TAB 7

Case Name:

Silver v. Imax Corp.

Between
Marvin Neil Silver and Cliff Cohen, Plaintiffs, and
Imax Corporation, Richard L. Gelfond, Bradley J. Wechsler and
Francis T. Joyce, Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992

[2009] O.J. No. 5573

66 B.L.R. (4th) 222

2009 CarswellOnt 7874

2009 CanLII 72342

Court File No. CV-06-3257-00

Ontario Superior Court of Justice

K.M. van Rensburg J.

December 14, 2009.

(445 paras.)

Securities regulation -- Marketplace operations and trading rules -- Records and reporting -- Motion by plaintiff shareholders for leave under s. 138.8 of Ontario Securities Act to pursue claim for secondary market misrepresentation against IMAX and directors allowed in part -- Plaintiffs met test for leave against defendants IMAX, Gelfond, Wechsler, Joyce and proposed defendants Braun, Copland, Girvan, Leebron and Gamble -- Motion for leave with respect to proposed defendants Utay and Fuchs dismissed, as plaintiffs had no reasonable possibility of success in claims against these individuals -- Action was brought in good faith and plaintiffs had reasonable possibility of success at trial in pursuing statutory claims against IMAX and directors -- Securities Act, R.S.O. R.S.O. 1990, c. S.5, s. 138.8.

Securities regulation -- Continuous disclosure -- General disclosure -- News release -- Financial disclosure -- Motion by plaintiff shareholders for leave under s. 138.8 of Ontario Securities Act to pursue claim for secondary market misrepresentation against IMAX and directors allowed in part --

Plaintiffs met test for leave against defendants IMAX, Gelfond, Wechsler, Joyce and proposed defendants Braun, Copland, Girvan, Leebron and Gamble -- Motion for leave with respect to proposed defendants Utay and Fuchs dismissed, as plaintiffs had no reasonable possibility of success in claims against these individuals -- Action was brought in good faith and plaintiffs had reasonable possibility of success at trial in pursuing statutory claims against IMAX and directors -- Securities Act, R.S.O. R.S.O. 1990, c. S.5, s. 138.8.

Securities regulation -- Civil liability -- Secondary market disclosure -- Motion by plaintiff shareholders for leave under s. 138.8 of Ontario Securities Act to pursue claim for secondary market misrepresentation against IMAX and directors allowed in part -- Plaintiffs met test for leave against defendants IMAX, Gelfond, Wechsler, Joyce and proposed defendants Braun, Copland, Girvan, Leebron and Gamble -- Motion for leave with respect to proposed defendants Utay and Fuchs dismissed, as plaintiffs had no reasonable possibility of success in claims against these individuals -- Action was brought in good faith and plaintiffs had reasonable possibility of success at trial in pursuing statutory claims against IMAX and directors -- Securities Act, R.S.O. R.S.O. 1990, c. S.5, s. 138.8.

Motion by Silver and Cohen for leave under s. 138.8 of the Ontario Securities Act to pursue a claim for secondary market misrepresentation against IMAX. IMAX was a public company that sold and leased 3D theatre systems. In February 2006, IMAX issued a press release announcing that it had completed 14 theatre installations in the fourth quarter of 2005, that it expected to meet or exceed its full year earnings guidance for 2005 of US$0.35 to $0.38 in net earnings per share, and that it would release its fourth quarter and full year financial results on March 9, 2006. On March 9, 2006, IMAX filed a Form 10-K containing its 2005 annual financial statements with the U.S. Securities and Exchange Commission and issued a press release reporting on its earnings and revenues. IMAX reported revenues of $144,930,000, including theatre system revenues of $97,753,000, with net earnings of $0.40 per share for the year ended December 31, 2005, an increase of 62 per cent over the previous year. IMAX issued a second press rel ease announcing the decision of its board of directors to explore strategic alternatives, including a sale or merger. On August 9, 2006, IMAX issued another press release reporting that there was presently no buyer interested in acquiring the company at a valuation sought by the Board. The press release also indicated that that the company was in the process of responding to an informal inquiry from the SEC regarding the timing of its revenue recognition, and in particular its use of multiple element arrangement accounting to recognize revenue on theatre systems that were not yet open, including theatres where the 3D screen had not yet been installed. The following day IMAX's share price dropped 40 per cent. In 2007, IMAX restated its financial statements for a number of years, including 2005. The Restatement acknowledged that the company had erred in recognizing revenue for theatre systems that were not completely installed, and that the company had not complied with generally accepted accounting principles (GAAP). Theatre system revenues of US$17.5 million (and net earnings of US$9.7 million) had been prematurely recorded in fiscal 2005. In a proposed class action, it was alleged that IMAX misrepresented that its revenue for fiscal 2005 met or exceeded the company's previously issued earnings guidance, had complied with GAAP, and had completed 14 theatre system installations in Q4 2005. The plaintiffs were two Ontario residents who purchased shares in IMAX on the TSX. They were suing for the devaluation in their shares which they claimed was due to the alleged misrepresentations. The plaintiffs proposed to represent a global class of IMAX shareholders who acquired shares on the secondary market on or after the February 2006 press release and continued to

hold such shares on August 9, 2006, the date of the correcting press release. The plaintiffs were suing IMAX, Gelfond and Wechsler, who were its two Chief Executive Officers, and Joyce, who was Chief Financial Officer at the time of the alleged misrepresentatio ns. Other proposed defendants included Gamble, IMAX's Vice President, Finance and Controller from July 2001 to November 27, 2006; Copland, a director of since 1999 and chair of its audit committee since 2004; Braun, a director since 2003 and a member of the audit committee; Leebron, a director since 2003 and a member of its audit committee; Girvan, a director since 1994 and an attendee at audit committee meetings; Fuchs, a director from May 1996 to June 1999, and from October 2002 until April 2006; and Utay, who had been a director since 1996. The plaintiffs also proposed to pursue, with leave, a claim for secondary market misrepresentation under the Ontario Securities Act, which provided a statutory cause of action to shareholders of reporting issuers. The statutory claim permitted a shareholder to sue a reporting issuer and certain others (including its directors and officers) when there had been a misrepresentation in its secondary market disclosure.

HELD: Motion allowed, in part. The plaintiffs met the test for leave under s. 138.8 of the Securities Act to pursue a statutory claim for misrepresentation in the secondary market against the defendants IMAX, Gelfond, Wechsler and Joyce and the proposed defendants Braun, Copland, Girvan, Leebron and Gamble. The motion for leave with respect to the proposed defendants Utay and Fuchs was dismissed, as the plaintiffs did not have a reasonable possibility of success at trial in their statutory claims against these individuals. The action was brought in good faith and the plaintiffs had a reasonable possibility of success at trial in pursuing the statutory claims. The statutory remedy for secondary market misrepresentation was afforded directly to shareholders for their own benefit and was not a vehicle to sue on behalf of the company for a wrong to the company. Proceedings alleging secondary market misrepresentation were brought to recover damages for loss to an individual shareholder or group of shareholders. Th e shareholder's personal loss was central. There was no reason to read in a high or substantial onus requirement for good faith in this type of proceeding. Another purpose of the statutory remedy was to enforce a corporation's disclosure obligations and thereby to protect and enhance the integrity of the secondary market. The plaintiffs were acting in good faith in pursuing these proceedings. They had a personal financial interest in the action as persons who acquired IMAX shares during the class period and continued to hold such shares on August 9, 2006. They had also asserted altruistic reasons for commencing the action, to hold the defendants accountable for misrepresentations to the public, and to send a message to directors and officers of other public companies that they too would be held accountable for misrepresentations to the public. These reasons for pursuing the action were consistent with the legislative purpose of the statutory remedy, which was deterrence. The plaintiffs had pleaded a misrepres entation that was supported by the evidence of IMAX's Restatement. There was no evidence of any ulterior motive or conflict of interest. Accordingly, the plaintiffs meet the first branch of the test for leave to assert a claim for secondary market misrepresentation. The plaintiffs had a reasonable possibility of success at trial in establishing a misrepresentation. The defendants asserted the "reasonable investigation" defence, which had two branches: whether the individual conducted or caused to be conducted a "reasonable investigation", and whether at the time the misrepresentation was made, he or she had no reasonable grounds to believe that the document contained a misrepresentation. The evidence concerning the "reasonable investigation" defence was not sufficient to preclude the possibility of success at trial against IMAX, the individual defendants and Gamble. In respect of Joyce and Gamble, there was a reasonable possibility on the evidence, in particular as to their direct involvement in the 2005 acc ounting decisions and reporting, that the plaintiffs would succeed at trial in establishing that they authorized, permitted or acquiesced in the release of the documents containing the mis-

representation. The plaintiffs did not seek to attribute to Utay and Fuchs any actual or constructive knowledge of a misrepresentation. These individuals were Board members who were not on the audit committee. As such, they had a limited role in respect of the company's financial reporting, and there was no reasonable possibility of success against them at trial.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 122(1)(b)

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 5(1)

Ontario Rules of Civil Procedure, Rule 21, Rule 39.03

Securities Act, R.S.O. 1990, c. S.5, s. 1(1), s. 1.1, s. 75(1), s. 75(2), s. 77, s. 78, s. 78(2), s. 78(3), s. 138.1, s. 138.3, s. 138.3(1), s. 138.3(1)(c), s. 138.4, s. 138.4(1), s. 138.4(3), s. 138.4(6), s. 138.4(7), s. 138.4(7)(a), s. 138.4(7) (k), s. 138.4(11), s. 138.5, s. 138.5(1), s. 138.5(2), s. 138.5(3), s. 138.6, s. 138.7, s. 138.7(2), s. 138.8, s. 138.8(1), s. 138.8(2), s. 138.8(3)

Counsel:

A.D. Lascaris, W. Sasso, M. Robb and J. Strosberg, for the Plaintiffs.

R.P. Steep and D.M. Peebles for the Defendants and Proposed Defendants.

TABLE OF CONTENTS

I. Overview and Summary

A. Background
B. Issues to be Determined
C. Decision on the Leave Motion

II. The Proceedings, The Claim and the Statutory Cause of Action

A. The Parties
B. The Factual Allegations in the Claim
C. Review of the Evidence (For Part Two of the Statutory Leave Test)

1. Revenue from Sales and Leases of IMAX Theatre Systems
2. Accounting Standards for Recognition of Theatre System Revenues

(a) SAB 101 and 104
(b) EITF 00-21

3. IMAX's Historical Practices and Policies for Recognition of Theatre System Revenues

(a) IMAX's Internal Accounting Policies
(b) Disclosure of Revenue Recognition for Theatre Systems in IMAX's Annual Statements

4. The Delhi Post
5. The 2005 Year-End Accounting

(a) The Progress of Theatre System Installations in Q4 2005
(b) Customer Incentives and Contract Amendments
(c) The Revenue Recognition Process

6. The PwC Audit

(a) The Transaction Memos
(b) The Application of MEA Accounting to Q4 2005 Theatre System Revenues During the Audit Process

7. The February 17, 2006 Press Release
8. The Board's Approval of the 2005 Financial Statements

(a) The March 1, 2006 Audit Committee Meeting

9. Information Unknown to PwC -- Status of Theatre System Installations
10. The 2005 10-K Filing, the March 9, 2006 Press Releases and IMAX's Pursuit of Strategic Alternatives
11. The SEC Inquiry Letter
12. The August 9, 2006 Press Release
13. The Restatement
14. Expert Evidence as to IMAX's Accounting: The Rosen Reports

D. The Causes of Action and Claims for Damages
E. The Statutory Cause of Action

1. The Genesis of the Statutory Cause of Action
2. The Statutory Context -- Continuous Disclosure Obligations
3. Liability for Misrepresentation
4. Relevant Defences
5. Calculation of Damages, Several Liability and the Cap on Damages
6. The Statutory Leave Procedure

F. The Procedure Followed in this Case

III. Determination of the Issues on the Motion for Leave to Proceed with the Statutory Claims

A. General Principles of Statutory Interpretation
B. Part One of the Statutory Leave Test: Is the Action brought in Good Faith?

1. Positions of the Parties
2. Analysis and Conclusion
3. Decision re: Good Faith

C. Part Two of the Statutory Leave Test: Is There a Reasonable Possibility that the Action will be Resolved at Trial in Favour of the Plaintiffs?

1. Interpretation of the Test

(a) Positions of the Parties
(b) Analysis and Conclusion

2. A Proposed Part Three of the Leave Test: Is it Necessary for the Plaintiffs to Plead Fraud or "*Scienter*"?
3. Applying Part Two of the Leave Test in this Case

(a) The Misrepresentations
(b) The "Reasonable Investigation" Defence

(i) The Reasonable Investigation Defence Defined
(ii) Does the Business Judgment Rule Apply to the Reasonable Investigation Defence?
(iii) Position of the Parties: Reasonable Investigation Defence
(iv) Analysis of the Reasonable Investigation Defence

(a) The Company, the Individual Defendants and Gamble
(b) The Outside Director Respondents

* Audit Committee Members and Girvan
* The Remaining Directors: Utay and Fuchs

(c) The Expert Reliance Defence
(d) Loss Causation

IV. Conclusion

REASONS FOR DECISION:
MOTION FOR LEAVE under s. 138.8 OF
THE *SECURITIES ACT*

K.M. van RENSBURG J.:--

I. Overview and Summary A. Background

1 IMAX Corporation ("IMAX" or the "Company") is a public company that sells and leases its 3D theatre systems, which are installed in customers' theatres throughout the world. Its shares are listed on the TSX and NASDAQ.

2 On February 17, 2006 IMAX issued a press release announcing: (a) that it had completed a record 14 theatre installations in the fourth quarter of 2005, ("Q4 2005"); (b) that it expected to meet or exceed its full year earnings guidance for 2005 of US $0.35 to $0.38 in net earnings per share ("EPS"); and (c) that it would release its fourth quarter and full year financial results on March 9th.

3 On March 9, 2006, IMAX filed its Form 10-K containing its 2005 annual financial statements, with the U.S. Securities and Exchange Commission (the "SEC") and on SEDAR[1], and issued a press release reporting on its earnings and revenues. IMAX reported revenues of $144,930,000, including theatre system revenues of $97,753,000, with net earnings of $0.40 per share for the year ended December 31, 2005, an increase of 62% over the previous year. IMAX issued a second press release announcing the decision of its board of directors (the "Board") to explore strategic alternatives, including a sale or merger.

4 Five months later, on August 9, 2006, IMAX issued another press release reporting on its second quarter results, noting that, although the process was ongoing, there was presently no buyer interested in acquiring the Company at a valuation sought by the Board.

5 The press release also indicated that that the Company was in the process of responding to an informal inquiry from the SEC regarding the timing of its revenue recognition, and in particular its use of multiple element arrangement accounting to recognize revenue on theatre systems that were not yet open, including theatres where the 3D screen had not yet been installed.

6 The following day IMAX's share price dropped 40%.

7 In 2007, IMAX restated its financial statements for a number of years, including 2005 (the "Restatement"). The Restatement acknowledged that the Company had erred in recognizing revenue for theatre systems that were not completely installed, and that the Company had not complied with GAAP (generally accepted accounting principles)[2]. Theatre system revenues of US $17.5 million (and net earnings of US $9.7 million) had been prematurely recorded in fiscal 2005.

8 In this proposed class action, it is alleged that IMAX misrepresented that: (a) its revenue for fiscal 2005 met or exceeded the Company's previously issued earnings guidance; (b) it had complied with GAAP; and (c) it had completed 14 theatre system installations in Q4 2005. The misrepresentations are alleged to have been made in IMAX's Form 10-K (including its Annual Report) and the February and March 2006 press releases.

9 The respondents (the defendants and proposed defendants) assert that this is an action about an accounting error that occurred without their fault or negligence, and in reliance on the advice of IMAX's auditors PriceWaterhouseCoopers LLP ("PwC").

10 The plaintiffs are two Ontario residents who purchased shares in IMAX on the TSX. They are suing for the devaluation in their shares which they allege was due to the alleged misrepresentations. Their individual losses are estimated at $1,503.87 for Cliff Cohen and $4,441.13 for Neil Silver.[3] The plaintiffs propose to represent a global class of IMAX shareholders who acquired shares on the secondary market on or after February 17, 2006 (the date of the first press release) and continued to hold such shares on August 9, 2006 (the date of the correcting press release).

11 The plaintiffs are suing IMAX, Richard Gelfond and Bradley Wechsler, who are its two Chief Executive Officers ("CEOs"), and Francis ("Frank") Joyce, who was Chief Financial Officer ("CFO") at the time of the alleged misrepresentations. The claims against these parties are for negligence, negligent and reckless misrepresentation, conspiracy, and punitive damages.

12 The plaintiffs also propose to pursue a claim for secondary market misrepresentation under Part XXIII.1 of the Ontario *Securities Act*, R.S.O. 1990, c. S. 5 (the "OSA"), which provides a statutory cause of action to shareholders of reporting issuers. These provisions (commonly referred to as Bill 198) came into force on December 31, 2005.[4]

13 The statutory claim permits a shareholder to sue a reporting issuer and certain others (including its directors and officers) when there has been a misrepresentation in its secondary market disclosure. Liability follows proof of the misrepresentation, without the need to prove reliance, subject to certain statutory defences. In this case, the principal defences relied on by the respondents are "reasonable investigation" and "expert reliance". The onus of proof of such statutory defences is on the defendants.

