, largely in order to prevent litigation of individual lawsuits against it.[63] In bankruptcy cases, all known creditors of the bankrupt are forced to present their claims for collection in a single proceeding. And they are each entitled to individual notice.[64] In *A.H. Robins*, although the class action was certified under subdivision (b)(1)(A), the district court issued notice to all identifiable class members and allowed them to present their claims in individual hearings, a procedure that the Fourth Circuit found to be equivalent to allowing them to opt out.[65]

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sory Committee noted, in requiring individual notice in (b)(3) class actions, "the interests of the individuals in pursuing their own litigations may be so strong here as to warrant denial of a class action altogether." Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 104-05 (1966).

[60] See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 101 (1966).

[61] 880 F.2d 709, 740-41 (4th Cir.), cert. denied, 493 U.S. 959 (1989).

[62] 982 F.2d 721 (2d Cir. 1992) [hereinafter *Johns-Manville*].

[63] See *A.H. Robins*, 880 F.2d at 717; *Johns-Manville*, 982 F.2d at 725.

[64] See Bankr. R. 2002. This rule requires individual notice unless "notice by mail is impracticable." Bankr. R. 2002(l). Moreover, creditors whose claims are neither listed nor scheduled by the debtor can avoid discharge if they did not receive timely notice. 11 U.S.C. § 523(a)(3) (1994); see 3 Collier on Bankruptcy § 523.13(4)-(5), at 523-95 to 523-97 (Lawrence P. King ed., 15th ed. 1995).

[65] See *A.H. Robins*, 880 F.2d at 744-45. In *Johns-Manville*, the Second Circuit expressed doubts about certification of a mandatory class action, but admitted that it was permissible, although it then held that the creditors should have been divided into subclasses that more clearly corresponded to their conflicting interests. See *Johns-Manville*, 982 F.2d at 735-45.

A strong argument can also be made against the practice of certifying employment discrimination class actions under subdivision (b)(2). Although subdivision (b)(2) refers only to injunctive and declaratory relief, employment discrimination class actions commonly result in individual awards of backpay, remedial seniority, and other fringe benefits.[66] These forms of individual relief, just as much as individual awards of damages in (b)(3) class actions, justify individual notice and the right to opt out. With claims for damages now generally available in employment discrimination cases, the argument for certification of these actions exclusively under subdivision (b)(2) has collapsed. Cases such as *Johnson v. General Motors Corp.*,[67] which require individual notice as a matter of due process when awards of backpay are at issue, recognize that the distinctions among class actions in subdivision (b) do not correspond to the requirement of notice, let alone the right to opt out, in subdivision (c).

Most of the decided cases in (b)(1) and (b)(2) class actions, however, have reached a different result from *Johnson*: they have not required individual notice as a matter of due process.[68] The common practice in (b)(1) and (b)(2) class actions is usually to give individual notice in the exercise of the court's discretion under subdivision (d) or before approval of a settlement under subdivision (e), but not to require it in all cases.[69] Individual notice to identifiable class members has not been required in cases in which it is unduly expensive or in which alternative means of notice—such as posting or publication—are likely to be equally effective.[70] The fact that the courts and the parties use these alternatives when they are allowed by the Rule suggests that individual notice should not always be required even in (b)(3) class actions.

The practice of giving individual notice to identifiable class members as a matter of discretion simply reflects the superiority of individual notice as a means of communication when cost is not an obstacle to notice. When the cost of individual notice is small, as on the facts of *Mullane v. Central Hanover Bank & Trust Co.*,[71] the functional superiority of individual notice becomes a constitutional requirement.

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[66] See, e.g., Franks v. Bowman Transp. Co., 424 U.S. 747, 779 (1975); Albemarle Paper Co. v. Moody, 422 U.S. 405, 421 (1975).

[67] 598 F.2d 432, 437 (5th Cir. 1979).

[68] See 7B Wright et al., supra note 2, § 1786, at 191-94.

[69] See 2 Newberg & Conte, supra note 30, §§ 8.15-.18, at 8-50 to 8-64.

[70] See, e.g., Fowler v. Birmingham News Co., 608 F.2d 1055, 1059 (5th Cir. 1979) (posting on company bulletin board); Fujishima v. Board of Educ., 460 F.2d 1355, 1360 (7th Cir. 1972) (posting or announcement over school intercom); see also 2 Newberg & Conte, supra note 30, § 8.24, at 8-75 to 8-76; 7B Wright et al., supra note 2, § 1797, at 368-71.

[71] 339 U.S. 306, 318-19 (1950).

When the cost of individual notice becomes greater, then the offsetting benefit that it confers upon class members should be correspondingly greater. In (b)(1) and (b)(2) class actions, courts can adjust both the form and timing of notice to maximize its value to class members. For instance, some courts have gone so far as to hold that class members are entitled, under the Due Process Clause, to individual notice of any settlement that grants individual relief.[72] If they do not receive such notice, then they are not precluded from filing independent actions for relief. Of course, by the remedial stage of a class action, notice will rarely be a crucial issue. The named plaintiff or the class attorney can place the cost of notice on the defendant, either directly as part of the assessed costs, or indirectly as an expense payable from the compensation awarded to the class.[73] If, as in most cases, an agreement has been reached on the total sum payable to the class, the defendant will not object to most forms of effective notice. And, in any event, the defendant benefits from the greater preclusive effect assured by the best notice possible to class members.

The less effective forms of notice allowed in (b)(1) and (b)(2) class actions create problems of preclusion when individual class members fail to receive notice. Most of these problems are solved by the requirement of adequate representation. When class members fail to receive notice at some earlier stage of a (b)(1) or (b)(2) class action, they remain bound by the result of the class action so long as their interests were adequately represented by the named plaintiff and the class attorney. This result follows from the holding of *Mullane*: where individual notice is not practical, but some class members received actual notice, adequate representation alone is sufficient for preclusion.[74]

Adequate representation of individual claims in a class action, however, creates complications not found in the ordinary rules of preclusion. Thus, in *Cooper v. Federal Reserve Bank*,[75] the Supreme Court limited the preclusive effect of a judgment dismissing claims of a pattern or practice of discrimination in promotions. Individual actions alleging discrimination in promotions, brought by class members who testified at trial but who were not allowed to intervene as plain-

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[72] See, e.g., Johnson v. General Motors Corp., 598 F.2d 432, 436-38 (5th Cir. 1979); Simer v. Rios, 661 F.2d 655, 666-67 (7th Cir. 1981) (holding that possibility of individual relief required identification of class members and notice), cert. denied, 456 U.S. 917 (1982).

[73] See, e.g., Kyriazi v. Western Elec. Co., 465 F. Supp. 1141, 1144 (D.N.J. 1979), aff'd, 647 F.2d 388 (3d Cir. 1981); see also 2 Newberg & Conte, supra note 30, § 8.20.

[74] See *Mullane*, 339 U.S. at 317-18.

[75] 467 U.S. 867, 880 (1984).

tiffs, were not barred by the judgment of dismissal. These class members were bound by the judgment in the class action only to the extent that it resolved the pattern or practice claims. Under ordinary principles of preclusion, the individual claims plainly would be barred because they arose out of the same transaction or occurrence as the pattern or practice claims, yet they were allowed to go forward because they raised issues that had not been presented in the class action. Ordinary principles of preclusion were limited by the requirement of adequate representation as it applies in class actions.

The real question posed by the existing practice of giving notice in (b)(1) and (b)(2) class actions is not whether it is sufficient for preclusion under the Due Process Clause, but whether it should be left to the discretion of the district court. Under subdivision (d), the court possesses plenary discretion whether or not to order any notice at all in the course of the class, and under subdivision (e), although the court must order notice before approval of a settlement or voluntary dismissal, the method and content of the notice is left entirely to its discretion. If the current version of Rule 23 goes too far in one direction in requiring individual notice in (b)(3) class actions, it goes too far in the other direction in leaving notice almost entirely to the discretion of the district judge in (b)(1) and (b)(2) class actions. Although courts cannot be deprived of discretion in managing class actions, they also need some guidance in how their discretion should be exercised. Otherwise the district judge might be caught between several inconsistent obligations: to protect the class; to allow the class attorney to represent the class; and not to favor the class over the defendant.

A rule that identified the minimum requirements of timing, means, and content of notice to be issued would provide a framework in which the parties and the court could better litigate class actions. Like a proposed revision of Rule 23 recently considered by the Advisory Committee,[76] any such rule should not draw sharp distinctions among notice in different kinds of class actions. (On the other hand, unlike the Advisory Committee's proposal, it should not depend so heavily on the discretion of the district judge.) The differences in notice should be differences of degree, not differences in kind. Because individual notice is expensive, and increasingly expensive as the size of the class increases, it should not be required more frequently than necessary. As in temporary settlement classes, only one round of notice should be required by the rule, on the model of the notice now required by subdivision (e). Individual notice, however, should be required only when it is both feasible and effective in protecting the

[76] See Bone, supra note 55, at 109-12.

rights of individual class members. Additional rounds of notice, as needed in a particular case, should be ordered only in the discretion of the court. Although the exact formulation of a rule requiring notice could be quite elaborate, even a rule that simply required that individual notice be given to class members to the extent reasonably practicable, no later than before trial, a proposed settlement, or voluntary dismissal of a class action, would provide the participants with more certain procedures than they now have.

III
Opting Out and Its Consequences

Unlike notice, the right to opt out cannot be refined into questions of degree. Either class members have the right to opt out or they do not. The only refinement that might be possible under existing practice is to allow class members to opt out as to individual relief, but not as to classwide injunctive relief. To use the existing terminology, class actions could be certified for individual relief under subdivision (b)(3) and certified for classwide injunctive relief under subdivision (b)(2). This is the procedure effectively adopted in cases that have required individual notice as a matter of due process, as well as in some cases that have certified class actions under both (b)(2) and (b)(3).[77]

Having gone that far, however, it would be better to recognize that the fundamental inquiry is whether the joinder of class members through certification of a class action is mandatory or permissive.[78] Again to use the existing terminology, the real choice is between certification of class actions under (b)(1) or (b)(3). On the issue of opting out, there is no need for the intermediate category of the (b)(2) class action, which appears to have been added to the Rule mainly (but not exclusively) to take account of the practice of seeking classwide injunctions in civil rights cases.[79] Under the existing Rule, the procedures in (b)(1) and (b)(2) class actions are exactly the same. Likewise, the rationales for certification under each subdivision, if not exactly the same, are nevertheless very similar: as under subdivision (b)(1), classwide injunctive or declaratory relief under subdivision (b)(2) usually requires certification of a class action because individual actions would establish inconsistent standards of conduct for the party

[77] See, e.g., Taylor v. Union Carbide Corp., 93 F.R.D. 1, 7-9 (S.D. W. Va. 1980); Waldrip v. Motorola, Inc., 85 F.R.D. 349, 354 (N.D. Ga. 1980).

[78] See generally Diane W. Hutchinson, Class Actions: Joinder or Representational Device?, 1983 Sup. Ct. Rev. 459, 482-96.

[79] See Fed. R. Civ. P. 23 advisory committee's note, reprinted in 39 F.R.D. 69, 98, 102 (1966).

opposing the class or would adversely affect the interests of members of the class covered by the injunction or declaration. A court usually cannot grant uniform classwide injunctive relief without binding the entire class. Class actions now certified under subdivision (b)(2) are just as necessary as class actions now certified under subdivision (b)(1). The two subdivisions should therefore be combined.

All other class actions should be certified under subdivision (b)(3) with an accompanying right to opt out. In order to be effective, however, the right to opt out need not be exercised, as it is now, soon after certification of the class. The following sections examine the consequences of giving individual notice and granting the right to opt out later in the class action.

A. Effects on Settlement

If opting out were allowed later, what consequences would it have for those who remain in the class action and for those who opt out? The two questions are interrelated, because, taken together, the answers to these questions determine the defendant's overall exposure to liability. When class members can profitably pursue individual actions on their own, allowing them to opt out after settlement or just before trial obviously exposes the defendant to greater liability than does the class action judgment alone. These conditions are not always met, but when they are, the goal of efficiency in litigation comes into conflict with the interest of class members in pursuing their own claims independently.

Class actions are usually divided between those concerned with viable claims, which can be profitably pursued in individual actions, and those concerned with nonviable claims, which cannot.[80] It is a mistake, however, to apply this distinction automatically to an entire class action. It may be that all the claims aggregated in a particular class action are either viable or nonviable, but it may also be that some claims are large enough, or perhaps even simple enough, to be viable on their own while others are not. Those who opt out also may join their claims together or have them consolidated into a single case.[81] A mix of viable and nonviable claims might leave the defendant faced with the risk that a settlement precludes only nonviable claims that would not have been brought anyway, while class members

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[80] See Dam, supra note 4, at 104-05; Macey & Miller, supra note 39, at 30-31.

[81] For instance, in In re "Agent Orange" Product Liability Litigation, 611 F. Supp. 1223 (E.D.N.Y. 1985) [hereinafter *Agent Orange I*], aff'd, 818 F.2d 187 (2d Cir. 1987), cert. denied, 487 U.S. 1234 (1988), over 280 class members opted out and pursued their individual claims, although they soon lost on defendants' motion for summary judgment. See id. at 1230.

with more valuable, viable claims opt out to pursue separate actions.[82] In this situation, allowing opt outs at settlement "skims the cream off" of the claims of class members, leaving the defendant with a judgment that precludes only the smaller and weaker claims of the class.

In general, the right to opt out has only as much value as the individual class member's claim, determined according to its discounted present value as of the time at which the right to opt out is exercised. If the claim is not viable, then the right to opt out has no value. This conclusion has led to proposals to alter the compensatory remedies available to class members, either by creating various approximate or fluid class recoveries, or by dispensing with compensatory relief entirely.[83] Approximate and fluid class recoveries assure that some victims of wrongdoing receive some relief, with the attendant cost of extending relief to some nonvictims. Dispensing with compensatory relief entirely acknowledges that sometimes small awards of compensatory relief are simply impractical. For reasons discussed earlier, these are plainly substantive proposals beyond the reach of any revision of Rule 23 (although not beyond the power of a judge interpreting the underlying substantive law).[84]

Dispensing with notice and the right to opt out as to nonviable claims does not raise such plainly substantive issues, but these steps would still affect substantive rights. Whatever the value of a class member's claim, she has the right, absent the need for mandatory joinder, to decide how to pursue her claim. Taking away that right by denying notice and the right to opt out may be justifiable, but if so, it is for substantive reasons. In any event, requiring one round of notice and the right to opt out to holders of nonviable claims does not add much to the cost of class actions. If these class members are entitled to any compensatory relief at all, they will have to be notified of their right to apply for it anyway. And if they choose to opt out, it makes little difference to the defendant because their claims are worth so little.

All of the serious problems with the right to opt out concern class members with viable claims. Because more is at stake with these claims, both the class members and the defendant have strongly opposed interests: the class members in maintaining control of the claim

[82] See In re "Agent Orange" Prod. Liab. Litig., 818 F.2d 145, 166 (2d Cir. 1987) [hereinafter *Agent Orange II*], cert. denied, 484 U.S. 1004 (1988).

[83] Such as the proposal drafted by the Department of Justice, see Office for Improvements in the Admin. of Justice, U.S. Dep't of Justice, Effective Procedural Remedies for Unlawful Conduct Causing Mass Economic Injury: Draft Statute with Comment 3 (1977) (proposing public action for penalty where victims' claims do not exceed $500 each).

[84] See supra text accompanying notes 13-14.

and the defendant in obtaining a judgment that precludes further litigation. For this reason, postponing notice and the exercise of the right to opt out creates a greater risk of disrupting any attempt at settlement. It adds a further element of uncertainty to settlement negotiations and so increases the risk that the class attorneys and the defendant will fail to reach agreement because each assesses the uncertainty differently. A class attorney who overestimates the number of viable claims likely to be included in the class action (by underestimating the number of class members who will opt out) will insist upon a larger settlement to cover the projected larger number of claims in the class action. Conversely, a defendant who overestimates the number of class members who will opt out will underestimate the value of the settlement, and so insist upon a smaller settlement, since only the claims of those who remain in the class will be precluded by the settlement. These divergent estimates may prevent a settlement by opening a gap between the class attorney's lowest asking price and the defendant's highest bid. From the perspective of a judge trying to manage a class action, any threat to the settlement process increases the chance of prolonged and complex litigation.

For instance, in *In re "Agent Orange" Product Liability Litigation (Agent Orange III)*[85] class members were required to decide whether to opt out of the class action by a deadline that fell shortly before the case was settled.[86] Because the proposed settlement was greeted with widespread disapproval by members of the class, many of them undoubtedly would have opted out of the settlement had the right to opt out been allowed at settlement. This prospect, in turn, would have deterred the defendants from entering into the settlement in the first place, because it would have left them exposed to massive liability, not to mention the costs of continued litigation, on a large number of individual claims. Before turning to the question of whether anything could be done to foster settlement in these circumstances, it is first necessary to ask whether anything should be done.

Recall that the principal objection to early notice of a class action is that it does not give the class members sufficient information to make an informed judgment about what to do with their claims: whether to stay in the class action and participate in any recovery on behalf of the class or to opt out and pursue an individual action.[87] In a variation on the procedure used in *Agent Orange III*, notice of the terms of the settlement gives class members precisely such informa-

[85] 689 F. Supp. 1250 (E.D.N.Y. 1988) [hereinafter *Agent Orange III*].

[86] See Peter H. Schuck, Agent Orange on Trial 226 (enlarged ed. 1987).

[87] See supra text accompanying notes 37-38.

tion.[88] If they then exercise their right to opt out, they are simply making a decision which, as a matter of substantive law, they are entitled to make. It is their claim, and it is therefore their decision what to do with it. An increased likelihood of settlement cannot come at the expense of their right to control their claims.

Of course, individual class members might be advised by their own attorneys to pursue individual actions because the attorneys might benefit from taking this course. On the other hand, the class attorney might exploit the claims of the class to obtain an enhanced award of attorney's fees through a settlement that precludes their claims for an inadequate recovery.[89] Indeed, this risk is widely recognized as a pervasive problem in class actions: the difficulty faced by the class in monitoring the actions of the class attorney. Procedures that allow class members to exit in response to inadequate representation of their interests directly address this problem.

Allowing class members to opt out late in the class action has all the virtues of its vices. It presents both the advantages and disadvantages of opting out in the most extreme form. It gives each class member control over her claim, while disrupting resolution of the claims of the class as a whole. The conflict between the individual and collective perspectives is so stark that it raises the question whether the right to opt out should be considered a procedural issue at all, as opposed to one of substantive law. The next section of this Article will take up this question in detail,[90] but even if the right to opt out is wholly procedural, it is important enough that it should not be effectively denied by inadequate notice. In particular, class members should receive notice at a time when they can make the most informed judgment about whether to stay in the class action. This time is not always—or even often—early in the class action, when the likely value of a class member's claim may not even be known to the class attorney. A proposed settlement provides class members with at least the rough equivalent of a bid on the value of their claim. Bare notice at the outset of the class action does not.

To some extent, the adverse consequences of late notice and opt out at the prospect of settlement could be reduced by changing the nature of settlements: offers of settlement could be made contingent upon acceptance of the offer by a sufficient number of class members

[88] Indeed, Judge Weinstein gave the class members who had opted out repeated opportunities to rejoin the class and to participate in the settlement, even after summary judgment had been granted against them in their individual suits. See *Agent Orange III*, 689 F. Supp. at 1261-63.

[89] See Macey & Miller, supra note 39, at 22-26.

[90] See infra text accompanying notes 100-07.

with sufficiently valuable claims. Settlements have been made and accepted along these lines,[91] but this practice is hardly common. Likewise, court approval of settlements could be made contingent upon acceptance by sufficient class members. Again, this proposal has some basis in existing practice under Rule 23(e), but it, too, is hardly common. If a proposed settlement elicits widespread objections from the class then the court can refuse to approve it on this ground, although a decision to disapprove also requires an evaluation of the merits of the class members' objections.[92] Likewise, at an earlier stage in present class action practice, the fact that many class members have opted out may constitute grounds for decertifying the class for reasons of inadequate representation or lack of numerosity.[93]

The closest models for such conditional settlements, however, are from entirely different fields of law: tender offers in corporate law that are conditional upon acceptance by a minimum number of shareholders and reorganization plans in bankruptcy that require approval by a minimum number of classes of creditors. In both instances, an agreement becomes effective only if it obtains sufficient support from those intended to benefit from it. In a tender offer for corporate stock, the necessary level of support is set by the terms of the offer itself, usually a majority of the shares of common stock in the corporation.[94] In bankruptcy, the rules are set by statute and are more complicated. A reorganization plan must either obtain support from all classes of creditors whose claims are settled at less than face amount, or, if any class of creditors rejects the plan, its claims must receive absolute priority over those of any class junior to it.[95] Moreover, if any member of any class dissents from the plan, that creditor must receive at least the liquidation value of his claim.[96] A reorganization plan that meets all of these requirements, like a proposed settlement of a class action, must also receive the approval of the court.[97]

The settlement of class actions, of course, need not follow precisely the forms or procedures for agreements in these other areas of law. The conditional nature of these agreements, however, does suggest that similar agreements could plausibly be made to settle class actions. Conditional agreements would not be likely to yield the same

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[91] See 3 Newberg & Conte, supra note 30, § 12.12, at 12-33 to 12-37.

[92] See 7B Wright et al., supra note 2, § 1797.1, at 409-13.

[93] See, e.g., Davis v. Roadway Express, Inc., 590 F.2d 140, 144 (5th Cir. 1979); see also 2 Newberg & Conte, supra note 30, § 7.47, at 7-144 to 7-146.

[94] See Robert C. Clark, Corporate Law § 13.1, at 532 (1986).

[95] See 11 U.S.C. § 1129(b) (1994); Douglas G. Baird, The Elements of Bankruptcy 255-56 (rev. ed. 1993).

[96] See 11 U.S.C. § 1129(a)(7)(A)(ii) (1994).

[97] See id. §§ 1128, 1129, 1141.

rate of settlement as unconditional agreements, for obvious reasons: the conditions for effectiveness of the agreements might sometimes fail to be satisfied and the agreement might be more difficult to reach because the conditions are an additional, and potentially complicated, term on which the parties might disagree. Protecting the right to opt out inevitably comes at some cost in securing settlement of class actions. In particular, if class members with strong claims decide to opt out, the parties may be forced to renegotiate the settlement, proceed to litigation, or abandon the class action.[98]

It is no simple matter to decide how to weigh the rights of individual class members to opt out of the settlement, or to object to its approval, against the collective interests of the class or the broader social interest in efficient litigation. It is doubtful that the balance can be struck correctly without relying to some degree on the district judge's discretion. As with notice, however, it is necessary for the rule on opting out to provide some structure for how that discretion should be exercised. The interests of absent class members cannot be left entirely to be considered by someone else, whether it is the district judge, the class attorney, or the party opposing the class. The real question posed by the analogies to corporate and bankruptcy law is not whether these areas of law strike the correct balance between individual rights and collective interests in class actions—it is doubtful that they can without significant modifications—but rather whether such a balance can be struck in the drafting or application of Rule 23. Can the right to opt out be either limited or denied completely without affecting substantive rights in violation of the Rules Enabling Act?

B. Substantive Rights and the Right To Opt Out

Disputes over whether rights are procedural or substantive can easily become too arcane to be useful. Nevertheless, the right to opt out has a strong claim to being characterized as substantive. If denying the right to opt out denies class members a realistic opportunity to pursue individual actions, then it denies them a substantive right. Other doctrines, such as those denying implied private rights of action or staying claims against a debtor in bankruptcy,[99] are plainly substantive and have the same effect on an individual's right to pursue a claim independently. For precisely the same reason, however, the right to

[98] See *Agent Orange II*, 818 F.2d 145, 166 (2d Cir. 1987) (class actions may be inefficient if plaintiffs with strong claims opt out), cert. denied, 484 U.S. 1004 (1988); Kenneth S. Abraham, Individual Action and Collective Responsibility: The Dilemma of Mass Tort Reform, 73 Va. L. Rev. 845, 878 (1987).

[99] See 11 U.S.C. § 362 (1994).

opt out is substantive only if class members can realistically pursue individual actions.

Most of the confusion over the distinction between substance and procedure arises from the fact that all legal rights have both procedural and substantive aspects: procedural aspects because any legal right must be capable of affecting the course of judicial proceedings; substantive aspects because any legal right also affects the outcome of litigation and the relationship between the parties outside of court. To take two simple examples: the standard of negligence in tort law, although clearly substantive, plainly determines the instructions to the jury or the decision of the judge in cases to which it applies; conversely, the time limits for answering a complaint, although clearly procedural, can result in a default judgment if the defendant fails to comply with them, thereby requiring the defendant to pay money to the plaintiff.[100]

The ambivalent character of legal rights cannot be invoked, however, to deconstruct the distinction between substance and procedure as applied to the Federal Rules of Civil Procedure. When Congress provided in the Rules Enabling Act that the rules "shall not abridge, enlarge or modify any substantive right,"[101] it meant to provide some limitation on the rulemaking power of the Supreme Court. What precisely Congress meant has been debated—perhaps too frequently—under *Erie Railroad* and particularly when federal courts are faced with the choice between applying a Federal Rule or applying state law.[102] Nevertheless, the Rules Enabling Act itself does not protect only substantive rights under state law. It protects all substantive rights, regardless of their source. The rulemaking process guarantees neither the representation to those outside the legal community nor the means of collecting evidence adequate to the task of making substantive rules of law.[103] The restrictions imposed by the Rules Enabling Act cannot be written off simply by equivocating over the distinction between substance and procedure.