14 The plaintiffs propose to assert the statutory claim against the named defendants as well the remaining directors of IMAX and Kathryn Gamble, who was the Vice-President, Finance and Controller at the time of the alleged misrepresentations.

15 Statutory claims for secondary market misrepresentation are subject to certain limitations, including the requirement for leave of the court before such an action can be pursued and a cap on damages that applies to the issuer and to individual defendants, except in certain circumstances. The plaintiffs in this case confine their claim to the damages limit of $25,000 against all of the individual respondents except Gelfond, Wechsler, Joyce and Gamble against whom the claim is not capped.

B. Issues to be Determined

16 There are three motions before the court. This decision is in respect of the first of these motions that were argued together in December 2008, with additional attendances and written submissions in May and July 2009. (There is no requirement for such motions to be heard together, however counsel proposed and the court agreed to proceed in such a manner.)

17 In the first motion, the plaintiffs seek leave under s. 138.8 of the OSA to proceed with the statutory cause of action contained in s. 138.3. Leave is mandatory if the plaintiffs establish that the action is brought in good faith and there is a reasonable possibility of success at trial.

18 This is the first case in Ontario in which the court has been asked to grant leave in such an action. My main task on this motion will be to interpret and apply the leave requirement of s. 138.8 of the OSA.

19 The statutory leave test involves a preliminary consideration of the merits of the action. In this regard, the parties filed more than 30 volumes of materials, consisting of affidavits, expert reports and public and non-public documents. A substantial part of these lengthy reasons is devoted to a review of the evidence, in order to determine whether the plaintiffs have a reasonable possibility of success in pursuing the statutory claims at trial.

20 In the second motion, the plaintiffs seek certification of this action as a class proceeding pursuant to s. 5(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the "CPA"). A third motion, brought by the respondents, is under Rule 21 of the Rules of Civil Procedure, R.R.O. 1990, Reg. 194, as amended, and seeks to strike parts of the common law claims as pleaded by the plaintiffs, as failing to disclose a cause of action. This third motion is properly considered part of the determination of the sufficiency of the pleading of the cause of action under s. 5(1)(a) of the CPA in the certification motion.

21 Separate reasons are being released at the same time as these reasons on the Rule 21 and certification motions.

C. Decision on the Leave Motion

22 For the reasons that follow, leave is granted to the plaintiffs to proceed with their claim for misrepresentation in the secondary market under s. 138.3 of the OSA against the defendants IMAX, Gelfond, Wechsler and Joyce and each of the proposed defendants Copland, Braun, Leebron, Girvan and Gamble.

23 I am satisfied that the action is brought in good faith and that the plaintiffs have a reasonable possibility of success at trial in pursuing the statutory claims against all such parties.

24 Leave is not granted to pursue the action against the proposed defendants Utay and Fuchs, as I am not satisfied that the plaintiffs have a reasonable possibility of success at trial in their statutory claims against these individuals.

25 As I will explain below, "reasonable possibility of success at trial" sets a relatively low threshold for a plaintiff seeking leave to proceed with an action, and whether it has been crossed in a particular case will depend on the evidence that the parties put before the court. This decision was reached after considering all of the evidence the parties put forward at this stage, as to the alleged misrepresentations and the defences asserted by the respondents. I will describe this evidence at some length below. This decision, however, does not amount to a final determination of the facts or of the merits of the statutory claim and should not be interpreted as such.

II. The Proceedings, the Claim and the Statutory Cause of Action

26 The Statement of Claim was issued in September 2006. There have been several changes to the pleading, resulting in a Fresh Statement of Claim (the "Claim") that was delivered shortly before the hearing of the leave and certification motions. While the Claim has not been formally amended (an amendment is part of the relief sought by the plaintiffs and is addressed in the certification reasons), the allegations in the proposed pleading, that includes both the common law claims against the named defendants and the statutory claims against the defendants and proposed defendants, were considered for the purpose of the leave, Rule 21, and certification motions.

A. The Parties

27 IMAX was incorporated under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 ("CBCA"), and has its head office in Mississauga, Ontario and executive offices in New York City. At all material times IMAX was a reporting issuer under the OSA, and its shares were listed for trading on the TSX. IMAX securities were also listed for trading on NASDAQ.

28 IMAX, together with its wholly-owned subsidiaries, is one of the world's leading entertainment technology companies, specializing in digital and film-based motion picture technologies and large-format two-dimensional and three-dimensional film presentations. Its principal business is the design, manufacture, sale and lease of projection systems based on proprietary and patented technology for large-format, 15-perforation film frame, 70 mm. format theatres, including commercial theatres, museums and science centers, and destination entertainment sites. The Company does not own IMAX theatres, but licenses the use of its trademarks along with the sale or lease of its equipment.[5]

29 The remaining defendants and the proposed defendants are all current and former officers and/or directors of IMAX as follows:

* Richard Gelfond and Bradley Wechsler were at all material times, and remain, the co-CEOs of IMAX and co-chairs of the Company's Board;
* Frank Joyce was the CFO of the Company from March 2001 to August 2006;
* Kathryn Gamble was IMAX's Vice President ("VP"), Finance and Controller from July 2001 to November 27, 2006;
* Kenneth Copland has been a director of IMAX since 1999, and has been the chair of its audit committee since 2004;
* Neil Braun has been a director of IMAX since 2003, and at all material times was a member of the audit committee;
* David Leebron has been a director of IMAX since 2003, and at all material times was a member of its audit committee;
* Garth Girvan has been a director of IMAX since 1994. Although not formally a member of the audit committee at the relevant time, he regularly attended audit committee meetings;
* Michael Fuchs was a director of IMAX from May of 1996 to June 1999, and from October, 2002 until April 2006; and
* Marc Utay has been a director of IMAX since 1996.

30 Mr. Gelfond, Mr. Wechsler and Mr. Joyce are identified in the Claim as the "Individual Defendants" and they are named together with the Company as defendants to the common law claims asserted therein.

31 The plaintiffs seek leave to proceed with the statutory claim against the defendants as well as all of the remaining individuals who are named as respondents to the leave motion (the "Proposed Defendants").

32 The plaintiff Cliff Cohen is an individual residing in Toronto, who purchased 300 common shares of IMAX on the TSX on August 1, 2006. He sold his shares at a loss on August 28, 2006.

33 The plaintiff Marvin Neil Silver purchased 500 shares of IMAX on August 3, 2006.

34 Mr. Cohen and Mr. Silver seek to represent a class of plaintiffs described in the Claim as:

> [A]ll persons, other than Excluded Persons, who acquired securities of IMAX during the Class Period and who held some or all of those securities at the close of trading on the TSX and NASDAQ on August 9, 2006, or such other definition as may be approved by the court.
>
> "Excluded Persons" is defined in the Claim as:
>
> > IMAX's subsidiaries, affiliates, officers, directors, senior employees, legal representatives, heirs, predecessors, successors and assigns, and any member of the defendants' families and any entity in which any of them has or had during the Class Period any legal or de facto controlling interest.

"Class Period" is defined as:

> [T]he period from and including the opening of trading on the TSX and NASDAQ on February 17, 2006 to and including the close of trading on the TSX and NASDAQ on August 9, 2006.

B. The Factual Allegations in the Claim

35 In this section, I shall set out the factual allegations as they are pleaded in the Claim, which I can do relatively briefly. Then, in the next section of these reasons, I will set out the evidence that was presented for the purposes of the motions before the court. It is this evidence that will form the factual foundation for whether to grant leave for the statutory cause of action.

36 In their Claim, the plaintiffs allege that IMAX and the Individual Defendants made certain misrepresentations concerning the Company's earnings in 2005 and compliance with GAAP, in particular with respect to the number of theatre systems installed by the Company during Q4 2005, and the revenue recognized for such theatre systems. It is alleged that the misrepresentations were made in its Form 10-K[6] (which contained its Annual Report with audited financial statements for 2005) filed with the SEC for the fiscal year 2005 and in press releases issued by the Company in February and March 2006.

37 The plaintiffs allege that on March 10, 2005, IMAX issued a press release in which it estimated that its 2005 EPS, calculated in accordance with GAAP, would be US $0.35 to US $0.38, an increase from its earlier estimate of US $0.32 per share.

38 On February 17, 2006, IMAX issued a press release confirming that it expected to meet its 2005 EPS guidance, and stating that, during Q4 2005, the Company completed 14 theatre installations, a record for a single quarter, with 34 theatre systems installed in the full year. The press release indicated that the Company expected to report revenues in the range of $145-150 million for 2005.

39 On March 9, 2006, IMAX filed its Form 10-K, in which Messrs. Gelfond, Wechsler and Joyce certified that the Annual Report represented fairly, in all material respects, IMAX's financial condition. The 10-K was also signed by or on behalf of each IMAX director and by Kathryn Gamble as Vice-President, Finance and Controller and Principal Accounting Officer.

40 The Annual Report reported revenue of US $49,310,000 and EPS of US $0.29 per share in Q4 2005. For the fiscal year 2005 revenue of US $144,930,000, and EPS of US $0.40 per share were reported. IMAX theatre systems revenue of US $97,753,000 was reported for the fiscal year 2005.

41 The Management's Discussion and Analysis ("MD&A") contained in the Annual Report also stated that ten theatre systems installed by IMAX in 2005 were scheduled to open in the first and second quarters of 2006.

42 The Claim alleges that on March 9th IMAX issued a press release repeating the EPS reported in the Annual Report. In a second press release on the same date, IMAX announced that its board of directors had begun a process to explore strategic alternatives to enhance shareholder value, including the sale or merger of the Company with another entity offering strategic opportunities for growth.

43 On August 9, 2006 IMAX issued a press release that announced, among other things, that it was responding to an informal inquiry from the SEC regarding its timing of revenue recognition,

including its application of multiple element arrangement ("MEA") accounting in its revenue recognition for theatre systems.

44 The press release noted that under IMAX's MEA accounting, revenues associated with different elements of a theatre system contract are segregated and can be recognized in different periods. The press release stated that IMAX had recognized revenue in Q4 2005 on ten theatre installations in theatres which did not open in that quarter, and in seven of those cases revenue associated with the screen element of the system was deferred until the final screen was installed. Of these seven, three theatres had their screens completed in the first quarter of 2006, two in the second quarter and screens in the remaining two theatres had either since been completed or were expected to be completed over the remainder of 2006. The value associated with the elements other than the screen elements of those system installations was recognized in the fourth quarter when they were substantially completed. IMAX further stated that it believed that its 2005 accounting was in accordance with GAAP.

45 The August 9th press release also disclosed that there was no buyer then willing to acquire the Company at the valuation sought by IMAX's board of directors.

46 On August 10th, the price of IMAX's shares fell to $6.44 on the TSX and US $5.73 on NASDAQ, a drop of more than 40% from the previous day.

47 The plaintiffs allege that the decrease in IMAX's share price after August 9, 2006 resulted from the announcement that day that IMAX had recognized revenue in Q4 2005 in relation to ten theatre systems that did not open during that quarter and that it had applied MEA accounting to the revenue arising from the sale of those systems. The plaintiffs allege that such revenue recognition practices violated GAAP.

48 The Claim also asserts that IMAX's application of MEA accounting did not fairly present the Company's 2005 financial results and was not consistent with its accounting practices in prior years. It is alleged that the application of MEA accounting resulted in the overstatement of revenues, gross earnings, net earnings, retained earnings and EPS as reported in IMAX's 2005 annual financial statements.

C. Review of the Evidence (For Part Two of the Statutory Leave Test)

49 What follows is a review of the evidence adduced in the motion for leave, with respect to the alleged misrepresentations, the knowledge and participation of the respondents, and the defences of reasonable investigation and expert reliance. The purpose of this review is to determine whether or not the test for granting leave, as described later in these reasons, has been satisfied.

50 The review of the evidence is organized according to the following topics:

1. IMAX's revenues under its contracts for the sale and lease of theatre systems;
2. The applicable accounting standards for recognition of theatre system revenues;
3. IMAX's historical practices and policies for recognition of theatre system revenues, including its internal policies disclosed in its annual statements;

4. The investigation of an anonymous posting in Q3 2005 alleging fraud in IMAX's recognition of revenue on a theatre system installation in New Delhi, India (the "Delhi Post");
5. IMAX's 2005 year-end accounting, including the progress of theatre system installations in Q4 2005, incentives to customers and contract amendments and the revenue recognition process followed by IMAX management;
6. The PwC audit and the application of MEA accounting to Q4 2005 theatre system revenues during the audit process;
7. The announcement of results in the February 17, 2006 press release;
8. The March 1, 2006 audit committee meeting and the Board's approval of the 2005 financial statements;
9. Information unknown to PwC regarding the status of theatre system installations in Q4 2005;
10. The 2005 10-K filing, the March 9, 2006 press releases and IMAX's pursuit of strategic alternatives;
11. The SEC inquiry letter;
12. The August 9, 2006 press release;
13. The Restatement; and
14. Expert evidence as to IMAX's accounting: the Rosen reports.

1. Revenue from Sales and Leases of IMAX Theatre Systems

51 The point of departure is to understand the source of IMAX theatre system revenues under its contracts for the sale and lease of theatre systems.

52 IMAX derives revenue from the sale and lease of its theatre systems, film production, distribution and post-production services, digital re-mastering of films, and theatre operations. The sale and lease of theatre systems is IMAX's most important line of business. In the years between 2001 and 2005 (prior to the Restatement), revenue from theatre systems accounted for between 55% and 67% of IMAX's reported revenue.

53 In its 2005 Form 10-K IMAX identified its theatre systems as its "primary products" as follows:

> The Company's primary products are its large-format theatre systems. IMAX theater systems traditionally include a unique rolling loop 15/70-format projector that offers superior image quality and stability; a 6-channel, digital sound system delivering up to 12,000 watts; a screen with a proprietary coating technology; a digital theatre control system and extensive theatre planning, design and installation services. Theater systems are also leased or sold with a license for the use of the IMAX brand.

54 IMAX supplies its theatre systems to customers on a long-term lease basis or pursuant to a purchase agreement. While there are differences between the two types of agreements and indeed the accounting for sales and leases, such differences are not material to the issues in these proceedings, and IMAX's lease agreements and purchase agreements for theatre systems will be referred to collectively as "Contracts".

55 IMAX customers generally contract to acquire a "System", defined in the Contracts to consist of (a) a Projection System; (b) a Sound System; (c) a Screen; and (d) a Glasses Cleaning Machine.

56 The 2005 Form 10-K describes IMAX screens as follows:

> Screens in IMAX theatres are as large as one hundred or more feet wide and eight stories tall and the Company believes they are the largest cinema screens in the world. Unlike standard cinema screens, IMAX screens extend to the edge of a viewer's peripheral vision to create immersive experiences which, when combined with the Company's superior sound system, make audiences feel as if they are a part of the on-screen action in a way that is more intense and exciting than in traditional theatres, a critical part of *The* IMAX *Experience*. [Emphasis in original].

57 In these proceedings, the special IMAX 3D screen was referred to as the "silver screen". IMAX 3D theatre systems cannot be operated commercially without a silver screen.

58 Typically, an IMAX customer (referred to in the Contract as the "Buyer" or "Client") renovates or builds a theatre that the customer owns, and IMAX delivers its equipment and then supervises its installation. The customer is required to provide a "fully complete" or "fully prepared" theatre, ready for installation of the System. The date a theatre opens to the public is largely within the control of the customer, but a Contract may specify a date by which the customer shall open the theatre to the public.

59 Schedule A to the Contracts, "Specifications of System, Installation Testing and Training Services", provides that, "installation will only commence upon receipt of the pre-installation checklist, as provided by the IMAX project manager, confirming satisfactory completion of the auditorium and projection room in accordance with Schedule B".

60 Schedule B, "Electrical, Mechanical and Acoustical Requirements to be Provided by the Client", provides that, prior to the commencement of installation, the theatre itself, projection room and equipment rooms are required to be in a satisfactory state of completion, and that installation will not commence until all services as called for are operational on a full-time basis. A checklist follows with the note, "Installation will not commence until the building completion checklist has been returned complete".

61 IMAX Contracts generally also require IMAX to fine tune and align the projection and sound systems, and to train the customer's staff in the operation of the IMAX equipment at the time of installation. Generally, the Contracts also oblige IMAX to supply and to supervise the installation of a glasses cleaning machine to clean the special eyeglasses used to view the 3D films shown by the IMAX System.

62 The Contracts typically provide for three major sources of revenue: (1) initial upfront rental fees or purchase price payments, (2) ongoing additional or lease payments (a percentage of theatre revenue in excess of specified minimums), and (3) maintenance fees.