A workable definition of "substantive rights" which was developed under the *Erie* doctrine is whether the right arises from a legal rule intended to affect conduct outside of litigation.[104] Because all

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[100] See John Hart Ely, The Irrepressible Myth of Erie, 87 Harv. L. Rev. 693, 732-33 (1974).

[101] 28 U.S.C. § 2072(b) (1994).

[102] See, e.g., Hanna v. Plumer, 380 U.S. 460 (1965).

[103] Experimenting with different procedural rules can be justified as a means of ascertaining their empirical effects, but experimenting with substantive rights cannot. See generally Laurens Walker, Perfecting Federal Civil Rules: A Proposal for Restricted Field Experiments, Law & Contemp. Probs., Summer 1988, at 67.

[104] See Ely, supra note 100, at 724-27.

legal rules will have some effect outside litigation, the precise form of this definition requires further elaboration. To be sure, in *Hanna v. Plumer*,[105] the Supreme Court held that any question about the effects of a Federal Rule should be resolved in favor of finding that it is procedural. The Court only addressed the question of whether to apply a Federal Rule—not the original decision about how broadly a Federal Rule should be drafted.[106] The rejection of the proposed Federal Rules of Evidence, partly on the ground that the provisions on evidentiary privileges affected substantive rights, demonstrates that the authority of the rulemakers really is limited by the Rules Enabling Act.[107]

According to the preceding definition, the question of whether to imply a private right of action under a federal statute is substantive. A private right of action alters the authority to enforce federal law and consequently affects the out-of-court relationship between those who possess the right and those who are regulated by the law that creates the right. Hence, recent decisions have emphasized the need to find that Congress intended to confer a right of action on private parties.[108] This question differs only slightly from the question of whether class members have a right to opt out and to sue individually: an individual who is denied a private right of action has no control over any enforcement action, while a class member denied the right to opt out has only the very limited control implied by the duty of adequate representation of her interests. The existence of a private right of action is a matter of all-or-nothing, while the right to opt out is a matter of all-or-almost-nothing.

The law of bankruptcy presents an even stronger analogy that supports the substantive character of the right to opt out. The denial of the right to opt out is the exact analogue of the automatic stay of claims against a bankrupt debtor: it precludes individual actions and forces all creditors into a single, consolidated proceeding.[109] This rule of bankruptcy procedure clearly affects substantive rights because it denies a creditor the right to prosecute his claims to the full extent of

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105 380 U.S. 460, 471 (1965).

106 Id. ("[T]he court has been instructed to apply the Federal Rule, and can refuse to do so only if the Advisory Committee, this Court, and Congress erred in their prima facie judgment that the Rule in question transgresses neither the terms of the Enabling Act nor constitutional restrictions.").

107 See Ely, supra note 100, at 693-97.

108 See, e.g., Touche Ross & Co. v. Redington, 442 U.S. 560, 575-76 (1979).

109 See 11 U.S.C. § 362 (1994). A similar provision in the federal interpleader statute also forces claimants into a single proceeding by authorizing injunctions against individual actions. See 28 U.S.C. § 2361 (1994). This statute, like the Bankruptcy Act, allows claimants to be individually represented in the interpleader proceeding. See id.

their value, without apportionment or subordination to other unsecured claims. Denying creditors the right to proceed individually plainly has substantive consequences, both over their conduct in dealing with debtors who are close to insolvency and in the distribution of the bankrupt debtor's assets. The whole point of bankruptcy is that creditors give up their right to maximize their individual shares of the debtor's property in order to maximize the collective recovery of all creditors.[110] Class members who are denied the right to opt out are also forced into a single proceeding, where their claims might be compromised or diminished based on the rival claims of other class members, which also sacrifices individual advantage for collective gain. In fact, the procedures in class actions without the right to opt out are even more detrimental to individual class members than the procedures in bankruptcy are to individual creditors; class members are denied the right to individual representation in the class action while individual creditors are not.

Forced consolidation of claims and the denial of individual representation, although they plainly concern litigation, cannot be dismissed as purely procedural. The question of who controls the presentation of a claim in court is not much different from the question of who owns it. And that question is as substantive as the question of who owns a piece of property, if indeed these questions can be distinguished. Ownership of property is, in a sense, nothing more than the right to bring actions to enforce a claim to the property. In bankruptcy, the priority attached to collective efficiency over individual recovery plainly affects substantive rights. To the extent that class actions deny the right to opt out, they depend upon a similar priority: the collective efficiency of a class action over individual pursuit of individual claims.

Granting class members the right to opt out leaves them in the same position that they were in before any class action was filed. Because they still have the right to opt out and to sue individually, their substantive rights have not been affected at all. Aside from the effects of the statute of limitations,[111] class members are in the same position that they would have been in if no class action had been brought. To be sure, this position does not guarantee them a day in court all to themselves. Whatever the rights of individual class members, they do not include the right to present an individual claim free of the usual

[110] See generally Thomas H. Jackson, The Logic and Limits of Bankruptcy Law 7-19 (1986).

[111] See infra Part III.C.

rules on joinder and consolidation.[112] They do include the right to select an attorney to present an individual claim subject to these rules. However, if class members are denied the right to opt out, then they are denied even these rights.

The crucial question is whether class members had a realistic opportunity to pursue individual actions in the first place. The distinctions drawn between different class actions in subdivision (b) have some bearing on this question, although they need to be drawn more precisely for reasons suggested earlier.[113]

1. Class Actions Under Subdivision (b)(1)

Claims that must be brought as class actions under subdivision (b)(1) really cannot be brought as individual actions. Following the model—and much of the language—of Rule 19 on necessary and indispensable parties, subdivision (b)(1) requires class actions because individual actions would prejudice either the party opposing the class or the class members themselves. The alternative to class actions under subdivision (b)(1) is not individual actions, but no action at all. Denying class members the right to opt out in (b)(1) class actions does not affect their substantive rights because, in the absence of a class action, they would not be able to bring any action at all.

Although the denial of the right to opt out in (b)(1) class actions is procedural, the question remains whether subdivision (b)(1) should be read to establish the equivalent of a bankruptcy proceeding, as it has been with increasing frequency.[114] In cases such as *In re A.H. Robins Co.*[115] and *Johns-Manville*,[116] the individual claims of class members may be large enough in the aggregate to bankrupt the employer. Nevertheless, these claims could be brought individually without prejudicing the right of other class members to obtain judgments against the defendant. The only prejudice, and therefore the only need for consolidation, arises not in the individual adjudication of the claims, but in proceedings to enforce the resulting judgments. In the

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[112] See Weinstein, supra note 5, at 480-81 (noting that consolidation of individual mass tort claims may make case into quasi class action); Spencer Williams, Mass Tort Class Actions: Going, Going, Gone?, 98 F.R.D. 323, 329-30 (1982) (stating that right of individual plaintiffs to control their own claims is overstated).

[113] See supra text accompanying notes 55-70.

[114] See 7A Wright et al., supra note 2, § 1774, at 441-43; 7B id. § 1805, at 545-47. The converse question also remains open: whether bankruptcy law, either in its present form or as amended, can assume some of the functions now performed by class actions. See generally Note, The Manville Bankruptcy: Treating Mass Tort Claims in Chapter 11 Proceedings, 96 Harv. L. Rev. 1121 (1983).

[115] 880 F.2d 709, 740-41 (4th Cir.), cert. denied, 493 U.S. 959 (1989).

[116] In re Joint Eastern and Southern District Asbestos Litigation [*Johns-Manville*], 982 F.2d 721, 735 (2d Cir. 1992).

analogous context of interpleader actions involving multiple claims arising out of a single accident, the Supreme Court has insisted that consolidation be limited to collection proceedings.[117] The same limitation should apply to interpretations of subdivision (b)(1): consolidation should be limited to collection proceedings. Class actions under subdivision (b)(1) do not constitute a substitute for bankruptcy proceedings, which consolidate the claims of all creditors against the bankrupt, not just the claims of those who happen to be members of the class.[118] In *A.H. Robins*, of course, the class action did not serve this purpose: it was conducted simultaneously with a reorganization under Chapter 11 that brought all the creditors before the court.[119]

2. *Class Actions Under Subdivisions (b)(2) and (b)(3)*

The baseline for determining whether the right to opt out is substantive in (b)(2) class actions depends on the individual action that would be brought if a class member opted out: if it concerns relief that applies equally to all members of the class, then it should be certified under subdivision (b)(1); if it depends on the class member's individual circumstances, then it should be certified under subdivision (b)(3). Claims for classwide injunctive or declaratory relief under subdivision (b)(2) should be analyzed in the same way as in (b)(1) class actions.[120] To the extent that such class actions concern claims that can only be considered in a class action, they should be binding on class members who do not have the right to opt out. To the extent that they concern claims that could be presented in individual actions, class members should retain the right to proceed individually. If class members have the right to proceed individually, as on the claims for backpay in *Johnson v. General Motors Corp.*,[121] then they have a sub-

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[117] See State Farm Fire & Casualty Co. v. Tashire, 386 U.S. 523, 533-37 (1967).

[118] See John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 Colum. L. Rev. 1343, 1457-61 (1995).

[119] The class action was against Robins's liability insurer, but it was intimately tied to the funds available to Robins to satisfy the claims against it in the reorganization proceedings. See *A.H. Robins*, 880 F.2d at 717-19. Class members also received a substitute for the right to opt out because they were allowed to present their individual claims to the court. See id. at 716-17, 744-45.

In *Johns-Manville*, the class action could have been considered part of the reorganization proceedings themselves, although the Second Circuit doubted whether the procedures for confirmation and amendment of the reorganization plan could be displaced by the procedures for approval of a settlement of a class action. See *Johns-Manville*, 982 F.2d at 735-49.

[120] Cf. Weber, supra note 6, at 411-13 (proposing use of Rule 19 to join individuals allowed to opt out of (b)(2) class actions).

[121] See 598 F.2d 432, 433 (5th Cir. 1979).

stantive right to opt out of any class action that includes their individual claims.

Conceptually, of course, the two categories of class and individual claims overlap: claims that can be brought as a single class action could theoretically be brought as a series of individual actions. An action to change general practices of the defendant, such as a class action alleging discrimination in a seniority system, could conceivably be broken down into a series of individual actions, each seeking individual relief from the same general practice. The test, however, should be one of practical necessity. What is conceivable in theory may not be feasible in practice. Uniform changes, where uniformity is required, may only be accomplished in a class action. It is not feasible for an employer to modify a seniority system for some class members but not others. The gain in efficiency from a class action is so great that it becomes a necessity.

The same reasoning could be extended to class actions that are now certified under subdivision (b)(3) but that consist of claims that are too small to be individually viable. As many commentators have pointed out,[122] denying class members the right to opt out and pursue these claims does not deny them anything of value. Although it may be difficult in any particular case to draw a precise distinction between viable and nonviable claims, even a conservative estimate of how much a claim must be worth to be independently pursued—say $1000—is better than no estimate at all. Individual notice and the right to opt out should be saved for the cases in which it really matters to the class members themselves.

From the perspective of the Rules Enabling Act, the right to opt out is allowed both too narrowly and too broadly under the current version of Rule 23. The right to opt out should be broadly allowed for any individual claim that could be prosecuted to judgment without prejudicing the rights of the party opposing the class or of other class members. But the right to opt out should be denied if class members have no realistic opportunity to pursue their claims individually.

C. Preclusion by Judgment and by the Statute of Limitations

Class members who opt out, of course, are not bound by the resulting judgment or settlement in a class action. That is just what the right to opt out means. Yet from the beginning, the drafters of the current version of Rule 23 recognized that questions of preclusion affect substantive rights beyond the scope of the rulemaking process.[123]

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[122] See, e.g., Dam, supra note 4, at 105 & n.42; Macey & Miller, supra note 39, at 30-31.

[123] See supra note 47.

Since the right to opt out is so intimately tied to questions of preclusion, the drafters' comments provide further support for the substantive character of the right to opt out. Even so, class members who are granted the right to opt out cannot simply luxuriate in the prospect of controlling their own claims.

Even if class members are not formally bound by a class action, they remain affected by it. If the settlement or judgment in the class action is favorable to the class, it bolsters the position of those who opt out. Conversely, if the outcome is unfavorable, it has the opposite effect.[124] In either case, class members who opt out are likely to use whatever segments of the record remain open to public knowledge to prepare their own claims. Knowing all this before they opt out, class members might well recognize that it is better for them to stay in the class action. Even if they lose control over their claims, they gain from the economies of scale that benefit the entire class.

Attorneys for individual class members, however, may suffer from the loss of contingent fees if their clients decide to remain in the class action. These attorneys are ethically obligated to act in the interests of their clients,[125] an obligation that could well be strengthened by explicitly requiring disclosure to the client of the costs and benefits of the decision to opt out. Although notice of settlement under Rule 23(e) already contains some of this information,[126] an ordinary class member may not understand it without the assistance of counsel. More elaborate and less formal communication, supervised by the court, may be necessary to inform class members effectively of their rights.[127] A fully informed decision, however it is achieved, might well lead the client not to exercise the right to opt out.

If the class member does decide to opt out, the class action likely will preclude him, practically if not formally, from obtaining certification of a separate class action. Only in the unlikely circumstance that the claims of class members who opt out independently meet the requirements of Rule 23 will they be able to obtain certification of a rival class action. Few decisions have allowed class actions to multiply in this way,[128] and even those that do can be better justified as deci-

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[124] See Dam, supra note 4, at 120.

[125] See Model Rules of Professional Conduct Rule 1.2(a) (1983) (requiring lawyers to abide by clients' decisions whether to accept a settlement); Model Rules of Professional Conduct Rule 1.5(c) (1983) (requiring contingent fee agreement to be in writing); see also Weinstein, supra note 5, at 490, 503 (discussing incentives of counsel to obtain contingent fees).

[126] See 2 Newberg & Conte, supra note 30, § 8.32.

[127] See Weinstein, supra note 5, at 546-47.

[128] In an earlier article, I surveyed the decisions on multiple class actions in employment discrimination cases. George Rutherglen, Notice, Scope, and Preclusion in Title VII Class

sions to limit the scope of the initial class action or to allow the equivalent of subclasses. Practical preclusion of subsequent class actions greatly limits the defendant's exposure to continued litigation and liability. It leaves the defendant vulnerable only to litigation of individual claims. To be sure, in mass tort cases such as *In re "Agent Orange" Product Liability Litigation*[129] and *Georgine v. Amchem Products, Inc.*,[130] these individual claims can reach staggering proportions. Because of the difficulty or complexity of proof, however, the cost of pursuing individual claims also can be quite high.

Yet even in these cases, class members who opt out to avoid preclusion by judgment still face the risk of preclusion under the statute of limitations. This question, too, raises issues of substantive law, since the statute of limitations protects the defendant's right to repose. In addition to protecting procedural values of preventing litigation based on stale evidence, the statute of limitations allows the defendant some means of assessing and limiting its overall exposure to liability.[131] For this reason, the text of Rule 23 does not address the statute of limitations, but decisions under the Rule have established a clear principle of tolling: from the time that a class action is filed until the class action is concluded—either because certification of a class is denied, or because a class is certified and then decertified—the running of the limitation period is tolled on the individual claims of class members.[132]

The decisions that established this principle concerned class actions in which class certification was denied. In cases in which the class action is certified and results in a settlement or judgment, questions of whether subsequent individual actions are barred by the statute of limitations generally do not arise because such actions are precluded by the judgment in the class action. It remains possible that an individual claim that originally fell within the class action was excluded from it when the class was certified, but these cases can easily fit within the tolling principle because the partial certification of a

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Actions, 69 Va. L. Rev. 11, 79-83 (1983). See generally 2 Newberg & Conte, supra note 30, § 7.31.

[129] See *Agent Orange II*, 818 F.2d 145, 148-52 (2d Cir. 1987), cert. denied, 484 U.S. 1004 (1988).

[130] 157 F.R.D. 246 (E.D. Pa. 1994), vacated and remanded, Nos. 94-1925 et al., 1996 U.S. App. LEXIS 11191 (3d Cir. May 10, 1996).

[131] See Ely, supra note 100, at 729-32.

[132] See Crown, Cork & Seal Co. v. Parker, 462 U.S. 345, 353-54 (1983); American Pipe & Constr. Co. v. Utah, 414 U.S. 538, 550-52 (1974). Depending on the underlying substantive law, the limitation period might be reinstated in its entirety and not just for the time remaining after the filing of the class action. See Chardon v. Fumero Soto, 462 U.S. 650, 658-62 (1983).

class action also constitutes a partial denial of certification. So, too, for class members who opt out, the limitation period begins to run again as soon as they opt out of the class.[133]

The question of tolling has also come up in cases in which a class member was entitled to individual relief under a settlement of a class action, but because she received no notice, failed to file a claim under the time limitations stipulated in the settlement for doing so. Sometimes courts have exercised their discretion to expand the time limits for filing claims under the settlement, as in *In re A.H. Robins Co.*;[134] at other times, they have held that the lack of notice to class members denied due process and so allowed them to bring individual claims.[135] Presumably the latter decisions tolled the running of the limitation until the class action reached a final judgment that distributed all relief under the settlement, so that the statute of limitations did not bar individual actions. Otherwise, these decisions succeeded only in shifting the ground of dismissal from preclusion by judgment to preclusion under the statute of limitations. In most cases, the statute of limitations does not leave class members who opt out with much time in which to decide whether to bring an independent action. This constraint, along with the cost of individual litigation, makes opting out a less attractive alternative to class members in practice than it might appear to be in theory.

The managerial problems created by the right to opt out are severe in one class of cases: mass tort litigation in which the statute of limitations does not operate as an effective bar on individual claims because of the long latency period before discovery or manifestation of the plaintiffs' injuries.[136] This problem has arisen in *Georgine*, in which settlement of claims on behalf of tens of thousands of current victims is contingent upon certification and settlement of claims on behalf of future victims of the same diseases.[137] Although all the future claimants were exposed to asbestos long in the past, the diseases which result from exposure have not yet manifested themselves. The commencement of the limitation period for bringing individual claims has therefore been postponed. The defendants to the present claims

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133 See *Crown, Cork & Seal Co.*, 462 U.S. at 351-52; Eisen v. Carlisle & Jacquelin, 417 U.S. 156, 176 n.13 (1974).

134 See In re A.H. Robins Co., 880 F.2d 694, 700 (4th Cir.), cert. denied, 493 U.S. 959 (1989).

135 E.g., Burns v. Elrod, 757 F.2d 151, 155-56 (7th Cir. 1985).

136 See 2 Calvin W. Corman, Limitation of Actions §§ 11.1.2.1 to 11.1.2.3, at 136-45 (1991); Coffee, supra note 118, at 1424-25.

137 See Georgine v. Amchem Prods., Inc., 157 F.R.D. 246, 266-67 (E.D. Pa. 1994), vacated and remanded, Nos. 94-1925 et al., 1996 U.S. App. LEXIS 11191 (3d Cir. May, 10, 1996).

and to these future claims, of course, would like to reach a settlement that establishes some overall ceiling on their liability. So long as a large number of future claims are outstanding, they will be unable to do so and, for that reason, they have refused to settle the present claims in the absence of a settlement of the future claims.[138]

The major question in cases such as *Georgine* is whether attorneys for the present claimants can adequately represent the future claimants, especially since the terms of the proposed settlement treat present claimants better than future claimants. The former receive cash payments, whereas the latter mainly receive the right to present their claims to a Center for Claims Resolution (although future class members could not, in any event, receive a fixed sum for future diseases that have not yet developed).[139] A further issue is the right of future class members to opt out, as 236,000 of them already have.[140] Proponents of the settlement are succeeding in voiding the opt-out responses already submitted, on the ground that they were tainted by misrepresentations about the case by individual counsel,[141] and in imposing new opt-out notices with shorter deadlines and more information to counteract alleged misrepresentations.[142] Whether or not these arguments are successful, the defendants must reduce the number of future claimants who opt out in order to obtain significant savings from the settlement.

From the arguments advanced earlier in this paper,[143] it follows that future claimants have a substantive right to opt out and that allowing them to opt out after the proposed settlement gives them more information than they would have had before the settlement. Misrepresentations of the settlement by class members' individual attorneys may be a serious problem, but the proposed cure in this instance—limiting the class members' right to opt out because of the misconduct of their attorneys—is worse than the disease.[144] Time limits plainly can be imposed on the right to opt out, but not in a way that effectively denies class members the opportunity to exercise that right.

Nevertheless, the managerial problems are real enough, and they should be addressed if possible. One means of doing so is to impose time limits on the right to bring a claim after the class member has

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138 See id.

139 See id. at 294-99.

140 See Roger Parloff, The Tort That Ate the Constitution, Am. Law., July/Aug. 1994, at 75, 79.

141 Georgine v. Amchem Prods., Inc., 160 F.R.D. 478, 518 (E.D. Pa. 1995).

142 Id. at 519.

143 See supra text accompanying notes 100-13.

144 For a similar proposal to grant future claimants the right to opt out, see Coffee, supra note 118, at 1446-53.

decided to opt out, again in a manner that does not deny the effective exercise of the right to sue. Bankruptcy law provides another useful analogy: for claims not discharged in bankruptcy and not subject to the automatic stay, the creditor has at least thirty days in which to bring an action outside of bankruptcy.[145] This provision creates only a minimum period for filing an action outside of bankruptcy, so that tolling of a claim under nonbankruptcy law can greatly extend the limitation period. Nor does it apply to claims that have yet to arise, like those in *Georgine*. Other limitations might deal with the problem more effectively—for instance, statutes of repose that impose outer limits on the time in which a claim may be brought,[146] or statutes of limitations that impose time limits from the termination of related proceedings.[147] These examples are only illustrative, but they suggest how problems of management might be addressed consistently with allowing a right to opt out.

Unlike time limits on the exercise of the right to opt out, these time limits plainly raise questions of substantive law.[148] The long period over which claims might be brought shows just how far this issue goes into matters of substantive law. On most tort claims, as in *Georgine*, the applicable substantive law is state law, and a federal court, under the *Erie* doctrine, would be required to accept the application of the statute of limitations by state courts. Over the long term, however, it might be desirable to change class action practice by statute to provide a separate statute of limitations—for instance, for a fixed period of time running from the decision to opt out—that leaves class members a reasonable period in which to file their individual claims. There is no doubt that such a statute falls within the power of Congress and that it could be part of a more general reform of class action practice. A statute along these lines would hardly solve all the problems created by the right to opt out of mass tort class actions such as *Georgine*, but it would at least pose the right issue in the right way: as one of substantive law that can be addressed only by limiting the substantive right of individual litigants to pursue their own claims as they see fit.

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145 See 11 U.S.C. § 108(c) (1994).

146 See 2 Corman, supra note 136, § 11.2.

147 For instance, under Title VII of the Civil Rights Act of 1964, individual claims against private employers must be filed within 90 days of receipt of a right-to-sue letter that terminates administrative proceedings before the Equal Employment Opportunity Commission. See 42 U.S.C. § 2000e-5(f)(1) (1994).

148 The Supreme Court recognized as much in framing its decision in American Pipe & Constr. Co. v. Utah, 414 U.S. 538 (1974), as one of federal common law. See id. at 556-59. As such, of course, it is subject to modification by Congress. Chardon v. Fumero Soto, 462 U.S. 650, 658-62 (1983).

CONCLUSION

The limited scope of Rule 23 limits the power of judges to manage large class actions. Any reform of the Rule must recognize these limits, as well as the desirability of more comprehensive reform by statute. This Article has argued that existing class action practice requires too much notice too early in the proceedings, yet results in too little real protection to class members. As others have pointed out, notice early in the class action is not likely to be effective, except in satisfying the formalities of the existing rule. It does not give class members information when it is most likely to be valuable to them: at the time when they are deciding whether or not to participate in a proposed settlement. So, too, the right to opt out should be more broadly allowed in any case in which class members have a realistic option of pursuing an individual claim for compensatory relief. Class members should be allowed to opt out at the time when they are most likely to receive information about how well their interests have been protected by the class action: either after a proposed settlement or just before trial.

Previous scholarship has emphasized the constitutional dimensions of these issues under the Due Process Clause. This Article has emphasized instead the substantive aspects of the right to opt out. Recognizing this limit on the power of the rulemakers, and on the power of federal judges to manage class actions based solely on the authority of the Rule, may prove disappointing to those impressed by the managerial problems created by large class actions. These problems can be addressed by a variety of other means, however, from substantive rulings of federal judges in interpreting federal statutes or in making federal common law, to amendments to the Judicial Code, to changes in state substantive law. They cannot be addressed successfully solely through a revision of Rule 23. Doing so would only increase the risk of reaching the wrong answer to a question of substantive law by asking it in purely procedural terms.