63 The initial payments vary depending on the type and location of the System, and are generally paid to the Company in installments commencing on the signing of the Contract, with the final installment tied to the "Date of Acceptance", defined as the earliest of (a) the date on which IMAX certifies to the client and the client is in agreement that the training of personnel, installation and

run-in testing of the System is complete; (b) the date on which the theatre is opened to the public; and (c) a specified date. That is, the final installment for the purchase or upfront rental of the System is to coincide with its installation.

64 IMAX's recognition of revenue from the initial payments on 14 theatres, ten of which were not yet open to the public in Q4 2005, is the focus of these proceedings.

2. Accounting Standards for Recognition of Theatre System Revenues

65 A number of GAAP accounting standards applicable to revenue recognition were referred to by Kenneth Copland, chair of IMAX's audit committee, in his Affidavit, and are relevant to this case.

66 In general, GAAP stresses the importance of revenue as a measure used to evaluate an entity's performance. The Canadian Institute of Chartered Accountants ("CICA") Handbook, as quoted by the plaintiffs' expert Lawrence Rosen, notes that recognition of revenue in the appropriate period is important because "the amount of revenue generated by an enterprise during the period is an important indicator of the level of the enterprise's activity. This information assists the users of financial statements in assessing the enterprise's performance".[7]

67 In order to measure the performance of an entity as consistently and accurately as possible, accounting principles concern themselves with identifying the "complete business cycle" associated with particular revenues, on the premise that revenues should be recognized when they are realized or realizable, and when they have been earned, generally by way of the revenue- producing entity having done what it is being paid to do.[8]

(a) SAB 101 and 104

68 In December 1999, the SEC published as interpretive guidance in applying GAAP to revenue recognition in financial statements, Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" ("SAB 101").[9] The guidance was released "due, in part, to the large number of revenue recognition issues that registrants encounter", noting that over half of financial reporting frauds identified in a study of public companies between 1987 and 1997 involved overstating revenue.[10]

69 SAB 101 provides that revenue should not be recognized until it is "realized or realizable and earned", or when all of the following criteria are met: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the seller's price to the buyer is fixed or determinable; and (iv) collectibility is reasonably assured."

70 With respect to the element of "delivery", SAB 101 further provides:

> A seller should substantially complete or fulfill the terms specified in the arrangement in order for delivery or performance to have occurred. When applying the substantially complete notion, the staff believes that only inconsequential or perfunctory actions may remain incomplete such that the failure to complete the actions would not result in the customer receiving a refund or rejecting the delivered products or services performed to date. In addition, the seller should have a demonstrated history of completing the remaining tasks in a timely manner and reliably estimating the remaining costs.

> If an arrangement ... requires the delivery or performance of multiple deliverables, or "elements", the delivery of an individual element is considered not to have occurred if there are undelivered elements that are essential to the functionality of the delivered element because the customer does not have the full use of the delivered element.

71 The concepts of "substantial completion" and the identification of "inconsequential or perfunctory actions", as well as, in the context of multiple deliverables, whether individual elements are essential to the functionality of the delivered elements, are significant to the accounting decisions giving rise to these proceedings.

72 SAB 101 emphasizes the importance of disclosure of a company's revenue recognition policies including where transactions have multiple elements:

> Because revenue recognition generally involves some level of judgment, the staff believes that a registrant should always disclose its revenue recognition policy. If a company has different policies for different types of revenue transactions, including barter sales, the policy for each material type of transaction should be disclosed. *If sales transactions* have *multiple elements, such as a product and service, the accounting policy should clearly state the accounting policy for each element as well as how multiple elements are determined and valued* [Emphasis added].

73 These provisions were repeated in SAB 104[11] dated December 17, 2003, which revised certain provisions of SAB 101. In respect of multiple-element arrangements, SAB 104 notes:

> Some revenue arrangements contain multiple revenue-generating activities. The staff believes that the determination of the units of accounting within an arrangement should be made prior to the application of the guidance in this SAB Topic by reference to the applicable accounting literature.

This excerpt of SAB 104 then footnotes Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21")[12].

(b) EITF 00-21

74 In 2003, the Emerging Issues Task Force of the Financial Accounting Standards Board[13] adopted EITF Issue No. 00-21 ("EITF 00-21") to provide guidance for accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. EITF 00-21 addresses "how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting".

75 EITF 00-21 also states:

> This Issue does not address when the criteria for revenue recognition are met or provide guidance on the appropriate revenue recognition convention for a given unit of accounting ... The timing of revenue recognition for a given unit of accounting will depend on the nature of the deliverable(s) composing that unit of

accounting (and the corresponding revenue recognition convention and whether the general conditions for revenue recognition have been met.

76 EITF 00-21 provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet the following criteria:

(a) the delivered item(s) has value to the customer on a standalone basis. That item(s) has value on a standalone basis if it is sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), ... this criterion does not require the existence of an observable market for that deliverable(s);
(b) there is objective and reliable evidence of the fair value of the undelivered item(s); and
(c) if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in control of the vendor.

77 EITF 00-21 also provides guidance as to the measurement and allocation of the arrangement consideration, generally requiring the arrangement consideration to be allocated to the separate units of accounting based on their relative fair values.

78 EITF 00-21 also provides, "a vendor should disclose (a) its accounting policy for recognition of revenue from multiple-deliverable arrangements (for example, whether deliverables are separable into units of accounting) and (b) the description and nature of such arrangements, including performance-, cancellation-, termination-, or refund-type provisions".

79 As Mr. Rosen notes, "EITF No. 0021 does not address revenue recognition for the units, but only whether individual components can be accounted for on a separate, individual unit basis. The further step of whether and when to record revenue is governed by GAAP for revenue recognition."[14]

80 The evidence is that IMAX management had initially recognized all revenues on 14 theatre systems in Q4 2005 on the basis that the remaining obligations were "inconsequential and perfunctory" (applying SAB 104), and that PwC could not agree with this assessment. PwC recommended that the Company consider MEA accounting, that is the application of EITF 00-21, resulting in the treatment of the screen as a separate unit of accounting.

81 The application of EITF 00-21 is important in the context of these proceedings, as IMAX, in its Restatement, acknowledged that it had erred in applying MEA accounting, that is, in treating the silver screen as a separate unit of accounting and recognizing all remaining revenue for its theatre system installations in 2005, and that it had failed to disclose a change in its accounting for theatre system revenues.

3. IMAX's Historical Practices and Policies for Recognition of Theatre System Revenues

82 The respondents contend that there was no change in accounting policies in Q4 2005, and that the MEA accounting that was applied to theatre system revenues at that time was the application of an existing policy and procedure to changed circumstances. At this stage I will review the evidence respecting IMAX's historical practices and policies with respect to the recognition of theatre system

revenues, and how such practices and policies were described by IMAX in its Form 10-Ks and in communications to regulators leading up to the 2005 year end accounting.

(a) IMAX's Internal Accounting Policies

83 In 2005 IMAX had in place three accounting policies related to the recognition of revenue for theatre systems, all dated December 1, 2004. The first, entitled "Policy No. 19: Revenue -- Systems" provided in part as follows:

> The Company recognizes revenues from sales-type leases upon installation of the theatre system. Revenue associated with a sales-type lease is recognized when all of the following criteria are met: persuasive evidence of an agreement exists; the price is fixed or determinable; and collection is reasonably assured.
>
> The timing of installation of the theatre system is largely dependent on the timing of the construction of the customer's theatre. Therefore, while revenue for theatre systems is generally predictable on a long-term basis, it can vary from quarter to quarter or year to year depending on the timing of installation.
>
> ...
>
> Revenue from sales of theatre systems is recognized when all of the following criteria are met: persuasive evidence of an agreement exists; the price is fixed or determinable; title passes to the customer; installation of the system is complete; and collection is reasonably assured.

84 IMAX's Policy 19-A, "Revenue-System Leases", repeated the same policy as above with respect to sales-type leases of theatre systems.

85 IMAX's Policy 19-B, "Revenue -- System Sales", stated:

> Revenue from sales of theatre systems is recognized when all of the following criteria are met: persuasive evidence of an agreement exists; the price is fixed or determinable; title passes to the customer; installation of the system is complete; and collection is reasonably assured.
>
> In determining that installation is complete for purposes of recognizing revenue for sales of IMAX theatre systems, the Company requires that the following criteria be met:
>
> * IMAX technology department concludes that the installation is complete, meeting full working standards according to contract provisions and system specifications.
> * All substantial issues which were raised by the client and which IMAX acknowledges and is in agreement with have been resolved.
> * The installed theatre system complies with all material terms of the contract, including the installation of the:

* Projection unit;
* Sound system;
* Screen system; and,
* 3D glasses system and cleaning system.

86 In a memo dated December 1, 2005, from Kathryn Gamble, IMAX's VP Finance and Controller to Frank Joyce, CFO entitled "Revenue recognition policy compliance"[15], Ms Gamble described IMAX's revenue recognition policy as follows:

> The Company recognizes revenue from sales-type leases upon installation of the theatre system when all of the following criteria are met: persuasive evidence of an agreement exists; the price is fixed and determinable; and collection is reasonably assured.

87 The memo went on to describe three guidelines followed by the Company for determining whether a particular theatre installation is "complete", including that the installed theatre system complies with all material terms of the contract, including the installation of the projection system, sound system, screen system, and 3D glasses system and cleaning system. The memo also noted that, "in the past, outstanding items such as the glass cleaning machine or the use of a white sheet [the non-3D screen] were evaluated and deemed inconsequential to the overall installation".

88 Ms Gamble's memo referred to a "certificate of acceptance" as evidence that "all substantial issues which were raised by the client and which IMAX acknowledges and is in agreement with have been resolved". The form of the certificate of acceptance used by IMAX at the material time provided for IMAX to certify the completion of the IMAX theatre system installation and run-in testing and for the customer to certify its acceptance. (Certificates of acceptance were obtained from the customers in respect of the 14 theatre installations in Q4 2005, although in some cases they were qualified by reference to outstanding obligations.)

89 In December 2005, as a result of recommendations following the investigation of an anonymous posting to Yahoo! containing allegations concerning improper revenue recognition on a theatre installation in New Delhi, India in Q3 2005 (see paras. 104 to 118 below regarding the Delhi Post), IMAX's general counsel, Robert Lister, recommended changes to the Company's revenue recognition policies for theatre system installations.

90 As a result, IMAX produced a new document, "IMAX Revenue Recognition Guidelines",[16] which was approved by PwC in January 2006. The new guidelines repeated the revenue recognition criteria set out in Policy 19, and went on to state:

> In determining whether the installation process is substantially complete for purposes of recognizing revenue for sales-type leases and sales of the Company's theatre systems, management requires that the following criteria be met:
>
> * The Company's Technology department concludes that the installation is substantially complete, meeting full working standards according to system specifications;
> * All substantial issues which were raised by the client that the Company acknowledges and is in agreement with have been resolved;

* Any remaining obligations are inconsequential or perfunctory (as considered in the indicators below); and,
* All material obligations of the contract and all material components of the installed theatre system as defined in the contract are substantially complete.

The Company would consider the following indicators (which are not meant to be dispositive or all-inclusive) in assessing whether certain tasks or activities are likely to be inconsequential or perfunctory:

* Failure to complete such tasks or activities would not likely result in the customer receiving a refund or rejecting the delivered product.
* Failure to complete such tasks or activities are not essential to the functionality of the theatre system.
* The Company has a demonstrated history of completing such tasks or activities in a timely manner, and can reliably estimate the remaining costs.
* The skills or equipment required to complete such tasks or activities are not specialized and are readily available in the marketplace.
* The time required to complete such tasks or activities are not lengthy.
* The timing of the payment obligation for the remaining portion of the sales price is not coincident with completing performance of such tasks or activities.

Each installation requires individual evaluation to determine if it is substantially complete. [Emphasis in original.]

91 None of IMAX's internal policies and procedures applicable to revenue recognition for theatre systems in force at the material time refers to EITF 00-21, or the possibility of accounting for IMAX theatre system sales and sales-type leases as arrangements with multiple elements. Indeed, in a memo on Revenue Recognition prepared for review by Mr. Lister in the course of the Delhi Post investigation, Mr. MacNeil (Vice President, Tax and Special Projects) stated, "Under EITF 00-21, a typical IMAX contract is viewed as a single unit of accounting as the equipment and installation are not currently separable after applying EITF 00-21. Under SAB 104, the arrangement revenue is deferred and recognized as the installation is performed".[17]

(b) Disclosure of Revenue Recognition for Theatre Systems in IMAX's Annual Statements

92 Prior to 2000, IMAX recognized revenue on the sales and leases of its theatre systems "upon delivery of the system" to the customer. In 2000, IMAX announced that it was revising its revenue recognition policy to accord with SAB 101 such that it began recognizing revenue related to the sale and lease of theatre systems at the time when the theatre system "installation is complete". That change in accounting resulted in IMAX taking a US $54.5 million charge against its earnings in its financial statements for the year 2000.[18]

93 As part of its continuous disclosure review program, the OSC carried out an issue-oriented review of issuers' accounting practices relating to revenue recognition, and in this regard corresponded with IMAX in 2000, 2001 and 2005.

94 In a letter to the OSC dated October 1, 2001, Mr. Joyce confirmed that IMAX recognized theatre system revenues at the time installation is complete and he described the event signifying the completion of installation, the point at which revenue is recognized as: "once the Imax supervisor in charge of the installation process certifies that the installation, run-in testing and training are complete. The Company's agreements typically call for customer agreement to the Company certification, further stipulating that such agreement will not be unreasonably withheld or delayed."[19]

95 In each Form 10-K from 2001 to 2004, IMAX disclosed that revenue recognition for theatre systems occurred "when the installation of the theatre system is complete" or "upon installation of the theatre system", and was subject to the following conditions: (a) persuasive evidence of an agreement exists; (b) the price is fixed or determinable; and (c) collection is reasonably assured.

96 Although EITF 00-21 came into effect on July 1, 2003, and according to Mr. Joyce, IMAX's former CFO, and Mr. Copland, the chair of its audit committee, IMAX adopted EITF 00-21 at that time, the 2003 Form 10-K makes no mention of the application of EITF 00-21 or MEA accounting to theatre system sales or leases.

97 IMAX first disclosed its application of MEA accounting in its 2004 Form 10-K in respect of film licenses and settlement revenue (occasions on which IMAX negotiates the termination of an agreement with a customer who is unable to proceed with the installation of a contracted theatre) as follows:

> On occasion, the Company will include film licenses or other specified elements as part of system sales or lease agreements. When separate prices are listed in a multiple element arrangement, these prices may not be indicative of the fair values of those elements because the prices of the different components of the arrangements may be modified through negotiation although the aggregate consideration may not. Revenues under these arrangements are allocated based upon the estimated relative fair values of each element.
>
> In the normal course of its business, the Company will have customers who, for a number of reasons are unable to proceed with theatre construction or wish to modify the terms of an existing arrangement. There is typically deferred revenue involved with these arrangements representing initial cash payments in advance of the default, settlement or modification of the arrangement. Pursuant to the policies discussed above, the total consideration to be received in these situations is allocated to each individual element of the settlement or modification arrangement based on the relative fair values of each element.
>
> Upon allocation of value to each element, each element is accounted for based on applicable revenue recognition criteria.[20]

98 On March 14, 2005, Mary Ruby, Senior Vice President, Legal Affairs, responded to a letter from the OSC advising that IMAX had been selected for a full review of its continuous disclosure record, including a specific request that the Company identify "which of the Company's revenue streams contain multiple elements, and how the Company recognizes revenue in these circumstances". Ms Ruby's response in substance repeated the passage noted above from the Company's

2004 10-K. She made no reference to the application of MEA accounting in respect of theatre system revenues. Her response was copied to Mr. Joyce and Mr. Lister.

99 In its 2005 Form 10-K (filed in March 2006), IMAX for the first time described an MEA accounting approach to its revenue recognition for theatre systems:

> The Company's system sales and lease transactions typically involve the delivery of several products and services, including the projector, projection screen and sound system, supervision of installation, training of theater personnel, and advice on theater design and custom assemblies. In addition, on occasion, the Company will include film licenses or other specified elements as part of these transactions.
>
> When the elements of theater systems meet the criteria for treatment as separate units of accounting, the Company generally allocates revenue to each element based on its relative fair value. Revenue allocated to an individual element is recognized when revenue recognition criteria for that element is met.
>
> ...
>
> The Company recognizes revenue from sales and sales type leases when the installation of the respective theatre system element is substantially complete and all of the following criteria are met: persuasive evidence of an agreement exists; the price is fixed or determinable; and collection is reasonably assured.

100 In his Affidavit, Mr. Copland asserted that this wording did not reflect any change in IMAX's accounting policy with respect to the recognition of revenue for theatre systems in 2005, but was an "enhancement to disclosure". In fact, he contended that the Company had applied MEA accounting to theatre systems even before 2003. He stated:

> The change in the wording of the Company's accounting policies surrounding revenue recognition on sales and sales type leases did not result in a change of policy to how IMAX recognized revenue compared to previous periods. The Company believed that these changes further enhanced its disclosure relating to these policies and their interactions.
>
> The Company adopted the consensus reached in EITF 00-21 effective in its quarter beginning July 1, 2003. Prior to this effective date, the Company followed the multiple element arrangement guidance in SAB 101, Revenue Recognition in Financial Statements and the related FAQ document. Where the Company negotiated a customer arrangement (including a sale or lease of a projection system) that had multiple elements within it, the Company allocated value to each individual element based on separation criteria with relative fair values supported by verifiable objective evidence. After separation, each individual element was then accounted for separately based on applicable revenue recognition criteria.[21]

101 Mr. Copland's description of a consistently applied accounting policy for the recognition of theatre system revenues is contradicted by other evidence in this motion.

102 In addition to the absence of any reference to MEA accounting for theatre systems in the Company's internal policies and procedures, and until 2005 in its Form 10-K disclosures, under cross-examination, Ms Gamble and Mr. Joyce acknowledged that prior to Q4 2005, IMAX had never applied EITF 00-21 to a theatre system installation[22]. In its report to the audit committee dated March 1, 2006, PwC noted that, "previously, such accounting had only been applicable to multiple elements in lease terminations and bundled contracts that included film licenses".[23]

103 The SEC considered this as a change as well. As stated by the SEC's Division of Corporate Finance in a September 20, 2006 letter to IMAX's Interim CFO:

> Confirm that you are now accounting for these [theatre system sales and lease] arrangements pursuant to EITF 00-21, Revenue Arrangements for Multiple Deliverables and, as we do not see similar disclosure in your 2004 10-K, *tell us the period in fiscal 2005 when you changed your revenue recognition policy.*[24] [Emphasis added.]

4. The Delhi Post

104 The issue of revenue recognition on IMAX theatre systems was raised in an anonymous posting to Yahoo! on November 10, 2005, that was emailed to the CEOs of IMAX and the SEC (the "Delhi Post"). This occurrence, in Q4 2005, and the investigations that followed internally at IMAX, are relevant to the conduct and knowledge of the respondents in this case in relation to the year-end accounting and in particular the recognition of revenue on theatre systems.

105 The Delhi Post was titled "SEC to Investigate Fraud at IMAX" and alleged, among other things, that, in order to achieve its "numbers", IMAX was "faking system installations before quarter ends", and "paying customers to fake installs and sign documents for auditors", and that this had been done specifically with respect to an installation in Delhi, India in Q3 2005.

106 The CEOs notified in-house counsel, Mr. Lister and Mr. Copland, in his capacity as chair of the audit committee, about the email, and IMAX Board members were advised, as were PwC and external legal counsel.

107 The audit committee met on November 14, 2005 and again on November 28th. Ultimately there were two investigations: Mr. Lister investigated and reported to the Board, and Jeffrey Vance, Manager Business Operations, and the individual responsible for the independent testing of internal controls under Sarbanes-Oxley[25], was directed by the audit committee to independently assess the Company's internal accounting functions. The two CEOs, Mr. Joyce and Ms Gamble were excluded from the investigations.

108 Mr. Lister reported on December 7, 2005[26] that there was no evidence of any kind that supported the allegations in the Delhi Post. There was no fraud, and there was no SEC investigation. Mr. Lister concluded that there was nothing "fake" or misleading about the Delhi installation, and that none of the installations recognized in 2005 were achieved by paying customers to "fake installs". He did note however that there were four deals in negotiation where incentives had been offered to clients, but observed that such incentives were fully transparent, documented and provided for as expense items in deal margin analyses.

109 In his report Mr. Lister observed that the Company's Policy 19-B, dealing with revenue recognition in connection with system sales, had a "small number of inaccuracies", making it not

wholly consistent with the Company's actual policy as articulated in its public filings. He noted that, in particular, Policy 19-B (a) required that system installation be complete to recognize revenue when Company policy called for "substantial completion", (b) required an "installed theatre system" to include a screen system, when Company policy and practice suggested that only the screen frame is a material part of the system agreement, not the actual screen skin; and (c) required an installed theatre system to include a 3D glasses system and cleaning system when Company policy and practice suggest these are perfunctory or routine items and not a material part of the system agreement. Mr. Lister recommended the revision of Policy 19-B "to make it consistent with the Company's actual (disclosed) revenue recognition policy".

110 In Mr. Vance's report to the audit committee dated December 7, 2005[27], there is no conclusion as to whether there had been any wrongdoing with respect to premature recognition of theatre system revenue on the Delhi installation. Mr. Vance noted that "final determination of the appropriateness of GAAP interpretation rests with PwC".

111 Mr. Vance's report also made recommendations about IMAX's accounting practices. He stated, "For each contract spanning a quarter-end in 2005, as well as on a go-forward basis for all installations spanning quarter or year-ends, the CFO and VP Finance, Controller will document their judgment of what is perfunctory in the context of each installation." He noted that IMAX's Policy 19-B was in the process of being amended to reflect the important role of management's judgment with respect to revenue recognition and the determination of the point of substantial completion.

112 Mr. Copland, as chair of the audit committee, provided a memo to the Board dated December 14, 2005[28]. He concluded, "The Audit Committee is of the unanimous view that there is no evidence that the Company has been involved in any of the fraudulent or wrongful conduct as alleged in the Posting." He adopted the conclusions and recommendations from the Lister report, however with less detail.

113 Mr. Copland's memo to the Board included the observation that "the Company's internal controls and reporting structure appear well-designed to discover these types of accounting fraud should they have occurred". This memo was faxed to audit partner Lisa Coulman at PwC, on December 20th.

114 A third review was undertaken by PwC itself. It reviewed the internal reports that had been prepared, as well as a package put together by the Company which included a customer acceptance document, the report of the installer and other documents relevant to the Delhi installation.[29] PwC concluded, having considered the facts, that IMAX's decision to recognize revenue in Q3 2005 for Delhi was appropriate.[30]

115 Although not raised in their affidavits, the respondents ultimately rely on the Delhi Post as part of their "reasonable investigation" defence -- that is, allegations about improper revenue recognition had been raised, and according to the respondents, properly investigated and resolved, with the result that each respondent was reassured about the propriety of the Company's revenue recognition practices as IMAX headed into its year-end accounting for 2005.

116 The plaintiffs assert that the investigations were inadequate as there is no indication that they went beyond the Company's internal documentation or that anyone outside the Company was contacted to confirm any information.

117 What is clear is that the Delhi Post and its investigation took place during Q4 2005, coincident with the period of time when several theatre installations had been budgeted to be completed, and when revenue recognition for theatre installations was a key concern within IMAX. As a result, there was a heightened awareness among IMAX management and Board members of the importance of properly accounting for theatre system revenues.

118 As Mr. Gelfond observed under cross-examination, particular attention was given to ensuring a proper process in the directors' minds and PwC because of the Delhi Post. With respect to the revenue recognition process followed for year-end 2005, he stated:

> Because of the posting on their message board by the anonymous source, the issue of ensuring a proper process was followed in 2005 was on all directors' minds and very much on PwC's mind. So, an enormous amount of thought and energy went into preparing those financial statements by our staff, by PwC. I remember seeing a binder, probably, you know, almost a foot thick or maybe thicker. There was a lot of contact between our Audit Committee, they were very involved, and PwC and the finance staff ... I am referring more specifically to the Audit Committee. But because we have a relatively small board, and everyone was aware of the level of analysis that PwC was going through, again, my general recollection is that our board paid a lot of attention to this.[31]

5. The 2005 Year-end Accounting

119 At the close of the third quarter of 2005, IMAX had generated EPS of only $0.11 for 2005, meaning that in order to achieve the lower end of the 2005 EPS guidance published in March 2005, it would have to generate more than twice as much EPS in the fourth quarter as it had generated in the first three quarters combined. There was a significant concern about meeting revenue targets in Q4 2005.

120 This part of the reasons contains a summary of the evidence relevant to the 2005 year-end accounting internally at IMAX; that is, the status of theatre system installations that were occurring in Q4 2005, arrangements that were made with customers to encourage the acceptance of installations by year-end, and the process that was followed by IMAX personnel in ultimately deciding to recognize revenue on 14 theatre system installations.

(a) The Progress of Theatre System Installations in Q4 2005

121 The IMAX department responsible for supervising theatre system installations is "Theatre Operations". In late 2005, Mark Welton, who directed the department, provided periodic email reports, summarizing the status of Q4 installations, to a number of people within the Company, including the CEOs, Mr. Lister, and Mr. Joyce, Ms Gamble and Mr. MacNeil in the finance department[32].

122 The emails emphasized the importance of completing as many installations as possible to meet the Company's projections, and reflected a concern with how delays in the installation of the theatre systems would affect earnings.

123 The emails disclosed that there were issues for a number of the installations, in particular in respect of delayed construction of theatre buildings. The intention was to commission some theatre systems with temporary power and a 2D white screen only; in some cases, the silver screen would

be erected and then taken down. One theatre was identified as a "demonstration" theatre only, by reason of its temporary location, and was not to open to the public. The emails also identified the amount of gross margin that IMAX could expect to recognize on its 2005 financial statements with respect to each theatre.

124 Senior management also received updates from the finance department in the form of "business affairs reports", specifically identifying the impact on the Company's financial statements that would result from particular installations falling to later periods, and how those results compared to IMAX's earnings guidance to investors. The updates circulated in Q4 2005 indicated that, in order for IMAX to achieve its budgeted numbers for 2005, it needed to install almost as many theatres in the final quarter as it had in the first three quarters of 2005 combined.

125 According to the plaintiffs, the information communicated in the emails and updates demonstrates that the situation was urgent -- unless revenue could be recognized on a significant number of the theatres that were not yet complete and would not open until the following year, IMAX would be unable to meet its projections. The emails also disclose the actual status of completion of each installation up to December 31, 2005.

126 Each of the Individual Defendants and the respondent Gamble was included in the distribution of the emails[33]. Accordingly, there is evidence that each of these respondents was aware of the true status of the theatre system installations.

(b) Customer Incentives and Contract Amendments

127 Toward the end of 2005, IMAX's business people made arrangements providing concessions to a number of its theatre system customers. These arrangements or "side agreements" were largely verbal until PwC, during the audit process, requested IMAX to reduce them to writing, in the form of amending agreements.

128 In some cases the Contract with a particular customer included an installation date, while in others there was no deadline. Installation was dependent on the completion of the theatre building, which was largely beyond IMAX's control.

129 IMAX offered financial incentives to certain customers for their acceptance of installation in Q4 2005. These consisted of the deferral of the final installments due on installation in respect of: the Lark International Multimedia Limited installation in Hong Kong ("Lark") in the sum of US$720,000; the Suvar-Kazan Company Ltd. installation in Kazan, Russia ("Kazan") in the sum of US$180,000; the Evergreen Vintage Aircraft Inc. installation in McMinnville, Oregon ("McMinnville") in the sum of US$340,000 and the Jafif Penhos Elias installation in Interlomas, Mexico ("Interlomas") in the sum of US$435,000, and the payment of marketing support or other payments in respect of Lark (US $39,490), Kazan (US $31,000), Interlomas (US $25,000) and McMinnville (US $50,000).[34]

130 While the CEOs and Mr. Joyce suggested in their cross-examinations that there were other business reasons for the side agreements and that they were typical business arrangements, IMAX did not receive any real benefit from the concessions other than the customer's agreement to accept installation of the system before the end of Q4 2005.[35]

131 Mr. Vance, in a February 7, 2005 note to Ms Gamble, Mr. Joyce and Mr. MacNeil during the PwC audit process, cautioned, "I think [PwC will] be looking very closely at the rationale for the

inducements in light of all the facts surrounding the installations" and observed in respect of the marketing payments, "This has not been a normal business practice in prior periods".[36]

132 The plaintiffs contend that IMAX departed from its usual practices in Q4 2005 in providing financial incentives to customers to accept installation of their theatre systems by year end, with the result that actual revenues which were supposed to have been received on installation were postponed, and additional costs were incurred. They argue that this is evidence of IMAX's determination to recognize more revenue than it would have been entitled to recognize under its existing Contracts and the proper application of its internal accounting policies, so as to meet its aggressive earnings guidance.

133 Apart from contending that the side agreements served a function other than as an incentive to accept system installation before year end, the respondents rely on the fact that PwC gave a clean audit opinion knowing the full details of the agreements IMAX had negotiated with its customers.

(c) The Revenue Recognition Process

134 IMAX management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting.[37]

135 The management representation letter from IMAX to PwC, as part of its annual reporting, confirms that IMAX is responsible for its financial statements, including establishing and maintaining an effective system of internal control over financial reporting and that the Company is responsible for the proper recording of transactions in the accounting records and for reporting financial information in conformity with GAAP.[38]

136 The decision-making team for IMAX's Q4 2005 revenue recognition consisted of Mr. Joyce (who was a certified public accountant and CFO), Ms Gamble (a chartered accountant and VP, Finance and Controller) and Mr. MacNeil (Vice President, Tax and Special Projects, who was regarded as the GAAP expert on the team).

137 According to Ms Gamble, revenue recognition became more complex in the fourth quarter of 2005. There were "more factors to consider", since ten of the 14 theatres were not yet open.

138 Ms Coulman of PwC, as the engagement leader on the IMAX audit team, met with Mr. Copland as chair of the audit committee in January 2006, after the report on the Delhi Post. She told Mr. Copland that they needed to be "very clear on the accounting for each of the transactions in the fourth quarter that they were going to recognize revenue on." In her examination she stated:

> ... We needed to understand, on each one of those, what were the remaining obligations. And we needed to understand the company's judgment on whether those remaining obligations were perfunctory or inconsequential. They can only recognize revenue on a particular item if the remaining obligations are perfunctory or inconsequential.[39]

139 In his affidavit, Mr. Copland[40] described the revenue recognition process for Q4 2005 as follows:

> In 2005, the Company's management evaluated the system arrangements for the purposes of revenue recognition based upon an analysis of whether any remain-

> ing installation items were either inconsequential or perfunctory to recognition (which included final screen installation). Effectively, this was the same method used in prior periods whereby, for convenience, everything was assessed at the same time given that the installation of all components were typically installed at the same time. The Company undertook and completed an evaluation of each individual installation in the Fourth Quarter of 2005 where the theatre itself was not open.
>
> Based upon these evaluations, the Company's management submitted its findings and opinion to PwC as support for its proposed revenue recognition decisions in 2005 as part of the year end process.

140 Ms Gamble described the process of preparing a preliminary report for PwC concerning revenue recognition on the 14 installations in question.

141 The people at IMAX that were involved in the preparation of the preliminary report were Gamble, Joyce and MacNeil, as well as three chartered accountants that reported to Kathryn Gamble. Mr. Vance, whom Ms Gamble described as the Company's "control guru", had a dotted line report to the audit committee, to help look objectively at management's information gathering.

142 IMAX's analysis took the form of revenue recognition or transaction memos (also referred to as "installation reports") for each theatre system installation in Q4 2005, that went through several iterations. The transaction memos were prepared by Mr. MacNeil, incorporating comments from Mr. Joyce, Ms Gamble, Mr. Vance and Mr. Lister. According to Mr. Joyce, the intention of the memos was to present all known facts relating to the installations; that is, to gather all the data.[41]

143 The first iterations of the transaction memos consisted of a single summary page. According to Ms Gamble, they were provided to PwC in mid-January and over a four week period went through several iterations and were expanded to three pages.[42] PwC considered the initial versions of the memos as "not fulsome enough".[43]

144 IMAX management decided to recognize revenue on 14 theatre installations in Q4 2005. In each case where there were remaining obligations at the end of the quarter, such as the installation of the silver screen, the glasses cleaning machine and customer training, such obligations were characterized as perfunctory and inconsequential.

145 It appears that this is the approach that management had taken with respect to such outstanding obligations in the past[44], including in respect of the recognition of revenue on the New Delhi installation in Q3 2005[45], notwithstanding the wording of the Company's internal policies on revenue recognition.

146 When asked to explain the "inconsequential and perfunctory" analysis under cross-examination, Mr. Joyce stated, "I just know that the installation of a final screen was almost always considered inconsequential and perfunctory because we had done it so many times before, and in our view, there wasn't a doubt as to whether we could do it again."[46]

6. The PwC Audit

147 This part of the reasons reviews the evidence respecting PwC's audit of IMAX's proposed financial statements for 2005. It is during this process that IMAX, on the advice of PwC, decided to

apply MEA accounting to its theatre system revenues, which resulted in a deferral of certain revenues for incomplete obligations.

(a) The Transaction Memos

148 According to Ms Gamble, there were many conversations and meetings between IMAX and PwC personnel in the United States and Canada, and legal opinions were obtained on some of the agreements with customers.

149 After IMAX management put together a summary of projector, screen and sound systems that had been sold separately, PwC asked them to quantify the labour and money required to complete the remaining work on each theatre system.