Tab 32

THE OXFORD ENGLISH DICTIONARY

SECOND EDITION

Prepared by

J. A. SIMPSON *and* E. S. C. WEINER

VOLUME VII

Hat–Intervacuum

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1989

Uncontaminated, uncorrupted, pure.

a 1695 Wood *Ath. Oxon., F. Junius* (1721) II. 603 Whose Inhabitants use the antient and intaminated Frisic Language.

intangibility (ɪnˌtændʒɪ'bɪlɪtɪ). [f. next + -ITY. Cf. mod.F. *intangibilité* (Littré).] a. The quality of being intangible.

1847 in Craig. 1848 *Fraser's Mag.* XXXVII. 99 There is an intangibility about all the charges that are made against her. 1885 Clodd *Myths & Dr.* II. vii. 184 Its [his shadow's] intangibility feeds his awe and wonder.

b. Inviolability.

1783 C. J. Fox *Memorials & Corr.* (1853) II. 102, I beg of gentlemen to be aware of the lengths to which their arguments upon the intangibility of this charter may be carried. 1929 *Times* 13 Aug. 10/2 There has been too much talk .. of the intangibility of the Young Plan.

intangible (ɪn'tændʒɪb(ə)l), *a.* and *sb.* [ad. med.L. *intangibil-is*, f. *in-* (IN-[3]) + L. *tangibilis* TANGIBLE: cf. F. *intangible* (1508 in Godef. *Compl.*).] A. *adj.* a. Not tangible; incapable of being touched; not cognizable by the sense of touch; impalpable.

1640 Wilkins *New Planet* II. (1684) 148 A Man should be still in danger of knocking his head against every Wall and Pillar; unless it were also intangible, as some of the Peripateticks affirm. 1717 Clarke *Leibnitz Papers* Reply iv. §45. 151 The Means by which Two Bodies attract each other, may be invisible and intangible. 1845 McCulloch *Taxation* III. iii. (1852) 476 The proportion of monied and other moveable and all but intangible property .. has increased ten-fold, since the accession of George I. 1871 Tyndall *Frogm. Sc.* (1879) I. iii. 76 The assumption of this wonderful intangible aether. 1880 Muirhead *Gaius* II. §14 Incorporeal [things] are those that are intangible .. such as an inheritance, a usufruct.

b. *fig.* That cannot be grasped mentally.

1880 *Mem. John Legge* 127 To the irreligious man all this is intangible, unintelligible. 1898 Ramsay *Was Christ born in Bethlehem?* 20 This abstract and rather intangible argument must yield to the demonstration of hard facts.

B. *sb.* Anything intangible; spec. (in *pl.*) = *intangible assets*, i.e. assets (e.g. goodwill, rights, etc.) which cannot easily or precisely be measured.

1914 *Cycl. Amer. Govt.* III. 496/1 The term 'personal property' .. includes .. visible property and intangibles. 1930 *Economist* 29 Mar. 710/1 Net tangible assets may be defined as total assets less 'intangibles' (goodwill, patents, etc.), current liabilities, and funded debt. 1933 *Discovery* Oct. 313/2 Scientific changes were coming in so thick and fast that other factors in social life—the intangibles of credit, the improvements in political and international ideas—were unequal to the task of accommodating them. 1949 *Here & Now* (N.Z.) Oct. 30/3 The intangibles—the many local developments—being not reducible to statistics, the food of all bureaucracy, count for nothing. 1957 *Economist* 19 Oct. (Suppl.) 1/2 The success of individual motor producers will depend mainly upon intangibles such as the success of their design policy.

Hence **in'tangibleness**; **in'tangibly** *adv.*, so as to be intangible.

1678 Cudworth *Intell. Syst.* I. v. 769 That which is extended also, but penetrably and intangibly which is space or vacuum. 1828 Webster, *Intangibleness*, the quality of being intangible. 1887 E. F. Byrne *Heir without Heritage* II. v. 91 The most intangibly delicate sense of duty.

in'tangle, -ment, obs. ff. ENTANGLE, -MENT.

†in'tangle, *a. Obs. rare*[−1]. [IN-[1].] In a tangle; entangled.

1642 Howell *For. Trav.* 40 His observations will lye confusedly huddled up, like a skeine of intangle silk.

in'tarissable, *a. rare.* [a. F. *intarissable* (Cotgr.), f. *in-* (IN-[3]) + *tarissable*, f. *tarir*, *tarissant* to dry up.] Not to be dried up, inexhaustible.

1656-81 Blount *Glossogr.*, *Intarissable*, not to be withered or dryed up. 1859 Mrs. Schimmelpenninck *Princ. Beauty* IV. v. §6 That intarissable fountain of gushing joy.

intarsia (ɪn'tɑːsɪə). Also -io. [It. *intarsio*.] = TARSIA. Also *attrib.*, *transf.* and *fig.* So **intarsiatore** (ɪnˌtɑːsɪə'tɔəreɪ), a worker in intarsia; **intarsiatura** (ɪnˌtɑːsɪə'tʊərə), pl. -e, = INTARSIA.

1863 A. Jameson *Legends of Monastic Orders* (ed. 3) 275 The fine intarsiatura in the Choir of San Francesco di Assisi. 1867 *Ecclesiologist* XXVIII. 216 Hidden under the intarsio pavement. 1868 C. C. Perkins *Italian Sculptors* 262 A celebrated wood-carver and 'intarsiatore' named Luchino Bianchini .. helped them to carve the presses for the sacristy. *Ibid.*, Luchino Bianchini .. made the woodwork about its great portal, as well as the intaglios and intarsiature of the choir at San Lodovico. 1892 A. M. Clerke *Familiar Stud. Homer* x. 266 Some rusty dagger-blades .. skilfully ornamented in coloured metallic intarsiatura. 1894 *Daily News* 6 Dec. 5/2 Humorous intarsia showing Polyphemus .. feeling the backs of the sheep. 1896 *Q. Rev.* Oct. 471 The intarsias of the choir-stalls of S. Maria Maggiore at Bergamo. 1906 *Westm. Gaz.* 4 July 2/1 The Brunellesse looked critically at the intarsia chests of drawers. 1913 Mrs. H. Ward *Mating of Lydia* IV. xix. 389 The gleaming reflections on lacquer and intarsia, on ebony or Sèvres. 1919 H. F. Jones *Samuel Butler* II. 67 The seats of the stalls in the church of Santa Maria Maggiore at Bergamo are ornamented with intarsia work. 1945 *Burlington Mag.* Aug. two or more colours... (2) A motif design in stitch and/or colour. 1958 *Listener* 11 Sept. 388/3 Of the poems, with their tessellated intarsia of natural scenery, natural passion and liturgical imagery, perhaps the most revealing on the subject of Zhivago's destiny is the first. 1970 *Times* 28 Feb. (Sat. Suppl.) p. vii/4 The most startling form of marquetry was perspective picture making in wood, known as intarsia. 1973 *Guardian* 10 Apr. 13/3 Sweater with intarsia thistle motif.

†in'tastable, *a. Obs. rare*[−1]. [IN-[3].] Incapable of being tasted.

a 1711 Grew (J.), Something which is invisible, intastable, and intangible .. existing only in the fancy, may produce a pleasure superiour to that of sense.

†in'taxable, *a. Obs. rare.* [IN-[3].] That cannot be taxed or charged with something.

1631 I. Craven *God's Tribunall* 16 The Lord of Hosts, whose .. iustice [is] intaxable, anger intollerable.

intechnı'cality. *rare.* [IN-[3].] Want of technicality; something not technically correct.

1821 *New Monthly Mag.* I. 618 Every power must be for ever on the alert, to detect intechnicalities, to fence with witnesses, to puzzle or persuade phlegmatic jurors.

†'integent, *a. Obs. rare*[−1]. [ad. L. *integent-em*, pr. pple. of *integĕre*, f. *in-* (IN-[2]) + *tegĕre* to cover.] That covers; covering.

1661 Lovell *Hist. Anim. & Min.* 319 As for the parts, they are dissimilar, *sc.* the basis and point, or similars external, as the fat, integent membran.

integer ('ɪntɪdʒə(r)), *a.* and *sb.* [a. L. *integer* untouched, intact, entire, f. *in-* (IN-[3]) + *tag-*, *teg-*, root of *tangĕre* to touch. Cf. F. *intègre* (1567 in Hatz.-Darm.), and ENTIRE.]

A. *adj.* (Now *rare* or *Obs.*)

†1. Having no part taken away or wanting; whole, entire: = INTEGRAL A. 3. *Obs.*

a 1509 Wolsey *Let. to Hen. VII* in *Lett. Rich. III* (Rolls) I. App. 443 Wher I seyd that the emperors m... he dote of thre hunderyth thousan .. should .. have the seyd integyr dote in effect and equyvalen .. [*MS. imperf.*]

†2. Marked by moral integrity; honest, upright. *Obs.*

1644 Vicars *God in Mount* 108 The face of their best and most integer proceedings.

3. *Math.* Denoting a whole thing or number of whole things; denoted by a whole number; 'whole', not fractional: = INTEGRAL A. 4 a. Now *rare* or *Obs.*

1660 Boyle *New Exp. Phys. Mech.* xii, I had .. found that .. 14 and 1 be the nearest of small integer numbers that express the proportion between the specifick gravities of quicksilver and water. 1806 Hutton *Course Math.* I. 52 A whole or integer number may be expressed like a fraction, by writing 1 below it, as a denominator. 1833 Herschel *Astron.* ii. 79 To keep the reckoning of the integer days correct .. is the object of the calendar.

B. *sb.* 1. *Math.* A number or quantity denoting one or more whole things or units; a whole number or undivided quantity. Opp. to *fraction*.

1571 Digges *Pantom.* IV. v. Vij b, The containing circles Semidimetient being very nighe 11½ for exactly nether by integer nor fraction it can be expressed. 1675 Ogilby *Brit.* Pref. 4 Not regarding the Fractional Parts of a Mile, but taking the lesser Integer. 1831 Carlyle *Sart. Res.* III. xi, The Fraction will become .. an Integer. 1875 Todhunter *Alg.* (ed. 7) lii, Theory of Numbers. Throughout the present Chapter the word *number* is used as an abbreviation for *positive integer*.

2. A particular quantity of any kind (as money, weight, length, etc.) taken as the unit of measurement. Now *rare* or *Obs.*

1822 J. Flint *Lett. Amer.* 50 The dollar is the integer of money in the United States. 1827 Faraday *Chem. Manip.* iii. 67 Two integers .. the pint and the cubic inch. 1868 Seyd *Bullion* (1880) 146 The Carat serves as the Integer.

3. *gen.* (often with allusion to 1): A whole or entire thing or entity, either as complete in itself, or as the sum of its parts or elements.

a 1848 R. W. Hamilton *Rew. & Punishm.* v. (1853) 202 The soul is the integer of the man. 1859 Helps *Friends in C.* Ser. II. II. viii. 150 You would never amongst you all make up the noble integer. 1875 E. White *Life in Christ* I. iii. (1878) 23 Death is followed by the speedy dissipation of the combined elements which formed the organism .. The Integer, the Animal which resulted from the former combination, is no more. 1899 R. C. Temple *Univ. Gram.* 4 Functionally a word is either—(1) An integer, or a sentence in itself.

ˌintegra'bility. [f. next: see -ITY.] The fact or character of being integrable; capability of being integrated.

1816 *Edin. Rev.* XXVII. 93 The theorem, which is called the *Criterion of Integrability*. 1816 tr. *Lacroix's Diff. & Int. Calculus* 337 Ascertaining whether the proposed equation satisfies the condition of integrability. 1882 *Nature* XXVI. 310 This definition .. satisfies as well the condition of integrability as the differential equation of motion.

1747-41 Chambers *Cycl.* s.v. *Calculus*, The differential quantity to be integrated .. must .. be reduced to an integrable finite, or an infinite series. 1809 Ivory in *Phil. Trans.* XCIX. 349 The expressions .. are all integrable with respect to one of the variable quantities they contain. 1882 J. B. Stallo *Concepts Mod. Physics* 107 *note*, When their equations are integrable.

b. *gen.*: see INTEGRATE *v.* 2.

1855 H. Spencer *Princ. Psychol.* (1870) I. 298 Dispersed atoms of integrable matter. *Ibid.* (1872) I. III. vi. 330 To the lowest living things, the integrable matter is everywhere present.

integral ('ɪntɪgrəl), *a.* and *sb.* [ad. late L. *integrāl-is*, f. *integer*, *integr-*: see INTEGER and -AL[1]. Cf. F. *intégral* (Oresme, 14th c.); It. *integrale* 'entire, consisting of entirenesse' (Florio).