150 PwC reviewed files for each theatre, including the Contracts and the terms of the amending agreements, which it requested to be put in writing. During the process, PwC showed IMAX a calculation of the remaining obligations as a factor of total costs (which estimated the remaining cost to complete in some cases at 15 and 16% (Kazan and Lark) and remaining hours to complete as 30% for Kazan and 40% for McMinnville. PwC also did independent confirmations, contacting the customer in writing in five cases.[47]

151 Mr. Vance reviewed the transaction memos on February 7 and 8, 2006 and raised his concerns in writing with Mr. MacNeil, Mr. Joyce and Ms Gamble.[48] He asked about the marketing support payment in relation to Kazan, noting that it had not been a normal business practice in prior periods. He raised a concern about the Lark theatre system possibly violating SAB 104 for revenue recognition in that the product may have been delivered for demonstration purposes. Mr. Vance asked: "What response does the company have to the suggestion that the $39,000 was an incentive to get the system in a temporary location in 2005 since the original site would not be ready in time?" With respect to McMinnville, he questioned the marketing allowance and whether concessions were offered to all theatres, and in respect of all theatres not open by year end, he questioned the number of hours remaining to complete the installations in comparison to total installation hours. Ms Gamble described Mr. Vance as playing the role of "devil's advocate" when he expressed these concerns. There is no evidence of any written response or whether the specific issues raised by Mr. Vance were in fact addressed by IMAX management with PwC.

152 The final versions of the transaction memos were sent to PwC on February 10, 2006. Ms Gamble admitted that she did not look at EITF 00-21 in preparing the first draft of the transaction memos; in fact, she indicated that she had only ever read a little subsection.[49] The transaction memos appear to address the factors relevant to SAB 104, and do not reference or address the criteria for accounting for multiple elements under EITF 00-21.

153 The transaction memos were available to members of the Board. According to Mr. Gelfond, Board members were provided with a binder containing details surrounding every installation.[50]

(b) The Application of MEA Accounting to Q4 2005 Theatre System Revenues During the Audit Process

154 According to Ms Coulman, during its audit, PwC was uncomfortable with the position IMAX management had taken on a number of the theatre system installations. Of the 14 installations, there were seven installations that only had a white sheet and not the silver 3D screen.

155 PwC disagreed with IMAX's judgment that the remaining obligations were inconsequential and perfunctory to the overall transaction, when considering the criteria under SAB 104.

156 Ms Coulman described the process of arriving at the decision to apply MEA accounting as follows:

> Q. 241: So, based upon your understanding of the facts as you knew them at that time, and your reading of this portion of SAB 104 and whatever other accounting literature you considered pertinent, you were troubled by the manner in which IMAX was recognizing revenue in respect of those theatres you mentioned in the fourth quarter?
>
> A: Initially, yes.
>
> Q. 242: I take it from your statement initially, that you changed your view at some stage; is that correct?
>
> A.: Well, after we had conversations with them that we could not accept their judgment call on the fact that the screen sheets were inconsequential to the overall theatre system, we then told them that they needed to consider multiple element arrangement accounting under EITF 00-21.
>
> Q. 243: When you say "needed to consider" what do you mean, exactly, that they needed to review EITF or that they should begin to apply it?
>
> A.: They had applied and were applying [it] in other situations. We, therefore, suggested to them that they needed to consider in these situations, that [it] was applicable.
>
> ...
>
> Q. 307: So, we were talking about a discussion that you had with Mr. Copland at the end of January or early February, I think you said. What was the next conversation you had with representatives of IMAX about the revenue recognition policies that you or anybody else from PwC had and that you can specifically recall?
>
> A.: So, at the beginning of February, we pushed back on the inconsequential concept and asked the company to consider the application of 00-21. They came back and said that they had determined that the screen was a separate unit of accounting under 00-21, and, therefore, they were going to bifurcate the screen from the overall revenue and record a journal entry to leave the screen, and the revenue associated with that screen on the balance sheet and record the balance of the revenue for the projector, the sound system and the glasses cleaning machine in the December period.
>
> ...

> Q. 328: So, could you, once more, explain to me what changed in the accounting position of the company, which caused you to have an adequate level of comfort that you could sign the audit opinion?
>
> Mr. Pepall [counsel for PwC]: We are now being specific to the theatre installations?
>
> Q.: I think so, yes.
>
> A.: So, by deferring the unit of accounting defined as the screen, on the balance sheet, the remaining obligations related to the other units of accounting that have been recognized, became ... the company proposed that those remaining obligations were perfunctory and inconsequential. We were able to accept that, because the indicators on those remaining obligations related to the projector system, sound system and glasses cleaning machine, appeared to be inconsequential and perfunctory.

157 According to Ms Coulman's account, IMAX management did not offer a specific explanation for why they considered the installation of the silver screen to be perfunctory and inconsequential, and PwC "continued to push back to them to say that [it] could not find their position acceptable because they felt that the items listed had not been fully thought through".[51] Ms Coulman described IMAX's initial response to PwC's "push-back" as follows:

> So, after they ... we pushed back on the inconsequential concept around the systems they were taking. *They withdrew and came back to us at the beginning of February and said that their revenue, as recognized, was their final position.* We, then, had internal meetings to discuss their position and after those internal meetings, we phoned the client back and told them that we could not accept their position that the remaining obligations were inconsequential and perfunctory and that they should consider multiple element arrangement accounting. They then proceeded to take our statement under advisement. They went back and did consider multiple element arrangements and proposed to us that the screens would be identified under the accounting ... would be identified and the revenue associated with those screens would be deferred on the balance sheet and the remaining revenue would be taken in the quarter. So, they then proceeded to book an adjustment to their accounts around the seven systems that had screens that were not installed.[52] [Emphasis added.]

158 Ms Coulman's evidence suggests that IMAX had taken a "final position" in early February 2006, that it would recognize revenue on all 14 theatres, based on the conclusion that all remaining obligations were inconsequential and perfunctory.

159 PwC disagreed with the Company's "perfunctory and inconsequential" analysis, in particular in relation to the failure to install the 3D screens. PwC suggested that IMAX consider MEA accounting, and IMAX management came back and proposed to defer revenue on the screens and to recognize all of the remaining revenue in the quarter. This required IMAX to book an adjustment for the systems that had screens that were not installed.

160 Ms Coulman's evidence is clear that it was the responsibility of IMAX management to decide whether to apply MEA accounting to elements of the theatre system, which would have involved a consideration of EITF 00-21 in determining which elements could be accounted for separately.

161 While Mr. Copland's affidavit (at para. 61) describes the criteria under EITF 00-21 considered by IMAX in concluding that the screen was a separate unit of accounting (an identical explanation was initially provided by IMAX in response to SEC and OSC inquiries in 2006), no contemporaneous documents were offered in evidence to demonstrate the EITF 00-21 analysis performed by IMAX management, as described by Mr. Copland, or at all. The transaction memos prepared for PwC and revised during the audit process do not address the criteria relevant to MEA accounting, and continue to deal with revenue recognition on the entire theatre system.

162 It is the respondents' evidence that there was ongoing communication between management and PwC on revenue recognition issues between January 2006 and the time of the Board's approval of the 2005 Form 10-K however the respondents refused to produce written communications by PwC to management during the 2005 audit raising questions about revenue recognition on Q4 2005 theatre systems, or seeking information on those installations.[53]

7. The February 17, 2006 Press Release

163 On February 17, 2006, one week after the final transaction memos were transmitted to PwC, and before PwC had signed off on its audit, IMAX issued a press release. The press release stated that, during Q4 2005, the Company "completed" 14 theatre installations, a record for a single quarter, with 34 theatre systems installed in the full year, and that the Company expected to report revenues approximately in the guided range of $145-150 million for 2005. (With the adjustments following the application of MEA accounting, revenues were in fact reported at $144.9 million.) The press release indicated that the results were based on preliminary financial data and subject to final closing of the Company's books and records.

164 The statement in the press release that the Company had completed 14 theatre installations in Q4 2005 was untrue, notwithstanding that Mr. Copland under cross-examination asserted that the statement was accurate under the "then definition" of "completed".[54] According to the respondents' evidence, by the time the press release was issued, the Company had decided to apply MEA accounting because PwC did not accept its "substantial completion" analysis. Under any definition that may have been applicable at the time, IMAX had not in fact "completed" 14 theatre installations.

165 Mr. Wechsler admitted reading and approving the press release. Both he and Mr. Gelfond were quoted in the press release. Mr. Joyce acknowledged that he must have read the release and that he would have had input into the number of installations they believed happened at that point.

8. The Board's Approval of the 2005 Financial Statements

166 This part of the reasons reviews the evidence concerning the review and approval of IMAX's 2005 financial statements by the IMAX audit committee and Board, and in particular the communications with IMAX management and PwC. The information that was provided to the audit committee members and Mr. Girvan, and then to the full Board, including the extent to which they were aware of the disagreement between IMAX management and PwC, is relevant in the assessment of whether each individual conducted a "reasonable investigation".

(a) The March 1, 2006 Audit Committee Meeting

167 The first audit committee meeting of 2006 took place on March 1, 2006.

168 At the meeting, Ms Coulman presented PwC's Preliminary Report to the Audit Committee for the year ended December 31, 2005.[55] The report noted: "As of the writing of this report February 23, 2006, we have not completed all the audit procedures that are required to finalize our audit opinions", and that the report would remain unsigned until the financial statements were filed.

169 PwC stated:

> During our audit, we spent a considerable amount of time reviewing the company's support for the accounting for the 14 system installations recorded in the 4th quarter. Our focus was mainly on the post installation obligations of ten installed systems where the theatre had not opened to the public by December 31, 2005. Management considered its positions with reference to both its internal revenue recognition guideline and SAB 104.
>
> ...
>
> Management concluded that all of its post-installation obligations are inconsequential or perfunctory. Accordingly revenues on the systems were initially fully recognized by management.
>
> Upon final review of the facts and circumstances around these transactions, we indicated to management that we believe certain of the obligations to be consequential and not perfunctory. Accordingly, the preferred accounting treatment for these installations was to first identify any elements which could be accounted for separately under multiple element accounting guidance. Any such separable elements are required to be fair valued, and, if undelivered, revenue and costs relating to these elements would be deferred until the element was delivered. For separation of elements to occur, specified criteria must be met under applicable accounting standards.
>
> This accounting treatment has been adopted by the Company and thus two material elements have been identified and deferred: the screen; and for one customer, a contingent obligation to reinstall the system in another location. Based on the identification of these two elements, the Company has deferred the screen system in seven of the ten installations, and the reinstallation obligation in one of the ten. This resulted in management recording an adjustment to defer revenue of $0.8 million and costs of $0.6 million resulting in gross margin impact of 0.2 million.
>
> After the deferral of these two elements, management has concluded for the ten installations that the remaining obligations on the delivered elements are inconsequential or perfunctory, and has therefore recognized revenue on these elements.

170 PwC also concluded that during the year, the Company did not adopt any new accounting policies. The report stated:

> During the year, the Company did not adopt any new accounting policies. However the fact pattern concerning post installation obligations of installed theatre systems led to the application of multiple element arrangement accounting to theatre system revenues. Previously, such accounting had only been applicable to multiple elements in lease terminations and bundled contacts that included film licenses. The 2005 accounting involves the application of an existing accounting standard and the Company's accounting policy to changed circumstances. It is therefore not considered a change in accounting policy.

171 IMAX management provided a Q4 2005 Review Package to the Audit Committee,[56] which was presented at the March 1st meeting by Ms Gamble. She included a chart showing the status of the installations for each theatre in respect of which revenue was to be recognized in Q4 2005, indicating that in certain cases revenue would be deferred on the screen and frame, which were not yet installed, until Q1 2006. She also briefly listed the remaining obligations that were "Performatory/Inseque" [*sic*], consisting in most cases of final alignment, sound tuning and training, and with respect to Lark, "weights, lens, possible relocation". Ms Gamble calculated that the effect of carving out the screen element was to reduce recognized revenues by $850,977.

172 Mr. Vance also made a presentation at the March 1st audit committee meeting, entitled "SOX Update".[57] As part of his report Mr. Vance noted a "significant deficiency" in the area of system installations, impacting on system revenue and system cost of sales as follows:

> During the year-end audit, PwC recommended a change from single element accounting to multiple elements accounting to reflect the changed facts and circumstances surrounding the Company's system installation process. This adjustment was contemplated after management had completed its identified process and had finalized its revenue recognition numbers, and as a result, was required to be considered as a control exception under Sarbanes-Oxley. The overall impact of the adjustment was a margin impact of $219,000, which was not material to both the Q4 and the annual results. The impact of this deficiency was also not material in any other quarter.

173 Mr. Braun and Mr. Leebron were members of the audit committee together with Mr. Copland, its chair.

174 Mr. Braun saw the audit committee's role as to supervise, ask questions and have a healthy skepticism about what the experts present and what management presents.[58] Mr. Braun had expressed the view that PwC's advice was on occasion too conservative, including the assessment that revenue should not be recognized on the screen where the silver screen had not been installed.[59] Mr. Braun was adamant that no one at the meeting discussed the fact that revenues should not be recognized on any of the installations until they were complete.[60]

175 Mr. Leebron recalled that the audit committee was aware that there had been a difference of opinion between IMAX management and the auditors about whether all the revenue on the 14 installations should be recognized and that since PwC's advice and opinion, which were independent and more conservative, had been accepted they were satisfied. They did not consider a possible

third approach of not recognizing revenue on systems where the silver screen had not been installed.[61]

176 Mr. Copland recalled that he had discussions with PwC personally about the 14 installations in the last quarter of 2005. After management had initially proposed to recognize revenue on all of the installations, PwC came back and had discussions with management in which he was involved.[62]

177 Although he was no longer a member of the audit committee, Mr. Girvan, a Board member and corporate lawyer whose firm acted for IMAX, regularly attended the audit committee meetings. He did not recall whether he was in attendance at the March 1st meeting, however he did review the package and saw PwC's comments about revenue recognition on the theatre systems. His evidence was that he did not have any comments because the treatment was acceptable to PwC.[63]

178 Mr. Girvan indicated that there were many discussions about revenue recognition both at audit committee meetings and meetings of the full Board over the years because it is so complex, however that had not raised any concern on his part about the possible manipulation of revenue recognition.[64]

179 The draft financial statements were presented to the IMAX Board on March 8th by the finance department and PwC, and by Mr. Copland as chair of the audit committee.[65] After discussion, the Board approved the release of the 2005 financial statements with the lesser recognition of revenue dictated by the application of MEA.[66]

180 As part of the 2005 Annual Report, management assessed the effectiveness of the Company's internal control over financial reporting and concluded that such internal control over financial reporting was effective as of that date and that there were no material weaknesses in internal control.[67] PwC also confirmed that it had audited IMAX's internal control over financial reporting and concluded that the Company maintained effective internal control over financial reporting as of December 31, 2005.[68]

9. Information Unknown to PwC re: Status of Theatre System Installations

181 The plaintiffs assert that PwC did not have important relevant information at the time that they advised IMAX to consider MEA accounting, and in giving a clean audit opinion for the Company's 2005 financial statements. They rely on an admission from audit partner Lisa Coulman that this may well have affected the advice that was given.

182 The respondents assert that PwC's advice to IMAX to apply MEA accounting was made on a full appreciation of all relevant facts respecting the theatre system installations in Q4 2005. PwC had a good understanding of IMAX's business; as a result of the extensive communications between management and the audit team in early 2006, PwC was aware of what was occurring at each location, as reflected in the transaction memos, including agreements with customers that provided for marketing support payments and deferred installment payments.

183 The emails that were exchanged between management in Q4 2005 provide evidence of the status of the installations. These emails reflect certain information about the theatres that was not contained in the transaction memos (or in the report of management provided to the audit committee at its March 1st meeting).

184 For example, for Kazan, ultimately the silver screen was not installed until October 19, 2006, and theatre construction at the end of 2005 was at a stage where there was no roof on the building.[69]

185 For Lark, the transaction memo does not disclose that the system had been installed in a temporary location as a "demonstration theatre" because the customer had not complied with its obligation to identify a permanent location for the first theatre system under a multi-system Contract. The memo refers to a "contingent" obligation to move the theatre. In his examination, Mr. Joyce described the reinstallation as an "option". In her report to the audit committee, Ms Gamble referred to the system's "possible relocation". The emails make it clear however that the requirement to move the system from its temporary location and to reinstall it in a permanent location was a certainty.[70]

186 The transaction memos for Interlomas, Mexico, McMinnville, Oregon and Lodz, Poland do not disclose that the construction of the buildings in which the theatre systems were installed had not been completed. The Interlomas memo refers to an expected opening date of May 2006 as the expected completion date "for the rest of the mall in which the theatre resides", but does not say anything about the state of completion of the theatre building. The Lodz and McMinnville memos make no reference to the fact that the building in each case was incomplete, to the fact that there was only a temporary power supply or to the white screen being taken down upon installation. All of these concerns had been identified in the emails on December 6th as the "major installation risks" for the quarter "due to the fact that the buildings [were] not complete".[71]

187 Ms Coulman was asked in her examination whether there were any remaining obligations that PwC was not made aware of by IMAX, that might have affected its audit opinion for 2005.

188 According to Ms Coulman, during the Restatement process in the spring of 2007, PwC first reviewed the emails and became aware of additional obligations that the Company might have around certain of the theatre system installations. She recalled that the installation of some of the systems was not as complete as PwC had been led to believe. She recalled specifically that they were made aware of the fact that it was snowing in the theatre in Kazan, and that the temperature of the theatre was below zero. During the Restatement process she was told by Mr. Vance of a side letter for the Lark theatre, postponing certain payments until the theatre had been moved to another location, which did not occur until 2007. There were other obligations PwC became aware of that she could not recall.[72]

189 Ms Coulman acknowledged that these were facts that came to light subsequent to the signing of a clean audit opinion that could have impacted her assessment of the judgments made by the Company. Ultimately however PwC did not have to revisit its 2005 audit opinion, because IMAX decided to change its accounting policy. While PwC has withdrawn its audit opinion for 2005, in fact, it has been superceded.[73]

10. The 2005 10-K Filing, the March 9, 2006 Press Releases and IMAX's Pursuit of Strategic Alternatives

190 On March 9, 2006, IMAX issued two more press releases, as well as its 2005 10-K. The 2005 10-K was filed with SEDAR and with the SEC. In the 2005 10-K, IMAX stated that:

(a) it had installed 10 theatre systems in 2005 that were scheduled to open in the first and second quarters of 2006;
(b) it had earned revenue of US$144.9 million, of which US$97.8 million was attributable to theatre system sales and leases;
(c) it had "recognized revenue on 38 theatre systems which qualified as either sales or sales type leases in 2005 versus 22 theatre systems in 2004";

(d) the Company's management had assessed the effectiveness of its internal controls over financial reporting, as at December 31, 2005, and had concluded that such internal control over financial reporting was effective as of that date. Additionally, based on the Company's assessment, the Company determined that there were no material weaknesses in its internal control over financial reporting as of December 31, 2005; and

(e) its financial statements had been prepared in accordance with U.S. GAAP.

191 IMAX issued two press releases on March 9, 2006. The first (the "Earnings Release") reported on the Company's earnings in 2005 and Q4 2005, stating that the Company had earnings of $0.40 per share, versus guidance of $0.35-$0.40 per share, that IMAX had completed a record number of 14 theatre installations in the fourth quarter and a total of 34 theatre installations for the full year, and that the Company's total revenues were $144.9 million, as compared to $136.0 million reported for the prior year, systems revenue was $97.8 million versus $86.6 million in the prior year, with revenue recognized on 38 theatre systems in fiscal 2005, versus 22 in 2004. The press release also attached IMAX's Condensed Consolidated Statements of Earnings for both 2005 and Q4 2005, and Consolidated Balance Sheets as at December 31, 2005.

192 Both the Earnings Release, and a second March 9, 2009 press release (the "Strategic Alternatives Release"), contained a statement by IMAX that it intended to explore a possible sale or merger of the Company. The Strategic Alternatives Release stated that IMAX had announced that day that its Board had decided to begin a process to explore strategic alternatives to enhance shareholder value, including, but not limited to, the sale or merger of the business with another entity offering strategic opportunities for growth. The company had retained Allen & Company and UBS Investment Bank as financial advisers in this process.

193 The evidence is that in early 2005, IMAX had been approached, without solicitation, by several prospective buyers. External investment banking advisers were retained, and the possibility of a change of control transaction was discussed in July 2005 with the Board.[74]

194 There had been no active discussion of a sale or merger during the remainder of 2005 and into early 2006.[75] On February 23, 2006, the investment bankers retained by IMAX made a presentation to the Board with a plan to market IMAX to potential investors.[76] At some point in the process, between April 2005 and March 8, 2006, UBS and Allen & Company had provided guidance to the Company as to the value that might be obtained in any transaction.[77]

195 The plaintiffs assert that a number of the Individual Defendants and respondents stood to profit significantly from a sale of IMAX, particularly if the Company were sold at a premium to the trading price of its shares. Mr. Wechsler owned (jointly and on his own) 2,682,800 shares and 1,150,000 options to purchase IMAX shares; Mr. Gelfond owned roughly two million shares and options; Mr. Utay owned over one million shares; Mr. Fuchs held between 46,000 and 58,000 options in 2005; and Mr. Joyce owned approximately 150,000 stock options.

196 In the period following the March 9, 2006 announcement, IMAX's financial advisers prepared a package to be delivered to potential acquirers, containing non-confidential, non-proprietary information. From the group of persons who received that package, a smaller group of approximately 40 or 50 potential investors expressed interest, signed a confidentiality agreement and received a Confidential Information Memorandum on IMAX.[78]

197 Of the 40 to 50 potential investors who expressed an interest, approximately 12 made "non-binding expressions of interest" in or around early May 2006. Most of those interested parties undertook a preliminary due diligence process beginning in mid-May. Some of those parties brought accounting advisers with them to the due diligence sessions and specifically sought to speak to IMAX's auditors. Others wished to discuss IMAX's accounting with Mr. Joyce and other finance staff.[79]

198 A representative of at least one potential investor took the steps necessary to review PwC's working papers in relation to IMAX, which contained, among other things, the Delhi Post. That potential acquirer asked PwC specific questions about IMAX's revenue recognition policy.[80]

199 Ultimately, the process came down to approximately three potential acquirers in July and early August. These parties made conditional offers, subject to due diligence, but by early August 2006, it had become apparent to the Board that the interest expressed would not translate into a deal at the price that the Board was seeking.[81]

11. The SEC Inquiry Letter

200 On June 20, 2006, IMAX received a letter from the SEC indicating that it wished to conduct telephone interviews with Mr. Joyce and Mr. MacNeil to discuss "the company's revenue recognition policies and practices, whether there were any changes to those policies and practices in the fourth quarter of 2005, and, if so, what was the nature of those changes and the reason(s) for them."[82]

201 The telephone interviews requested by the SEC were conducted in or about the first half of July 2006.[83] The June 20th letter was also provided to the potential investors who remained interested in acquiring IMAX at the time it was received.[84]

12. The August 9, 2006 Press Release

202 On August 9, 2006, IMAX issued a press release which stated, in relevant part, that the Company was in the process of responding to an informal inquiry from the SEC regarding the Company's timing of revenue recognition, including its application of MEA accounting in its revenue recognition for theatre systems. The press release stated:

> Under multiple element arrangement accounting, the revenues associated with different elements of an IMAX theatre system contract are segregated and can be recognized in different periods. The Company recognized revenue in the fourth quarter of 2005 on 10 theatre installations in theatres which did not open in that quarter, and in seven of those cases, revenue associated with the screen element of the system was deferred until the final screen was installed. Of these seven installations, three theatres had their screens completed in the first quarter of 2006, two in the second quarter of 2006, and screens in the remaining two theatres have either since been completed or are expected to be completed over the remainder of 2006. The value associated with the elements other than the screen elements of those system installations was recognized in the fourth quarter when they were substantially completed. The Company believes its application of the above accounting policy is, and has historically been, in accordance with GAAP, and the Company's position is supported by its auditors, PricewaterhouseCoopers LLP. This accounting policy has similarly been applied to one theatre installation in

> the second quarter of 2006, where revenue associated with the screen element has been deferred to a future period. The Company is cooperating in this inquiry.[85]

203 The August press release also disclosed that the Company had not succeeded in finding a buyer at the price sought by the Board, but that efforts to sell the Company continued.

204 The plaintiffs contend that, in the context of its previously disclosed revenue recognition policy stating that it recognized revenue on theatre system installations on the completion of those installations, and in the absence of any disclosure of a change in IMAX's revenue recognition policy, the representations respecting the number of theatre installations completed in Q4 2005, its financial results for 2005 and that its statements complied with GAAP, created the impression that IMAX had performed substantially better in the relevant period than it had.

205 The plaintiffs assert that that impression was corrected by the August 9th disclosure that in fact IMAX had not installed the 3D screens in seven of the 14 allegedly complete installations in Q4 2005.

206 Following issuance of the August 9, 2006 press release, the trading price of IMAX's securities suddenly declined. On August 9, 2006, the closing price for IMAX's securities was US $9.63 on the NASDAQ and C $10.77 on the TSX. On August 10th, IMAX's securities closed at US $5.73 on NASDAQ and C $6.44 on the TSX, representing a single day decline of approximately 40%. Over the next ten trading days, IMAX's stock closed at between US $4.85 and $6.05 on NASDAQ, and between C $5.43 and $6.51 on the TSX.[86]

13. The Restatement

207 The 2006 10-K containing the Restatement[87] was signed by all of the respondents, except for Gamble and Joyce, who were no longer employed by IMAX, and Fuchs who had ceased to be a director. The Restatement had the effect of shifting certain theatre systems revenues from the period in which they were previously reported to subsequent periods. A total of 16 installations were shifted between reported quarters within their originally reported years and 14 installations were shifted between fiscal years. Nine of the 16 installations that shifted within fiscal years and ten of the 14 that shifted between fiscal years were installations originally recognized in 2005.[88]

208 The Restatement is evidence that IMAX had erred in its annual report for 2005, both in its revenue recognition for theatre systems and in its statement that the financial statements complied with GAAP. Accordingly, the Restatement is evidence of the misrepresentations alleged in the Claim.

209 The plaintiffs also rely on a number of statements in the Restatement as admissions that there were weaknesses in the Company's internal controls that contributed to the errors that were made.

210 The Restatement identified that there were a number of material weaknesses in the Company's internal control over financial reporting, and stated in part with respect to the application of GAAP and revenue recognition for theatre system sales and leases:

> Five of the Company's material weaknesses relate to controls over the analysis and review of certain transactions to be able to correctly apply U.S. GAAP to record those transactions. The financial impact of these material weaknesses on the Company's restated financial results was principally related to the analysis and

review of transactions which were complex or non-standard. These material weaknesses are:

1. The Company did not maintain adequate controls, including period-end controls, over the analysis and review of revenue recognition for sales and lease transactions in accordance with U.S. GAAP. *Specifically, effective controls were not maintained to correctly assess the identification of deliverables and their aggregation into units of accounting and in certain cases the point when certain units of accounting were substantially complete to allow for revenue recognition on a theatre system.* [Emphasis added.]

211 The 2006 10-K identified material weaknesses related to controls over the lines of communication between different departments as follows:

> The Company did not maintain adequate controls over the lines of communication between operational departments and the Finance Department related to revenue recognition for sales and lease transactions. Specifically, effective controls were not maintained to raise on a timely basis certain issues relating to observations of the installation process, any remaining installation or operating obligations and concessions on contractual terms that may impact the accuracy and timing of revenue recognition. This control deficiency contributed to the restatement of the Company's consolidated financial statements for the years ended December 31, 2002 through 2005.

212 PwC provided its opinion as part of the Restatement, concurring with management's assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2006.[89]

14. Expert Evidence as to IMAX's Accounting: The Rosen Reports

213 The plaintiffs also put forward, as part of their evidence, the expert opinions of Lawrence Rosen, a chartered and forensic accountant. It was Mr. Rosen's opinion that IMAX's revenue recognition for theatre system sales for the year ended December 31, 2005 was not in accordance with U.S. GAAP. IMAX prematurely recognized revenue on its theatre systems and thereby rendered its 2005 financial statements materially misleading to investors and other financial statement users.

214 Mr. Rosen concluded that the application of MEA accounting (referred to in his reports as Revenue Accounting for Multiple Deliverables or "RAMD"), was not consistent with the terms and conditions of IMAX's theatre system sales transactions. He noted that RAMD is intended to account for separate and distinct components of multi-part transactions or parts of a series of transactions.

215 One of the criteria for the application of EITF 00-21 is that a revenue arrangement has "multiple deliverables". Mr. Rosen reviewed IMAX's own marketing of integrated theatre systems, the fact that individual component parts lack productive functionality without the related parts, the absence of a practice of selling components of the system on a stand-alone basis as well as the description of the product and the payment obligations of customers under the Contracts. He concluded that it would be illogical and inappropriate to artificially subdivide a single transaction (the sale of a complete theatre system) into component parts for revenue accounting purposes.

216 His reports concluded that the sale of an IMAX theatre system is more fairly characterized as a single transaction involving multiple sub-components: that is, a single deliverable being the complete theatre system.

217 Mr. Rosen also expressed the opinion that IMAX's recording of revenues prior to the completion of each theatre installation would not be appropriate, regardless of the application of MEA accounting. Applying the criteria from SAB 104, he noted that delivery of the theatre system could not be considered to have occurred until all of the elements essential for its functionality are installed and the transfer of risks and rewards could not occur until the system is installed with testing and training completed, so that the owner can realize the rewards through operation of the theatre.

218 Mr. Rosen noted that IMAX chose to employ RAMD in fiscal 2005 on a prospective basis, without retroactively stating its prior years' results or disclosing the net income effect on retained earnings. "All else being equal, IMAX's 2005 reported results inappropriately appeared to be improved relative to prior years' earnings (assuming the prior years accounting did not employ RAMD)."

219 The respondents have not put forward any expert opinion of their own with respect to the accounting issues in these proceedings. Although they contend that the matter was complex and involved substantial judgment, they have not attempted to justify the accounting approach that was taken initially by IMAX management (proposing to recognize all revenue on 14 theatre systems in Q4 2005), and they have not offered an expert opinion to support PwC's MEA accounting approach as correct or even a reasonable alternative.

220 The respondents accordingly do not appear at this stage to defend the accounting judgments that were made by the Company and PwC; rather they assert that it was reasonable for the respondents to rely on the advice of its experienced and informed auditors as to the application of MEA accounting in recognizing revenue on 14 theatre systems in Q4 2005.

D. The Causes of Action and Claims for Damages

221 In their Claim, the plaintiffs claim damages of $200 million against IMAX and the Individual Defendants for negligent and "reckless" misrepresentation, negligence and civil conspiracy. Punitive damages of $10 million are also claimed. The substance of the allegations in support of the common law claims is addressed in detail in my reasons in the certification and Rule 21 motions.

222 Against all of the defendants as well as the proposed defendants, the plaintiffs claim damages for secondary market misrepresentation under s. 138.3 of the OSA, calculated in accordance with s. 138.5 (essentially the difference between the average price paid for the securities and the price received on disposition, or where shares are held more than ten days after the correction of the misrepresentation, the lesser of the difference between the average purchase price and the price received on disposition and the difference between the average purchase price and a benchmark price).

E. The Statutory Cause of Action

223 This section of the reasons provides an overview of the substance and mechanics of the statutory cause of action provided for in the OSA, Part XXIII.1, Civil Liability for Secondary Market Disclosure, with reference to the specific allegations of the plaintiffs set forth in the Claim.

224 Before discussing the specific statutory provisions and how they relate to the claims in these proceedings, I will describe the genesis of the statutory cause of action and place it in its statutory context.

1. The Genesis of the Statutory Cause of Action

225 Typically, secondary market disclosure obligations have been enforced through the investigatory and enforcement powers of the OSA and other provincial securities regulators and the SEC, the U.S. national securities regulator, as well as the various stock exchanges.

226 The adoption of a statutory civil liability regime as an additional measure for ensuring proper continuous disclosure was proposed by a federal task force as early as 1979[90], and by the OSC in 1984[91].

227 In the early 1990s the TSE established a committee on Corporate Disclosure, headed by Thomas I.A. Allen, Q.C. (the "Allen Committee"), with the mandate to "review current corporate disclosure practices in Canada, to examine the rules and determine whether investors should be able to pursue private remedies if a company fails to comply with disclosure rules".[92]

228 The reasons for the establishment of the Allen Committee have been described as follows:

> ... The TSE initiative to establish the Allen Committee was the result of a number of factors. These included several high profile and well publicized incidents of alleged misrepresentations and questionable disclosure by public companies in Canada which illustrated the anomalous gap between statutory civil liability for prospectus disclosure and the absence of such liability for continuous disclosure. This gap was underscored by the fact that primary issuances of securities under a prospectus accounted for only about 6% of all capital markets trading while secondary market trading constituted the remaining 94% of such activity. Also, there was a growing recognition that private rights of action were a necessary complement to the enforcement activities of securities regulators. In addition, the primary focus on the prospectus as the cornerstone of issuer communication was becoming an increasingly outmoded notion in today's electronic media-driven environment. Lastly, there were perceived differences between the Canadian and U.S. liability regimes as well as perceived gaps in the standard and quality of disclosure in the two countries.[93]

229 The Allen Committee released its interim report[94] in December 1995, which recommended limited statutory civil liability for misleading continuous disclosure by a reporting issuer. This recommendation was repeated in its final report entitled "Responsible Corporate Disclosure"[95] released in 1997 after significant additional consultation with market participants.