'*Integralis pars*', and '*partium integralium*, quæ si conveniant, totum exstat', occur in a 6th c. Comment. on Cicero *de Invent. Rhet.*, in Suringar *Hist. Crit. Scholiast. Latin.* (1834) pp. 248, 222.]

A. *adj.*

1. Of or pertaining to a whole. Said of a part or parts: Belonging to or making up an integral whole; constituent, component; *spec.* necessary to the completeness or integrity of the whole; forming an intrinsic portion or element, as distinguished from an adjunct or appendage. (Cf. INTEGRANT.) (Formerly distinguished from *essential*: see quots. 1697, 1727.)

1551 T. Wilson *Logike* 39 b, The integral partes, which make perfect the whole, and cause the bignesse thereof. *a* 1639 W. Whateley *Prototypes* II. xxvi. (1640) 43 The parts integrall, viz. as the severall members of the matter, head, heart, &c. in man. 1651 N. Bacon *Disc. Govt. Eng.* II. xv. (1739) 79 In a mixt Commonwealth they [kings] are integral Members. 1697 Locke *2nd Vind. Reas. Chr.* 247 (Seager) Integral parts .. are contradistinguished to essential; and signify such parts, as the thing can be without, but without them will not be so complete and entire as with them. 1727-41 Chambers *Cycl.*, *Integral*, or *Integrant*, is applied by the schoolmen, to those parts which are necessary to the integrity of a whole... In which sense they stand contradistinguished from *essential* parts... The arms, legs, etc. are *integral* parts; body and soul *essential* parts of a man. 1786 Burke *W. Hastings* Wks. 1842 II. 220 Forming no legal or integral part of the government. 1862 Goulburn *Pers. Relig.* III. x. (1873) 238 Recreation must form an integral part of human life. 1867 Freeman *Norm. Conq.* I. ii. 69 A dependency of the British Crown .. not an integral part of the United Kingdom. 1923 Glazebrook *Dict. Appl. Physics* V. 165/1 This cylinder has an open-ended steel barrel with integral fins. 1958 *Chambers's Techn. Dict.* 987/1 *Integral stiffeners*, the stiffening ridges left when an aircraft skin panel is machined from a solid billet. 1968 *Gloss. Formwork Terms* (*B.S.I.*) 16 *Integral facing*, a special facing concrete or mortar cast simultaneously with the backing concrete so as to be monolithic with it. 1972 [see INTEGRALLY *adv.* b].

2. Made up of component parts which together constitute a unity; in *Logic*, said of a whole consisting of or divisible into parts external to each other, and therefore actually (not merely mentally) separable. Now *rare* or *Obs.* exc. in technical use.

1588 Fraunce *Lawiers Log.* I. vi. 33 The whole Integrall cannot bee affirmed of any one of his parts, for a part is not the whole. 1628 T. Spencer *Logick* 203 An Integrall whole is not in each part, neither according to their whole essence, nor vertue, and therefore it is no wayes predicated of the singular parts. 1649 Jer. Taylor *Gt. Exemp.* II. vi. §19 In every Christian there are three parts concerning this integral Constitution, body and soul, and Spirit. 1725 Watts *Logic* I. vi. §10 As an integral Whole is distinguish'd into its several Parts by Division, so the Word Distribution is most properly used when we distinguish an universal Whole into its several Kinds of Species. *Ibid.*, Logicians have sometimes given a mark or sign to distinguish when it is an integral whole, that is, divided into its parts and members, or when it is a genus, an universal whole, that is, distributed into its species and individuals. 1836-7 Sir W. Hamilton *Metoph.* xxxvii. (1859) II. 340 The Integral or, as it ought to be called Integrate whole (*totum integratum*), is composed of integrant parts (*partes integrantes*) which are either homogeneous, or heterogeneous. 1864 Bowen *Logic* iv. 67 *note*, The Essential or Physical whole is that which consists of Matter and Form, or substance and accident, as its essential parts. 'The characteristic of this whole is that, as its parts do not exist out of each other, they cannot be separated except in Thought .. The Mathematical or Integral whole, on the other hand, has parts which are external to each other, so that they can be divided asunder. 1945 H. D. Smyth *Gen. Acct. Devel. Atomic Energy Mil. Purposes* xii. 132 Two 'integral experiments' (experiments on assembled or integrated systems comprising fissionable material, reflector, and perhaps moderator also) may be described. 1953 C. Wallace *Photographer's Pocket-Bk.* 112 In modern colour materials the colours are achieved by building up on a suitable base .. an 'integral tri-pack' of three separate emulsions.

3. a. Having no part or element separated, taken away, or lacking; unbroken, whole, entire, complete. Now somewhat *rare*. [= mod.F. *intégral*.]

1611 Florio, *Integrale*, whole or integrall. 1626 Bacon *Sylva* §344 All Locall Motion keepeth Bodies Integrall, and their Parts together. 1651 Biggs *New Disp.* 238 Thorow the integral porous pelt. 1659 D. Pell *Impr. Sea* 484 Their hearts are not integral, and entire in prayer. 1794 Mathias *Purs. Lit.* (1798) 157 Excerpta of Writers whose integral works are lost for ever. 1862 Lytton *Str. Story* II. 15 Who

could expect that every link in a madman's tale would be found integral and perfect?

b. Of things immaterial.

1651 JER. TAYLOR *Serm. for Year* I. iv. 51 Repent with an integral, a holy and excellent repentance. 1656 EARL MONM. *Advt. fr. Parnäss* 281 They are thought by them to merit their Princes integral love. 1847 R. W. HAMILTON *Sabbath* v. (1848) 181 It is felt that, if we would retain Christianity, we must hold fast the full, the integral, sabbath.

†c. *Gram.* Applied by Wilkins to a word or part of speech denoting a complete notion; see B. 3. *Obs.*

1668 WILKINS *Real Char.* 305 They supply the room either, 1. Of some Integral word, as Pronouns, or 2. Of some Sentence or complex part of it, as Interjections.

4. *Math.* a. That is, or is denoted by, an integer, or involves only integers; consisting of a whole number or undivided quantity; not fractional, or not involving a fraction.

1658 PHILLIPS s.v., In Arithmetick integral numbers are opposed to fraction[s]. 1674 JEAKE *Arith.* (1696) 15 To express the true content of any Number Integral. 1812 J. SMYTH *Pract. of Customs* (1821) 286 The fractional part of a foot..is to be given up in favour of the importer, and the duties to be charged only upon the integral feet. 1816 tr. *Lacroix's Diff. & Int. Calculus* 185 *Q* being a rational and integral function of *x*. 1875 TODHUNTER *Algebra* (ed. 7) xxxvi. §516 When *n* has any value positive or negative, integral or fractional.

b. Relating to or involving integrals (see B. 4); obtained by, belonging to, or proceeding by integration.

integral calculus: the calculus of integrals (see B. 4); that branch of the infinitesimal calculus which deals with the finding and properties of integrals of functions (in this restricted sense, the inverse of the differential calculus, and corresponding to the 'inverse method of fluxions' in the Newtonian calculus), also used to include the solution of differential equations, and parts of the theory of functions and other branches of the higher mathematics. *integral sign* = *sign of integration*: see B. 4 a, and INTEGRATION 2.

1727-41 CHAMBERS *Cycl.* s.v. *Calculus*, The *integral Calculus*..is the inverse of the differential one. *Ibid.*, Suppose ∫ the sign of the sum, or integral quantity. 1802 WOODHOUSE in *Phil. Trans.* XCII. 95 Expressions deduced from the true integral equations. 1875 C. P. BUCKINGHAM *Diff. & Int. Calc.* (1880) §157 The..problem of the integral calculus is to pass from a given differential of a function to the function itself. 1881 MAXWELL *Electr. & Magn.* I. 21 In the expression under the integral sign only the finite values ..are to be considered. 1887 R. A. ROBERTS *Int. Calc.* 1 The principal object of the Integral Calculus is to find the value of a function of a single variable when its differential coefficient is given.

c. Applied to the entire or total amount of a continuous quantity (*e.g.* curvature) taken between definite limits, and thus expressible by a definite integral (see B. 4 a).

1879 THOMSON & TAIT *Nat. Phil.* I. I. §10 The *integral curvature*, or *whole change of direction* of an arc of a plane curve, is the angle through which the tangent has turned as we pass from one extremity to the other.

d. *integral domain*: see DOMAIN *sb.* 4 d.

B. *sb.*

1. Something entire or undivided; a whole, either as wanting no part, or as made up of parts: see A. 2, 3. *Obs.* exc. as *transf.* from 4 = total sum.

1620 T. GRANGER *Div. Logike* 177 A tree, a body, an house ..are totall Integrals, whose integritie, or wholenesse..is made of their parts. 1657 TOMLINSON *Renou's Disp.* 9 In the third genus are contained all Animals whether Integrals or In-parts. 1784 J. BARRY in *Lect. Paint.* iv. (Bohn 1848) 152 Any other conjunction of parts forming an integral or whole. 1834 LANDOR *Exam. Shaks.* Wks. 1846 II. 299/2 No more.. than breaking an eggshell is breaking an egg, the shell being a part, and the egg being an integral. 1881 *Nature* No. 625. 582 What is seen in a sun-spot is the integral, as it were, of all that is taking place..in many thousand miles of solar atmosphere.

†2. An integral part or element; a constituent, component: see A. 1. *Obs.*

1658-9 *Burton's Diary* (1828) III. 557 We must, therefore, be very circumspect in the materials of the other House. Let us, therefore, look to the integrals in this building. *a*1677 HALE *Prim. Orig. Man.* I. i. 21 Anatomy can give us the Position..of all the several Integrals of the Body of Man or Beast. *Ibid.* IV. viii. 372 They all make up a most magnificent and stately Temple, and every Integral thereof full of wonder. 1680 BAXTER *Answ. Stillingfl.* 82 Doth not every good Law and Rule distinguish between *Essentials*, *Integrals*, and *Accidents*, and make more Accidents than are Integrals, and Integrals, than are Essentials? 1685—— *Paraphr. N.T., 1 Cor.* xii. 14 So wise, as besides the Essentials of Christianity, to know all the Integrals.

†3. *Gram.* Applied by Wilkins to those words or parts of speech which of themselves express a distinct notion, as distinct from those which express relations between notions. *Obs.*

1668 WILKINS *Real Char.* III. i. §2 By Integrals or Principal words, I mean such as signifie some entire thing or notion. 1688 R. HOLME *Armoury* III. 251/2. 1845 STODDART *Gram.* in *Encycl. Metrop.* I. 124/1 Wilkins includes under the term *integral* both the noun and the verb.

4. *Math.* a. (of a function): That quantity of which the given function is the differential or differential coefficient (corresponding to the fluent of a given fluxion in Newton's method); so called because it may be regarded as the whole sum of a series of consecutive values assumed by an infinitesimal function (differential) of the variable while the latter changes continuously from any one value to any other. When such *limits* of variation are fixed or determinate, it is called a *definite integral*: see quot. 1877. An integral is denoted by the sign ∫ (originally a long *s*, for L. *summa* sum); in a definite integral the inferior and superior limits are indicated at the bottom and top of the sign, thus $\int_a^b$. (Formerly sometimes applied to the quantity from which a given 'finite difference' or 'increment' is derived, as in quot. 1763; cf. quot. 1831 s.v. INTEGRATE *v.* 3.) b. (of a differential equation, or a system of such equations): An equation or system of equations from which the given equation or system can be derived by differentiation. (In relation to a system of equations, any quantity which that system makes constant is sometimes called its integral.)

1727-41 CHAMBERS *Cycl.* s.v. *Calculus*, *fydx* will denote the sum, or integral of the differential *ydx*. 1763 EMERSON *Increments* p. vii, Some Increments have no integrals, but what infinite series afford. 1802 WOODHOUSE in *Phil. Trans.* XCII. 90 The integral or fluent of *Px* is that function from which *Px* is derived. 1877 B. WILLIAMSON *Int. Calc.* (ed. 2) vi. §91 The expression $\int_{x_0}^{X} \phi(x)dx$ is called the *definite integral* of $\phi(x)dx$ between the limits x_0 and X, and represents the limit of the sum of the infinitely small elements $\phi(x)dx$, taken between the proposed limits... In contradistinction, the name *indefinite integrals* is often applied to integrals..in which the form of the function is merely taken into account, without regard to any assigned limits. 1881 MAXWELL *Electr. & Magn.* I. 27 The double integrals destroy each other.

integralism (ɪn'tegrəlɪz(ə)m). [f. INTEGRAL *a.* 1 + -ISM.] A name sometimes adopted for a philosophical or political, etc., doctrine or theory which involves the concept of an integral whole.

1871 S. P. ANDREWS *Primary Synoptis Universology* xii. 178 Integralism is the new and final philosophy; the all-sided and complete reconciliation of all possible sectarian divisions in all spheres; not as extinguishing individual differences, but as softening, co-ordinating, and utilizing them. 1939 *Times* 18 Feb. 17/4 The counterpart of the Nazi movement—Integralism—has its supporters. 1964 D. G. MACRAE in J. H. Plumb *Crisis in Humanities* 127 By 'integralism' is meant a set of beliefs that involve one in claiming that social structures form a 'seamless web' in which every institution and social position is linked to every other and is part of a unique, interconnected configuration. 1969 D. M. SMITH *Italy* (ed. 2) VII. xxi. 255 The Rome party congress of 1906 had recorded a victory for 'integralism'.. yet revolutionary socialism continued to spread.

integralist (ɪn'tegrəlɪst), *sb.* [f. INTEGRAL *a.* 1 + -IST.] One who favours a policy or doctrine of integralism. Also *attrib.* or as *adj.* Cf. INTEGRIST.

1907 I. ZANGWILL *Ghetto Comedies* 412 Russia is to be saved..by the Integralists, who alone maintain the purity of the Social Revolutionary programme. 1922 *Glasgow Herald* 23 Jan. 11 The so-called 'integralists' who held that every good Catholic should see eye to eye with the Holy Father in everything. 1930 *Times Educ. Suppl.* 3 May 197/2 The schools or coteries of the last few decades—the symbolists, ..integralists,..and so forth. 1938 *Sun* (Baltimore) 12 May 1/1 To smash completely the outlawed integralist Greenshirt organization. 1967 C. SETON-WATSON *Italy from Liberalism to Fascism* vii. 267 His [*sc.* Ferri's] contribution to the restoration of party unity was..inspired by the 'integralist' formula of 'Neither to right nor to left, but straight ahead'. *Ibid.* xi. 437 So far from being an integralist, he had during his years at Bologna come under suspicion of modernist sympathies. 1968 R. K. MERTON *Social Theory* (rev. ed.) III. xv. 529 He [*sc.* Sorokin] adopts an 'integralist' conception of truth.

integrality (ɪntɪ'grælɪtɪ). [prob. ad. med.L. **integrālitās*, f. *integrālis* INTEGRAL: see -ITY; cf. F. *integralité* (Cotgr.), It. *integralità* 'a whole entire masse' (Florio, 1611).] The condition of being integral (see prec. A. 3); wholeness, entirety, completeness: = INTEGRITY 1.

1611 COTGR., *Integralité*, integralitie, wholeness. 1627 DONNE *Serm.* cviii. IV. 476 Here is the latitude, the Totality, the Integrality of the means of salvation. 1651 BIGGS *New Disp.* 239 What God made and ordained in its integrality. 1728 EARBERY tr. *Burnet's State Dead* I. 87 There the Integrality that gives Denomination to the Species is to be found. 1838 GLADSTONE *State in Rel. Ch.* (1839) 173 Establishing the independence and integrality of the nation as a collective body. 1853 *Tait's Mag.* XX. 265 The maintenance of the Empire of the Sultans in its integrality is necessary.

integrally ('ɪntɪgrəlɪ), *adv.* [f. as prec. + -LY². Cf. med.L. *integrāliter* entirely, wholly.] a. In an integral manner; as a whole, in its entirety; completely, entirely, wholly.

1471 RIPLEY *Comp. Alch.* II. v. in Ashm. (1652) 136 When the Erth ys integrally yncynerat. 1649 JER. TAYLOR *Gt. Exemp.* II. Disc. viii. 74 We should choose vertue..and pursue it integrally and make it the businesse of our lives. 1816 BENTHAM *Chrestom.* App. ii. Wks. 1843 VIII. 188 The only part of speech which is perfectly simple in its import, and at the same time integrally significant, is the noun-substantive. 1850 LYNCH *Theo. Trin.* x. 200 The more an individual is integrally a man, the more may he know of man.

b. As an integral whole: see INTEGRAL A. 1.

*a*1680 CHARNOCK *Attrib. God, God a Spirit* (1682) 116 Whatsoever is compounded of many parts, depends either essentially or integrally upon those parts. 1936 COLVIN & STANLEY *Turning & Boring Pract.* ix. 131 Gisholt lathes have been materially changed in design and construction: Headstocks are now cast integrally with the bed. 1952 S. E. RUSINOFF *Forging & Forming Metals* iv. 55 Small steam hammers have the anvil and frame cast integrally, but large hammers have a separate anvil. 1972 *Sci. Amer.* Jan. 49/2 (Advt.), An integral peak-reading meter lets you optimize record level without using a scope. Options include a 5 to 30 foot loop adaptor, an interrupting voice channel, and an inverter for 12 or 28 VDC..all integrally mounted.

integrand ('ɪntɪgrænd). *Math.* [ad. L. *integrand-us*, gerundive of *integrāre* (see INTEGRATE *v.*): see -AND².] An expression that is to be integrated.

1897 H. F. BAKER *Abel's Theorem* xviii. 561 The integrand of the Abelian integral *u*, is single-valued on the Riemann surface. 1937 *Proc. Cambr. Philos. Soc.* XXXIII. 374 It is natural to approximate by expanding the integrand in powers of *x*. 1968 FOX & MAYERS *Computing Methods for Scientists & Engineers* ix. 178 We illustrate this process..by considering the computation of the integral $I = \int_0^1 (0{\cdot}92 \cosh x - \cos x)\,dx$... Table 9.3 gives the tabulated values of the integrand and its differences.

integrant ('ɪntɪgrənt), *a.* (*sb.*) [ad. L. *integrānt-em*, pr. pple. of *integrāre*: see INTEGRATE *v.* Cf. F. *intégrant* (1690 in Hatz.-Darm.).]

Of parts: Making up or contributing to make up a whole, constituent, component; essential to the completeness of the whole: = INTEGRAL A. 1.

integrant parts, in F. *parties intégrantes*, is etymologically more correct than the usual *integral parts*.

1637 GILLESPIE *Eng. Pop. Cerem.* III. viii. 186 The Church consisteth of two integrant parts, *viz.* Pastors and Sheepe. 1651 CHARLETON *Ephes. & Cimm. Matrons* II. (1668) 38 An Appendix, or rather an integrant part of his fellow. 1727 [see INTEGRAL A. 1]. 1773 HORSLEY in *Phil. Trans.* LXIV. 246 Imagine the integrant particles of A to be equal in quantity of matter and bulk..to the integrant particles of B severally. 1794 BURKE *Rep. Lords' Jrnls.* Wks. 1842 II. 598 These judges..are no integrant and necessary part of that court. 1836-7 [see INTEGRAL A. 2]. 1849 KEMBLE *Saxons in Eng.* II. II. vi. 235 There is no reason to suppose that the ceorls did not form an integrant part of the shire-moot. 1875 H. C. WOOD *Therap.* (1879) 91 Iron constitutes a necessary integrant portion of the red blood-corpuscles.

B. *sb.* That which integrates; a component.

1824 COLERIDGE *Aids Refl.* (1848) I. 261 It is the differentia of immortality, of which the assimilative power of faith and love is the integrant, and the life in Christ the integration. 1827 COLEBROOKE *Misc. Ess.* (1837) I. 389 The aggregate and its integrants are utterly different.

integraph ('ɪntɪgrɑ:f, -æ-). [ad. F. *intégraphe* (B. Abdank-Abakanowicz 1885, in *La Lumière électr.* 17 Oct. 111/1), f. *intégral* INTEGRAL *a.* and *sb.*, *intégrer* to INTEGRATE *v.*: see -GRAPH.] Any of various kinds of apparatus which mechanically draw a curve representing the variation in the integral of some given curve or function as a limit or parameter varies.

1885 *Min. Proc. Inst. Civil Engin.* LXXXII. 162 The machines that he [*sc.* B. Abdank-Abakanowicz] had called briefly 'Integraphs' traced these curves mechanically. 1902 *Encycl. Brit.* XXX. 582/1 While an integrator determines the value of a definite integral, hence a mere constant, an integraph gives the value of an indefinite integral, which is a function of *x*. 1927 *Jrnl. Franklin Inst.* CCIII. 64 Mechanical integrators usually evaluate the definite integral between given fixed limits... The present machine, which we have called an integraph, since it records the result of an integration in the form of a plot or graph, has therefore been developed to evaluate $F(x)$ against x from the expression $F(x) = \int_a^x f_1(x)f_2(x)dx$ where f_1 and f_2 are known functions, formal or empirical. 1931 *Ibid.* CCXII. 77 The Photo-Electric Integraph..extends the range of practical solution of mathematical problems through its usefulness in the evaluation of integrals having a variable parameter within the integrand. 1961 S. FIFER *Analogue Computation* IV. xxv. 968 The development of the harmonic analyzer is closely associated with the development of two devices, (1) the planimeter,..and (2) the integraph, which draws a graph of the indefinite integral of a function.

integrate ('ɪntɪgrət), *a.* [ad. L. *integrāt-us*, pa. pple. of *integrāre*: see next.] 1. Made up, as a whole, of separate (integrant) parts, composite; belonging to such a whole; complete, entire, perfect: = INTEGRAL A. 2, 3.

1485 [implied in INTEGRATELY]. 1599 B. JONSON *Cynthia's Rev.* II. iv, Exceeding wittie and integrate [said of a joke]. 1697 tr. *Burgersdicius his Logick* I. xiv. 46-7 An Integral Whole is that which has Part out of Part... This Whole termed Mathematical; because Quantity is of Mathematical Consideration: Vulgarly, Integral, more properly Integrate. 1836-7 [see INTEGRAL A. 2]. 1837-8 SIR W. HAMILTON *Logic* iii. (1866) III. 51 We may consider Logic either as a universal, or as an integrate whole. 1888 J. T. GULICK in *Linn. Soc. Jrnl.* XX. 249/2 A transition from Integrate Fecundity to Segregate Fecundity usually takes place at a point in the history of evolution intermediate between the formation of an incipient variety and a strongly marked species. 1898 *Daily News* 20 Apr. 5/5 The people of Spain are for the war to keep integrate their possessions in Cuba.

2. *Psychol.* Of, pertaining to, or designating people with strong eidetic imagery (particularly in the theories of Jaensch).

1930 O. OESER tr. *Jaensch's Eidetic Imagery* III. 93 In these individuals functions that later are separate still interpenetrate one another to a high degree and influence each other. That is why we call them 'integrate'. The

Tab 33

WORDS & PHRASES

Judicially Defined in Canadian Courts and Tribunals
Termes et locutions définis par les tribunaux canadiens

VOLUME 4
F-I

CARSWELL

As I have said, the BPQ itself is the prerequisite to obtaining the annual licence and quota; without being allotted a BPQ the farmer is prohibited from producing tobacco on any land. A farmer wishing to produce tobacco would therefore have first to acquire a BPQ. Furthermore, in the course of commerce BPQ's are "traded"; they are transferred for valuable consideration from one farmer to another as a thing of commercial value. If that type of transaction takes place in the market, although the "thing" bought and sold does not fit into the ordinary concept of property (because it appears to be unique), the common law is quite capable of embracing it as a form of property; the categories of property are not perpetually closed. It is a state of eligibility which entitles the holder to apply for the annual licence and (as of 1978) the marketing quota.

The character of the BPQ is clouded by reason of the fact that the regulations do not contemplate that the "owner" of the BPQ can transfer it to a purchaser. The owner must apply to the local board, jointly with the purchaser, to allot the BPQ to the purchaser. Clearly the owner does not possess full rights of ownership; he can only apply to the local board to cancel his BPQ and to allot the same thing or its counterpart to the purchaser. Again, however, on well-settled principles, so long as the conditions specified in the regulations are met, I am in no doubt that the vendor and the purchaser could obtain an order from the Court compelling the local board to comply. Nevertheless I view this right as a form of chose in action which is personal property of the purchaser once enforced. There is no evidence that the local board has in practice capriciously refused to effect the transfer upon proper application and this result is fortified by the fact that BPQ's are regularly and successfully traded in the market.

I conclude, therefore, that the BPQ is a form of personalty, albeit of an unusual kind. In my opinion it falls within the definition of "intangible" in the *Personal Property Security Act* and s. 2 of the Act embraces it.

(Personal Property Security)

National Trust Co. v. Bouckhuyt (1987), 44 R.P.R. 264 at 292, 293, 39 D.L.R. (4th) 60, 7 P.P.S.A.C. 113, 59 O.R. (2d) 556 (H.C.) Henry J.

♦ The basic issue is whether or not there can be a security interest in the R.R.S.P. or the letter of direction or the money deposited in the R.R.S.P. (all sometimes collectively referred to as the "item").