230 The Canadian Securities Administrators (the "CSA") publicly supported the Allen Committee's recommendations and established a committee comprised of staff from the securities commissions of B.C., Alberta, Saskatchewan, Ontario and Québec to consider the Allen Committee reports. The CSA committee issued draft legislation for public comment in 1998 and ultimately issued revised draft legislation in 2000, together with a report detailing the history, purpose and rationale for proposed amendments to provincial securities laws throughout the country.[96]

231 The key features of the CSA proposal for a statutory remedy for secondary market misrepresentation included the right to sue, whether or not an investor had actually relied on the misrepresentation or failure to make timely disclosure, defences for various participants based on their responsibility for the disclosure, liability caps and proportionate liability based on share of responsibility, subject to certain exceptions, and the requirement of court approval of settlement agreements. The report also proposed a "screening mechanism" for such actions (which had not been part of the Allen Committee recommendations) and stated:

> One of the risks of creating statutory liability for misrepresentations or failures to make timely disclosure is the potential for investors to bring actions lacking any real basis in the hope that the issuer will pay a settlement just to avoid the cost of litigation. To limit unmeritorious litigation or strike suits, plaintiffs would be required to obtain leave of the court to commence an action. In granting leave, the court would have to be satisfied that the action (i) is being brought in good faith, and (ii) has a reasonable possibility of success.[97]

232 Later in its report under the topic "Strike Suit Exposure", the CSA noted the concerns raised by issuers about strike suits. In *Epstein v. First Marathon Inc.,* [2000] O.J. No. 452 (S.C.), Cumming J. at para. 41 described a "strike suit" as follows:

> The term "strike action" or "strike suit" has emerged in the context of certain class proceedings litigation in the United States. The term connotes the commencement and pursuit of a class proceeding where the merits of the claim are not apparent but the nature of the claim and targeted transaction is such that a sizeable settlement can be achieved with some degree of probability. The term suggests a class proceeding that is properly regarded as an abuse of process.

This decision and Cumming J.'s definition of "strike suit" were referenced in the CSA report.

233 The CSA noted that the screening mechanism was designed "not only to minimize the prospects of an adverse court award in the absence of a meritorious claim but, more importantly, to try to ensure that unmeritorious litigation, and the time and expense it imposes on defendants, is avoided or brought to an end early in the litigation process."[98] In addition to the screening mechanism, the requirement for court approval of any settlement and the "loser pays" costs rule in such proceedings (overriding any inconsistent costs provisions in class action statutes) would provide further disincentives to strike suits.

234 The CSA contrasted its proposal for a statutory cause of action with the approach in U.S. jurisdictions under s. 10b of the *Securities Exchange Act of 1934* and Rule 10b-5 promulgated thereunder.[99] The report noted:

> As a starting point, it is important to recognize that the 2000 Draft Legislation (and previously the 1998 Draft Legislation) is fundamentally different from Rule 10b-5. The 2000 Draft Legislation is a specific and comprehensive code whereas Rule 10b-5 is a general anti-fraud rule from which U.S. courts have implied a right of action and which has evolved and been variously interpreted by U.S. courts over the past several decades. In fact, there has been considerable litiga-

> tion in the U.S. over what could be considered strictly threshold issues such as who bears liability and what is the nature of such liability.
>
> In a Rule 10b-5 action, a plaintiff must prove that the defendant acted with "*scienter*", defined by the U.S. Supreme Court as a "mental state embracing intent to deceive, manipulate or defraud", with most courts agreeing that recklessness constitutes *scienter* as well. Reliance, and to some extent causation, have been made easier to prove in the U.S. as a result of U.S. courts' decision to adopt a "fraud-on-the-market" theory. Essentially, this theory creates the presumption that because most publicly available information is reflected in the market price of an issuer's securities, an investor's reliance on any public material misrepresentations may be presumed. In this context, Rule 10b-5 has developed into a fully compensatory model.[100] [Footnotes omitted.]

235 The CSA commented on the rejection of the fraud on the market theory or deemed reliance in Winkler J.'s decision in *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780 (S.C.), and noted the limitations inherent in class actions in securities litigation in Canadian jurisdictions based on the common law. The report went on to observe:

> The CSA recognize that a due diligence standard is a more rigorous liability standard than the fraud based standard under Rule 10b-5. The key element of intent or recklessness which a plaintiff must establish to succeed in a Rule 10b-5 action need not be proved to establish liability on the basis of an absence of due diligence. The rationale for the allocation of the burden is twofold. The first reason is to provide a deterrent to poor continuous disclosure. By requiring the defendant to prove due diligence there is a much greater incentive to exercise due diligence. The second reason is access to evidence. The necessary information to establish that an officer or director, for example, was or was not duly diligent would be under the control of that officer or director. In this context, the 2000 Draft Legislation, unlike Rule 10b-5, is essentially a deterrent model.[101]

236 The Allen Interim Report, under the topic, "Should Liability for Damages be Unlimited?", states:

> Any claim by damaged shareholders of a corporation will, if successful, lead to a bill being paid indirectly by all shareholders of the corporation ... at the risk of a sweeping generality, such claims pit short term trading shareholders against long term shareholders.[102]

237 To the same effect, the CSA noted:

> The proposal is primarily directed to providing an effective deterrent to misrepresentation and failures to make timely disclosure. Providing compensation for investor damages is a secondary objective, which should be balanced against the interests of long term security holders of the issuer, who effectively pay the cost of any damage awards. *In order to achieve this balance, the proposed legislation would limit the potential exposure of issuers and other potential defendants.*[103] [Emphasis added.]

238 Accordingly, the statutory cause of action that was proposed and ultimately adopted in Ontario (and later throughout Canada) differed from the U.S. approach in its primary emphasis on deterrence. A plaintiff would not have to establish intent or recklessness (elements present in the U.S. Rule 10-b claim), and the onus would be on the defendants to establish a due diligence type defence. At the same time, claims would typically be subject to a damages cap and other limitations, including the threshold requirement for leave of the court before the statutory claim may proceed.

2. The Statutory Context -- Continuous Disclosure Obligations

239 The OSA, s. 1.1 provides that the purposes of the Act are (a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets.

240 Part XVIII of the OSA, "Continuous Disclosure", provides for the disclosure by a reporting issuer of any "material change" in the affairs of the company, and the issuance of interim and annual financial statements.

241 Material changes require a news release authorized by a senior officer disclosing the nature and substance of the change (s. 75(1)) and a report to the OSC in accordance with the regulations (s. 75(2)). Quarterly and annual financial statements comparative to the period covered by the preceding financial year "made up and certified as required by the regulations and in accordance with generally accepted accounting principles" must be filed (ss. 77 and 78). The annual financial statement must be accompanied by the report of the auditor prepared in accordance with the regulations, preceded by such examinations as will enable the auditor to make such report (ss. 78(2) and (3)).

242 The continuous disclosure reporting obligations are set out in National Instrument 51-102 ("NI 51-102") of the CSA, which has been adopted by securities administrators throughout Canada, including the OSC.[104]

243 NI 51-102 outlines requirements for annual and interim financial statements, and requires that both be accompanied by a "management discussion and analysis" ("MD&A"), which provides a plain language narrative explanation from the perspective of management about the company's performance, financial condition, and future prospects. An annual information form ("AIF"), which provides material information on the company and its operations, in both historical and future contexts, is also required to be filed. For issuers who are required to report under the U.S. *Securities Exchange Act of 1934,* such as IMAX, filing a Form 10-K meets the requirement of filing an AIF.[105]

244 NI 51-102 requires a reporting issuer to file annual financial statements accompanied by an auditor's report. Annual statements must include statements of income, retained earnings, and cash flow in respect of the most recent financial year and the financial year immediately preceding that year. They must be approved by the board of directors before being filed and such approval may not be delegated to the audit committee of the board. The CEO and CFO must certify annual filings of financial statements, the MD&A, and AIF.

3. Liability for Misrepresentation

245 The statutory cause of action is set out in s. 138.3 of the OSA, which provides for liability for misrepresentations (and failure to make timely disclosure) in favour of any person or company who acquires or disposes of a "responsible issuer's" security between the time the document was released and the misrepresentation was publicly corrected, without regard to reliance.

246 Section 138.3(1) provides in relevant part as follows:

> Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against,
>
> (a) the responsible issuer;
> (b) each director of the responsible issuer at the time the document was released;
> (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document; ...

247 "Responsible issuer" is defined in s. 138.1 to include a "reporting issuer" and any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded. IMAX is a reporting issuer under the OSA.

248 "Misrepresentation" is defined in s. 1(1) of the OSA as (a) an untrue statement of a material fact, or (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made. A "material fact" is defined in s. 1(1) in relation to issued securities as "a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of such securities".

249 The misrepresentations alleged in this case fall under (a), the untrue statements of IMAX's financial results, its compliance with GAAP and the number of installed theatre systems, which are alleged to be material facts.

250 In respect of misrepresentations in documents, the s. 138.3 right of action is against the responsible issuer and any director at the time the document was released, and any officer who authorized, permitted or acquiesced in the release of the document. (There is also a right of action against an 'influential person' or an 'expert' as defined in Part XXIII.1, which is not engaged in these proceedings.)

251 "Document" is defined under s. 138.1 as:

> Any written communication, including a communication prepared and transmitted only in electronic form,
>
> (a) that is required to be filed with the [Ontario Securities Commission], or
> (b) that is not required to be filed with the commission and,
>
> (i) that is filed with the commission,
> (ii) that is filed or required to be filed with a government or an agency of a government under applicable securities or corporate law or with any stock exchange or quotation and trade reporting system under its by-laws, rules or regulations, or

(iii) that is any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer.

252 There is no question that the communications in question in these proceedings were "documents" within the meaning of s. 138.1.

253 The Act distinguishes between misrepresentations made in "core" and other or "non-core" documents. A "core document" is defined to include annual and interim financial statements of the issuer and the MD&A. IMAX's annual financial statements for 2005 including the MD&A (together the "Annual Report") and Form 10-K filed with the SEC (which included the Annual Report) are accordingly "core" documents, while the press releases are "non-core" documents.

254 For misrepresentations in non-core documents, except in relation to a claim against an expert, the plaintiff must prove that the person or company:

(a) knew at the time that the document was released, that the document contained the misrepresentation;
(b) at or before the time that the document was released, deliberately avoided acquiring knowledge that the document contained the misrepresentation; or
(c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document that contained the misrepresentation: see s. 138.4(1).

255 In the Claim the plaintiffs define "Representation" as follows:

> the statement explicitly and/or implicitly contained in the February Press Release and expressly repeated in the Form 10-K and Annual Report, that IMAX's revenue for the 2005 fiscal year were [*sic*] prepared and reported in accordance with GAAP and that such revenues met or exceeded the earnings guidance previously issued by IMAX.

256 In addition to the defined Representation, the Claim alleges that the statements that IMAX had successfully completed 14 theatre system installations in the fourth quarter of 2005 and that ten theatre systems installed by IMAX in 2005 were scheduled to open in the first and second quarters of 2006 were "misstatements". The misstatements, together with the Representation, are the "misrepresentations" that the plaintiffs allege give rise to statutory liability in this case.

257 It is alleged that the misrepresentations were made in the February and March 2006 press releases (non-core documents) and in IMAX's Form 10-K/Annual Report (core documents). With respect to a core document, as against IMAX and its directors (that is each of the defendants and proposed defendants except for Joyce and Gamble), the plaintiffs need only prove that the document contained a misrepresentation. The onus will then shift to each of these parties to establish one or more of the statutory defences.

258 In order to succeed in their claims against Joyce and Gamble (who are the only non-director officers named as proposed defendants), the plaintiffs must prove, in addition to the release of a document containing a misrepresentation (whether core or non-core), that they authorized, permitted or acquiesced in the release of the document: see s. 138.3(1)(c).

259 With respect to the non-core documents, before the onus shifts to a defendant, the plaintiffs will have to prove, in addition to the release of the documents containing a misrepresentation, the mental element of knowledge, willful blindness or gross misconduct required by s. 138.4(1).

260 In this case, the Claim pleads the elements of s. 138.4(1) against the Individual Defendants and Gamble only; that is, that only these individuals are subject to statutory liability for the alleged misrepresentations in the press releases. The allegations against the remaining proposed defendants are restricted to the alleged misrepresentations in the Company's Form 10-K/Annual Report.

4. Relevant Defences

261 Section 138.4 provides defences to liability for secondary market misrepresentation. There are two defences relied upon by the respondents in these proceedings.

262 Subsection 138.4(6) provides for a defence of "reasonable investigation" as follows:

> A person or company is not liable in an action under section 138.3 in relation to,
>
> (a) a misrepresentation if that person or company proves that,
>
> (i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and
> (ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation[.]

263 Subsection 138.4(7) directs the court, in determining whether an investigation was reasonable under ss. (6) or whether a person or company is guilty of gross misconduct under ss. (1) or (3), to consider all relevant circumstances, including those listed in paras. 138.4(7)(a) through (k). These include such factors as the knowledge, experience and function of the defendant, the existence of a system within the issuer corporation and the reasonableness of reliance by the defendant on such system and on the issuer's officers, employees and others (see para. 360 below).

264 A second defence to secondary market misrepresentation that is raised by the respondents in these proceedings is the "expert reliance" defence in s. 138.4(11), which provides as follows:

> A person or company, other than an expert, is not liable in an action under section 138.3 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert in respect of which the responsible issuer obtained the written consent of the expert to the use of the report, statement or opinion, if the consent had not been withdrawn in writing before the document was released or the public oral statement was made, if the person or company proves that,
>
> (a) the person or company did not know and had no reasonable grounds to believe that there had been a misrepresentation in the part of the document or public oral statement made on the authority of the expert; and

(b) the part of the document or oral public statement fairly represented the report, statement or opinion made by the expert.

265 The onus of proving each of these statutory defences rests with the defendant on the usual civil standard, a balance of probabilities.

5. Calculation of Damages, Several Liability, and the Cap on Damages

266 Section 138.5 of the OSA provides a formula for the assessment of damages in a successful action for secondary market misrepresentation.

267 In general, under ss. 138.5(1) and (2), damages are assessed in favour of a person or company that acquired an issuer's securities after the misrepresentation and disposed of the securities within ten days after the public correction of the misrepresentation, based on the difference between the average price paid for the securities and the price received on their disposition, calculated taking into account the result of hedging or other risk limitation transactions.

268 For shareholders who disposed of their securities after the tenth trading day after the public correction of the misrepresentation or have not disposed of the securities, damages are based on the lesser of the difference between the average price paid for the securities and the price received on their disposition, and the difference between the average price paid for the securities and the trading price of the issuer's securities on the principal market for the ten trading days following the correction of the misrepresentation.

269 Subsection 138.5(3) addresses the issue of "loss causation" and provides that, despite subsections (1) and (2), assessed damages shall not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the misrepresentation. Again, the onus is on the defendant to prove that other factors caused a reduction in market value of the shares.

270 Liability for damages is several among defendants, based on a party's responsibility for the damages, except that there is joint and several liability where a court determines that a particular defendant, other than the responsible issuer, authorized, permitted or acquiesced in the making of the misrepresentation while knowing it to be a misrepresentation: see s. 138.6.

271 Section 138.7 provides for a cap on damages. In the case of the responsible issuer, the cap is the greater of five per cent of its market capitalization and $1 million. For a director or officer of a responsible issuer, the cap is the greater of $25,000 and 50% of the aggregate of the director's or officer's compensation from the responsible issuer and its affiliates.

272 Under s. 138.7(2), the damages cap does not apply to a defendant other than the responsible issuer, if the plaintiff proves that such defendant authorized, permitted or acquiesced in the making of the misrepresentation, while knowing that it was a misrepresentation.

273 In this case the Claim pleads the elements of s. 138.7(2) against the Individual Defendants and Gamble only. The statutory claim against the other proposed defendants would accordingly be subject to the statutory cap on damages.

6. The Statutory Leave Procedure

274 Subsection 138.8(1) of the OSA requires that any action claiming secondary market misrepresentation requires leave of the court, and provides as follows:

> No action may be commenced under section 138.3 without leave of the court granted upon motion with notice to each defendant. The court shall grant leave only where it is satisfied that,
>
> (a) the action is being brought in good faith; and
> (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

275 Subsection 138.8(2) requires the plaintiff and each defendant to serve and file one or more affidavits setting forth the material facts upon which each intends to rely, and s. 138.8(3) provides for examination of the makers of the affidavits in accordance with the rules of court.

F. The Procedure Followed in this Case

276 In the present case, each plaintiff filed his own affidavit[106]. The plaintiffs also relied on several affidavits sworn by their lawyers, attaching various public documents and filings relating to IMAX.[107] The plaintiffs filed two affidavits sworn by Lawrence S. Rosen attaching his expert report dated February 12, 2007 on IMAX's accounting for theatre systems in Q4 2005[108], and a second report dated August 2, 2007, following the restatement in July 2007 of IMAX's financial results for 2002 through the first three quarters of 2006[109], and the affidavits of Lawrence Kryzanowski[110] and Robert Comment[111], providing their expert opinions on loss causation, market efficiency and the calculation of damages.

277 Each defendant and proposed defendant filed his or her own affidavit[112] and also referred to and relied on the affidavit of Kenneth G. Copland (chair of IMAX's audit committee) sworn September 8, 2007 (the "Copland Affidavit")[113]. The respondents also filed the affidavit of expert witness Denise Neumann Martin sworn September 7, 2007[114], setting out her opinion critiquing the Kryzanowski expert opinion, and the affidavit of a law clerk, sworn September 11, 2007[115], attaching various IMAX press releases and other public documents and articles discussing IMAX.