. . .

The item is not a document of title because the item does not purport to cover goods. It is not an instrument because it is either money itself or is not an item that in the ordinary course of business is transferred by delivery. It is not a security because it is not one of the items clearly defined in s. 1(w) [of the *Personal Property Security Act*, R.S.O. 1970, c. 344]. It is not chattel paper because it does not refer to specific goods.

The definition of "intangible" [in *Personal Property Security Act*, R.S.O. 1970, c. 344, s. 1(m)] is wide enough to include all of the items including the money itself.

(Personal Property Security)

Berman, Re (1979), 30 C.B.R. (N.S.) 164 at 166, 167, 24 O.R. (2d) 79, 8 B.L.R. 134 at 137, 97 D.L.R. (3d) 379 (H.C.) Steele J.

Saskatchewan

♦ . . . an account is not a type of collateral mentioned in s. 24 [of *The Personal Property Security Act*, S.S. 1979-80, c. P-6.1]. This is understandable considering all the collateral referred to falls into the category of tangibles. An account is intangible. Moreover, s. 2(b) and (v) define "account" and "intangible" respectively, so these words have definite meanings. Had the legislature intended s. 24 to include these items, precise terminology would have been used.

(Personal Property Security)

Triple T Enterprises (1986) Ltd. (Trustee of) v. Sherwood Credit Union (1989), 74 C.B.R. (N.S.) 240 at 242, 9 P.P.S.A.C. 106, 78 Sask. R. 288 (Q.B.) Halvorson J.

INTANGIBLE INJURY

See AGGRAVATED DAMAGES.

INTEGRAL

See also ACCESSORY; VITAL.

Alberta

♦ The issue . . . is whether or not the crane units are an integral part of a process [under the *Municipal Tax Act*, R.S.A. 1980, c. M-1, s. 1(n)(iii)], and attachment to the land is only one of several considerations.

. . .

The Shorter Oxford Dictionary defines "integral" as including:

> Of or pertaining to a whole . . . Belonging to or making up an integral whole; constituent . . . necessary to the completeness of the whole . . .

Webster's New Collegiate Dictionary defines "integral" as including:

Essential to completeness; constituent; formed as a unit with another part; lacking nothing essential.

". . . the two cranes in the case before me form an integral part of the operational unit designed for use in processing logs delivered to the storage site . . .

(Taxation; Municipal Law)

British Columbia Forest Products Ltd. v. Alberta (Assessment Appeal Board) (1986), 45 Alta. L.R. (2d) 85 at 88, 89 (Q.B.) Purvis J.

Ontario

♦ In [*Decision No. 921/89* (1990), W.C.A.T.R. 207 (Ont. W.C.A.T.)], the panel argued that "integral" as opposed to "accessory" might not tell us if someone was or was not a worker.

They wrote that . . .

A casual reading of *Decision No. 154* [(1986), 1 W.C.A.T.R. 208 (Ont. W.C.A.T.)] might lead one to conclude that the only question to be asked is whether the person in question is an "integral part" of a business. This, of course, cannot be the case. The Concise Oxford Dictionary of Current English . . . defines "integral" as "of, or necessary to the completeness of, a whole". If one merely asks whether the person's work is an integral part of the business, one has generally provided the answer through the phrasing of the question because the result or answer is a foregone conclusion. It would be a strange business person indeed who retained the services of someone who was not integral to the business. Very few successful entrepreneurs retain the services of persons who are not integral to the business and, if they do so on a regular basis, they are not successful for long. In dealing with relationships within a sophisticated market economy, merely asking whether the work is "integral" is somewhat superficial.

Nor is it sufficient to ask whether the work is "integral" as opposed to "accessory". Attempting to distinguish between "integral" and "accessory" appears to this panel to offer little significant assistance, since "accessory" work may well be necessary to the completeness of the business operation and therefore may fit within the definition of "integral". In most business operations, a service is either necessary, or it is not.

Furthermore, just as "integral" work . . . may be performed by either a "worker" or "independent operator," so "accessory" work may be performed by an "independent operator" or "worker."

(Employment Law)

Decision No. 177/91 (1991), [1992] 19 W.C.A.T.R. 241 at 255 (Ont.) Shartal (concurring)

♦ The Concise Oxford Dictionary of Current English (Oxford: Oxford University Press) defines "integral" as "of, or necessary to the completeness of, a whole". If one merely asks whether the person's work is an integral part of the business, one has generally provided the answer through the phrasing of the question because the result or answer is a foregone conclusion. It would be a strange business person indeed who retained the services of someone who was not integral to the business. Very few successful entrepreneurs retain the services of persons who are not integral to the business, and, if they do so on a regular basis, they are not successful for long. In dealing with relationships within a sophisticated market economy, merely asking whether the work is "integral" is somewhat superficial.

Nor is it sufficient to ask whether the work is "integral" as opposed to "accessory". Attempting to distinguish between "integral" and "accessory" appears to this panel to offer little significant assistance, since "accessory" work may well be necessary to the completeness of the business operation and therefore may fit within the definition of "integral". In most business operations, a service is either necessary, or it is not.

Futhermore, just as "integral" work (such as pizza computer consulting and repairs . . .) may be performed by either a "worker" or "independent operator", so "accessory" work may be performed by an "independent operator" or "worker."

(Employment Law)

Decision No. 921/89 (1990), 14 W.C.A.T.R. 207 at 218 (Ont.) Strachan (Vice-Chair), Cook and Nipshagen

INTEGRAL AND SUBSTANTIAL PART OF THE EMPLOYER'S OPERATION

British Columbia

♦ The four criteria required by s. 85(3) [*Industrial Relations Act*, R.S.B.C. 1979, c.212] were interpreted by the Council in *Lafarge Canada Inc., Western Region* [IRC No. C156/88] . . . as follows (at pp. 9-11):

The third criteria is whether the work is an "integral and substantial part of the employer's operation". The focus of the third criteria is on the nature of the employer's operation and the significance of the work performed by members of the trade union to that operation . . . Once the

Tab 34

BLACK'S LAW DICTIONARY®

Definitions of the Terms and Phrases of
American and English Jurisprudence,
Ancient and Modern

By

HENRY CAMPBELL BLACK, M. A.

SIXTH EDITION

BY

THE PUBLISHER'S EDITORIAL STAFF

Coauthors

JOSEPH R. NOLAN
Associate Justice, Massachusetts Supreme Judicial Court

and

JACQUELINE M. NOLAN-HALEY
Associate Clinical Professor,
Fordham University School of Law

Contributing Authors

M. J. CONNOLLY
Associate Professor (Linguistics),
College of Arts & Sciences, Boston College

STEPHEN C. HICKS
Professor of Law, Suffolk University
Law School, Boston, MA

MARTINA N. ALIBRANDI
Certified Public Accountant, Bolton, MA

ST. PAUL, MINN.
WEST PUBLISHING CO.
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year, and is amortized over the period benefited, not to exceed forty years. *See* Amortization; Intangible property.

Intangible drilling costs. Costs incurred incident to and necessary for the drilling and preparation of oil or gas wells for production that have no salvage value. Under I.R.C. § 263, such costs may be deducted in the year paid rather than capitalized and depreciated.

Intangible property. As used chiefly in the law of taxation, this term means such property as has no intrinsic and marketable value, but is merely the representative or evidence of value, such as certificates of stock, bonds, promissory notes, copyrights, and franchises. *See* Intangible asset. *Compare* Tangible property.

Intangibles. Property that is a "right" such as a patent, copyright, trademark, etc., or one which is lacking physical existence; such as goodwill. *See* Amortization; General intangibles; Intangible asset.

Intangibles tax. In certain states such tax is imposed on every resident for right to exercise following privileges: (a) Signing, executing and issuing intangibles; (b) selling, assigning, transferring, renewing, removing, consigning, mailing, shipping, trading in and enforcing intangibles; (c) receiving income, increase, issues and profits of intangibles; (d) transmitting intangibles by will or gift or under state laws of descent; (e) having intangibles separately classified for taxes.

Intangible value. Nonphysical value of such assets as patents, copyrights, goodwill.

Integer /íntəjər/. Lat. Whole; untouched. *Res integra* /ríyz íntəgrə/ means a question which is new and undecided.

Integral. Term in ordinary usage means part or constituent component necessary or essential to complete the whole. Matczak v. Secretary of Health, Ed. and Welfare, D.C.N.Y., 299 F.Supp. 409, 413.

Integrated agreement. *See* Integrated contract; Integrated writing.

Integrated bar. The act of organizing the bar of a state into an association, membership in which is a condition precedent to the right to practice law. Integration is generally accomplished by enactment of a statute conferring authority upon the highest court of the state to integrate the bar, or by rule of court in the exercise of its inherent power. Integration of Bar Case, 244 Wis. 8, 11 N.W.2d 604.

A "unified bar" or an "integrated bar" is qualitatively different from a "voluntary bar"; membership in a unified or integrated bar is compulsory, whereas membership in a voluntary bar is voluntary, and in effect, one is not at liberty to resign from a unified bar, for, by so doing, one loses the privilege to practice law. Petition of Chapman, 128 N.H. 24, 509 A.2d 753, 756.

Integrated contract. Contract which contains within its four corners the entire agreement of the parties and parol evidence tending to contradict, amend, etc., is inadmissible; the parties having made the contract the final expression of their agreement.

An agreement is integrated where the parties thereto adopt the writing or writings as the final and complete expression of the agreement and an "integration" is the writing or writings so adopted. Wilson v. Viking Corporation, 134 Pa.Super. 153, 3 A.2d 180, 183. *See* Integrated writing.

Partial integration. Such exists where only a certain part of transaction is embodied in writing and the remainder is left in parol. Schwartz v. Shapiro, 299 C.A.2d 238, 40 Cal.Rptr. 189, 197.

Integrated property settlements. Contract commonly made on separation or divorce of spouses wherein the parties intend that the contract become part of the court order, decree or judgment.

Integrated writing. The writing or writings adopted by the parties to an agreement as the final and complete expression of the agreement. Restatement, Second, Contracts, § 209. Pettett v. Cooper, 62 Ohio App. 377, 24 N.E.2d 299, 302. *See also* Integrated contract.

Integration. The act or process of making whole or entire. Bringing together different groups (as races) as equals.

Horizontal integration. Combination of two or more businesses of the same type such as manufacturers of the same type of products. Such combinations may violate antitrust laws under certain conditions. *See also* Merger.

Vertical integration. Combination of two or more businesses on different levels of operation such as manufacturing, wholesaling and retailing the same product. *See also* Merger.

Integrity. As used in statutes prescribing the qualifications of public officers, trustees, etc., this term means soundness or moral principle and character, as shown by one person dealing with others in the making and performance of contracts, and fidelity and honesty in the discharge of trusts; it is synonymous with "probity," "honesty," and "uprightness."

Intelligibility. In pleading, the statement of matters of fact directly (excluding the necessity of inference or argument to arrive at the meaning) and in such appropriate terms, so arranged, as to be comprehensible by a person of common or ordinary understanding. "Each averment of a pleading shall be simple, concise, and direct." Fed.R. Civil P. 8(e).

Intemperance. A lack of moderation. Habitual intemperance is that degree of intemperance from the use of intoxicating liquor which disqualifies the person a great portion of the time from properly attending to business, or which would reasonably inflict a course of great mental anguish upon an innocent party. Habitual or excessive use of liquor. *See* Intoxication.

Intend. To design, resolve, propose. To plan for and expect a certain result. To apply a rule of law in the nature of presumption; to discern and follow the probabilities of like cases. *See also* Intent.

Court of Appeal File No.: M42068
Court File No.: CV-12-9667-00CL

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, RSC 1985, c. C-36, AS AMENDED,

AND IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

COURT OF APPEAL FOR ONTARIO

Proceeding Commenced at Toronto

BOOK OF AUTHORITIES OF THE APPELLANTS, INVESCO CANADA LTD., NORTHWEST & ETHICAL INVESTMENTS L.P., AND COMITÉ SYNDICAL NATIONAL DE RETRAITE BÂTIRENTE INC.

VOLUME 2 OF 2

KIM ORR BARRISTERS P.C.
19 Mercer Street, 4th Floor
Toronto, Ontario M5V 1H2

James C. Orr (LSUC #23180M)
Won J. Kim (LSUC #32918H)
Megan B. McPhee (LSUC #48351G)
Michael C. Spencer (LSUC #59637F)

Tel: (416) 596-1414
Fax: (416) 598-0601

Lawyers for the Appellants, Invesco Canada Ltd., Northwest & Ethical Investments L.P. and Comité Syndical National de Retraite Bâtirente Inc.