278 Although such examination is not provided for under s. 138.8, counsel for the plaintiffs examined as a witness under Rule 39.03, Lisa Coulman of PwC. The court was advised that no objection was taken to the examination, which proceeded prior to the cross-examinations of the affiants.[116]

279 The plaintiffs and respondents were cross-examined out of court. Each of the named defendants was examined twice, attending on the second occasion to answer questions that had been ordered to be answered, after initially being refused, and questions arising out of answers to undertakings.

280 Since this is the first proceeding under Part XXIII.1 of the OSA, there was no guidance for counsel or the court as to the type, nature and volume of evidence that would be required for the purpose of the court's determination of whether to grant leave. Experienced counsel for both sides proceeded with a view to adducing sufficient evidence relevant to the statutory claim and defences, while recognizing that the matter should not devolve into a "paper trial". The defendants and proposed defendants included in their affidavits documentary exhibits, including a number of documents that would be considered confidential to IMAX. Questions on the examinations led to the production of additional documents, although there were numerous refusals as counsel quite properly attempted to control the scope of examinations so that they were focused on the immediate proceedings and not full discovery.

281 This process was clearly a challenge to the parties, as the leave procedure involves a testing of the merits of the action. Some questions refused were abandoned and others were pursued in a motion to this court: see *Silver v. IMAX Corporation*, [2008] O.J. No. 2751 (S.C.).

III. Determination of the Issues on the Motion for Leave to Proceed with the Statutory Claims

282 As described above, the statutory leave test under s. 138.8 provides that the court shall grant leave only where it is satisfied that, (a) the action is being brought in good faith; and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

283 This section of the OSA has never been interpreted previously, and there are no other statutory provisions in force in a Canadian jurisdiction, that adopt the same type of test.

284 How high the court should set the bar for a prospective plaintiff seeking to bring a claim for secondary market misrepresentation was the subject of extensive argument at the hearing of the motion, particularly in respect of how the court should interpret whether the plaintiffs have "a reasonable possibility of success at trial".

285 The plaintiffs argue for a low threshold. The low bar would permit actions to proceed unless they are clearly an abuse of process or a "strike suit". The respondents, acknowledging in their factum that this action is not in fact a "strike suit", contend that the object of the leave test is to screen out unmeritorious actions. They argue for a more stringent test, with onerous obligations on a plaintiff to establish their good faith and that the case has obvious merit.

286 I turn now to the issues of determining the standard for granting or refusing leave under s. 138.8 of the OSA and of applying that standard to the particular circumstances of this case.

A. General Principles of Statutory Interpretation

287 In the Court of Appeal decision in *Kerr v. Danier Leather Inc.* (2005), 77 O.R. (3d) 321 (C.A.), aff'd 2007 SCC 44), Laskin J.A. summarized the correct approach to statutory interpretation. In the context of interpreting s. 130 of the OSA (liability for misrepresentation in an offering memorandum or prospectus), he stated, at paras. 82 to 85:

> Section 130 should be interpreted by applying Professor Driedger's "modern approach" to statutory interpretation, the approach consistently preferred by the Supreme Court of Canada:
>
> > Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
>
> See Elmer A. Driedger, *The Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) at 87 ("*Driedger*"), approved in, for example, *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2 at para. 21; and *Bell ExpressVu Limited Partnership v. Rex*, [2002] 2 S.C.R. 559, [2000] S.C.J. No. 43 at para. 26.

> This modern approach has two aspects. One aspect is that context matters. The court must interpret s. 130, not as a stand-alone provision, but in its total context. In *Bell ExpressVu* at para. 27, Iacobucci J. stressed the importance of context in interpreting the words of a statute:
>
> > The preferred approach recognizes the important role that context must inevitably play when a court construes the written words of a statute: as Professor John Willis incisively noted in his seminal article "Statute Interpretation in a Nutshell" (1938), 16 *Can. Bar Rev.* 1 at p. 6, "words, like people, take their colour from their surroundings."
>
> The context for interpreting s. 130 includes its purpose, the purpose of the OSA as a whole, an issuer's express disclosure obligations in Part XV of the statute, and related provisions of the OSA dealing with disclosure of material facts and material changes.
>
> The second aspect of this modern approach imports the sound advice of Professor Ruth Sullivan, who has edited the third and fourth editions of *Driedger*. In interpreting a statutory provision, the court should take account of all relevant and admissible indicators of legislative meaning. After taking these indicators into account, the court should adopt an interpretation that complies with the legislative text, promotes the legislative purpose, and produces a reasonable and sensible meaning: see Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002) at 1-3 ["*Sullivan and Driedger*"]. [Additional citations omitted.]

288 With reference to determining legislative purpose, Laskin J.A. noted that committee reports would be relevant[117], stating at para. 119:

> Traditionally, committee reports have been considered a relevant and admissible indicator of legislative purpose but not of legislative meaning: see for example *Morguard Properties Ltd. v. Winnipeg (City)*, [1983] 2 S.C.R. 493, 3 D.L.R. (4th) 1. More recently, courts have begun to rely on these reports as evidence of legislative meaning. The weight to be accorded to any particular report must be assessed on a case-by-case basis: see *Sullivan and Driedger*, *supra,* at pp. 500-502.

289 Applying the approach described by Laskin J., in interpreting the statutory leave test for secondary market misrepresentation, the court must consider the statutory words in their context and "in their grammatical and ordinary sense" harmoniously with the scheme and object of the OSA, and in particular the continuous disclosure obligations in Part XVIII, and the intention of the legislature when the statutory remedy was introduced.

290 In interpreting the statutory provision, the court should take account of all relevant and admissible indicators of legislative meaning, including committee reports leading to the statutory amendment (in this case, the Allen Committee reports and the CSA report), as well as any sources that may have been consulted by the legislature in devising the statutory threshold (such as the OLRC report on class actions referenced below).

291 In identifying indicators of legislative meaning in order to interpret the test for granting leave under s. 138.8, it is also helpful to consider comparable situations where the legislator has required leave before an action may be brought against a corporation. One such situation is the derivative action.

292 While derivative actions serve a different purpose in permitting individual shareholders to sue on behalf of a corporation, they are also subject to leave by the court (on meeting the threshold test of good faith, that the directors will not diligently pursue the action and that the action appears to be in the best interests of the corporation)[118]. In *Richardson Greenshields of Canada Limited v. Kalmacoff* (1995), 22 O.R. (3d) 577, the Court of Appeal considered an appeal from a decision refusing to grant leave to commence a derivative action under the CBCA. In authorizing the derivative action, Robins J.A. observed at pp. 584-585:

> In deciding whether leave should be granted, it should be borne in mind that a derivative action brought by an individual shareholder on behalf of a corporation serves a dual purpose. First, it ensures that a shareholder has a right to recover property or enforce rights for the corporation if the directors refuse to do so. Second, and more important for our present purposes, it helps to guarantee some degree of accountability and to ensure that control exists over the board of directors by allowing shareholders the right to bring an action against directors if they have breached their duty to the company: M. A. Maloney, "Whither The Statutory Derivative Action?" (1986), 64 *Can. Bar Rev.* 309.
>
> It should also be borne in mind that s. 339 is drawn in broad terms and, as remedial legislation, should be given a liberal interpretation in favour of the complainant. The court is not called upon at the leave stage to determine questions of credibility or to resolve the issues in dispute, and ought not to try. These are matters for trial. Before granting leave, the court should be satisfied that there is a reasonable basis for the complaint and that the action sought to be instituted is a legitimate or arguable one.

293 The statutory cause of action for secondary market misrepresentation also serves a dual purpose, of permitting the recovery of damages by a shareholder, and as a deterrent to breach of a reporting issuer's continuous disclosure obligations under the OSA.

294 Similarly, the statutory cause of action was introduced as remedial legislation; that is, in recognition of the obstacles to pursuing claims for secondary market misrepresentation under common law. Accordingly, the leave test prescribed by the legislature should be interpreted so as to permit access to the courts by shareholders with legitimate claims.

B. Part One of the Statutory Leave Test: Is the Action Brought in Good Faith?

295 The first part of the leave test requires the plaintiffs to satisfy the court that the action is brought in good faith. Good faith is not presumed, but must be established by the plaintiffs on the normal civil standard; that is, on a balance of probabilities.

296 The representative plaintiffs Cohen and Silver each depose in their affidavits that their purposes in bringing the action are to:

(a) recover the losses that he and other class members have suffered as a result of their investments in IMAX shares during the Class Period; and
(b) ensure that the defendants are held accountable for their behaviour, and to send a message to the officers and directors of public companies that they will be held accountable for their misrepresentations.

1. Positions of the Parties

297 The parties agree that "good faith" involves a consideration of the subjective intentions of the plaintiffs in bringing their action, which is to be determined objectively.

298 The respondents argue however that the plaintiffs have a heavy onus to establish good faith, and are required to offer cogent evidence of their motives. The defendants also assert that "good faith" means that the action must be for the benefit of the corporation and not for the plaintiffs' individual benefit. Finally, the respondents contend that the plaintiffs must demonstrate a reasonable belief in the merits of their claim, based on an assessment of the evidence placed before the court at the time of the hearing of their motion.

299 The plaintiffs submit that "good faith" refers to a belief in the claim that is honestly held, and the absence of any ulterior or improper purpose in bringing the litigation.

2. Analysis

300 The cases relied on by the respondents in support of a "high" onus on the plaintiffs to prove good faith arose in the context of motions for leave to bring derivative actions (that is, claims by individual shareholders or others attempting to sue for a wrong done to the corporation).

301 In *Tremblett v. S.C.B. Fisheries* (1993), 116 Nfld. & P.E.I.R. 139; (Nfld. S.C.T.D.), for example, Puddester J. described the obligation to satisfy the court as to the plaintiff's good faith in a derivative action as a "substantial onus". His decision however is clearly based on considerations that a derivative action provides a shareholder with extraordinary rights to intervene in majority decisions internal to corporations, to use corporate resources and to create a position of legal conflict between the corporation and others, and his conclusion that another company controlled by the plaintiff would stand to gain personally if the derivative action were allowed to proceed.

302 Similarly, in *Chandler v. Sun Life Financial Inc.*, [2006] O.J. No. 451 at paras. 25-26 (S.C.), C. Campbell J. recognized a "high onus" to establish good faith on a party seeking leave to bring a derivative action, noting that in the absence of evidence to the contrary there would be a presumption that the directors (in refusing to commence the proceedings on behalf of the company) have exercised reasonable and sound judgment and recognizing the risk of a collateral purpose on the part of the applicant shareholders.

303 Such analysis is not directly applicable to the requirement of "good faith" as that term is employed in s. 138.8 of the OSA. The statutory remedy for secondary market misrepresentation is afforded directly to shareholders for their own benefit and is not a vehicle to sue on behalf of the company for a wrong to the company. Proceedings alleging secondary market misrepresentation are brought to recover damages for loss to an individual shareholder or group of shareholders. The shareholder's personal loss is central. There is no reason to read in a "high" or "substantial" onus requirement for good faith in this type of proceeding.

304 Another purpose of the statutory remedy is to enforce a corporation's disclosure obligations; that is, to protect and enhance the integrity of the secondary market. In this case, on the evidence

that is available, it is clear that both of these objectives are being pursued in good faith by the plaintiffs. There was no cross-examination of the plaintiffs going to any ulterior motive or lack of good faith in pursuing these proceedings.

305 In any event, as Robins J.A. remarked at p. 587 in *Richardson Greenshields of Canada Limited* v. *Kalmacoff*, even in a derivative action, a plaintiff may be motivated by self-interest, and still be acting in good faith:

> Whether it is motivated by altruism, as the motions court judge suggested, or by self-interest, as the respondents suggest, is beside the point. Assuming as I suppose, it is the latter, self interest is hardly a stranger to the security or investment business. Whatever the reason, there are legitimate legal questions raised here that call for judicial resolution. The fact that this shareholder is prepared to assume the costs and undergo the risks of carriage of action intended to prevent the board from following a course of action that may be *ultra vires* and in breach of shareholders' rights does not provide a proper basis for impugning its *bona fides*. In my opinion, there is no valid reason for concluding that the good faith condition specified in [the statutory leave provision] has not been satisfied.

306 The respondents' counsel in argument also asserted that, having commenced the motion for leave, there is an obligation on the part of the individual plaintiffs, after all of the affidavits are exchanged and the cross-examinations completed, to evaluate the evidence and to demonstrate that they continue to believe on reasonable grounds that they have a claim, notwithstanding the defences that have been put forward. They assert that the failure of Mr. Silver and Mr. Cohen to personally review the respondents' affidavits and the transcripts of their cross-examinations is fatal.

307 I disagree. Parties pursuing legal proceedings are entitled to rely on their legal counsel to analyze and evaluate the evidence as the case unfolds. There is no reason to require a plaintiff in this type of action (with complex and voluminous evidence) to demonstrate that his or her good faith pursuit of the action is based on a personal evaluation of all of the evidence as it unfolds, independent of the advice and assistance of counsel.

308 Accordingly, I interpret "good faith" in the context of s. 138.8, to require the plaintiffs to establish that they are bringing their action in the honest belief that they have an arguable claim, and for reasons that are consistent with the purpose of the statutory cause of action and not for an oblique or collateral purpose. "Good faith" involves a consideration of the subjective intentions of the plaintiffs in bringing their action, which is to be determined by considering the objective evidence.

3. Decision re: Good Faith

309 I am satisfied that the plaintiffs are acting in good faith in pursuing these proceedings. They have a personal financial interest in the action, as persons who acquired IMAX shares during the Class Period and continued to hold such shares on August 9, 2006. They have also asserted altruistic reasons for commencing the action, to hold the defendants accountable for misrepresentations to the public, and to send a message to directors and officers of other public companies that they too will be held accountable for misrepresentations to the public. These reasons for pursuing the action are consistent with the legislative purpose of the statutory remedy, which is deterrence. The plaintiffs have pleaded a misrepresentation that is supported by the evidence of the Company's Restate-

ment. There is no evidence of any ulterior motive or conflict of interest. Accordingly, they meet the first branch of the test for leave to assert a claim for secondary market misrepresentation.

C. Part Two of the Statutory Leave Test: "Is There a Reasonable Possibility that the Action Will Be Resolved at Trial in Favour of the Plaintiffs?"

310 The second branch of the leave test requires that the court be satisfied that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff. The interpretation of this part of the leave test was the focus of extensive argument at the hearing of the leave motion.

1. Interpretation of the Test

(a) Positions of the Parties

311 The respondents assert that the onus in this part of the test is on the plaintiffs and is substantial. They submit that the plaintiffs must prove that they have a reasonable possibility of success at trial on each element they are required to establish; namely: the existence of the misrepresentation in the Form 10-K and press releases, and the required mental element for Joyce and Gamble as officers and for all respondents in respect of the misrepresentations in the press releases. The respondents also assert that the plaintiffs must "overcome" the statutory defences asserted by the plaintiffs, and that the court must evaluate the plaintiffs' evidence respecting damages pleaded above the damages cap.

312 The plaintiffs, however, contend that the threshold for a reasonable possibility of success at trial is low and is met as long as there is some evidence which, if accepted by the court, is consistent with a misrepresentation. The plaintiffs argue that the issue of due diligence should be left for the trial judge unless the defendants demonstrate that they are entitled to summary judgment on this issue.

(b) Analysis and Conclusion

313 The phrase "a reasonable possibility that the action will be resolved at trial in favour of the plaintiff" does not appear to have any direct antecedent in Canadian legislation. The origin of this wording however is in a screening mechanism for class actions that was proposed by the Ontario Law Reform Commission ("OLRC") in its 1982 *Report on Class Actions*.[119] (This recommendation, it may be noted, was not adopted as a part of the *Class Proceedings Act, 1992.*)

314 The OLRC proposed a procedure that is identical to that required under the OSA, requiring the parties to file affidavits setting out the facts material to the proposed certification tests upon which they intend to rely and permitting examination of the affiants.

315 The test was described by the OLRC as a "substantive adequacy test" and a "prophylactic measure against potential abuse of the proposed class action procedure."[120]

316 The respondents' counsel, relying on the OLRC report, argued that the plaintiffs at this stage of the leave test have a "substantial burden" of proving the "substantive adequacy" of their action. In my opinion, this formulation is a misreading of the report, and the particular page reference cited by the respondents in their factum.[121] In fact, the OLRC speaks of the preliminary merits test as one of testing the "substantial" or "substantive" adequacy of the proposed class proceeding. There is no reference to a "substantial burden" of proof.

317 The OLRC described the test by positioning it between two existing standards of proof that courts commonly apply in civil motions: "The preliminary merits test that we propose would require a standard of proof that is not as strict as a *prima facie* case test, but more than simple proof that a triable issue exists".[122]

318 It appears that although the OLRC recommended some examination of the merits of a proposed class action, it was concerned about not setting the bar for certification too high. (Here, it should also be noted that the overall thrust of its report was to make class actions more available than was previously the case for representative actions under then Rule 75 of the *Rules of Practice.*)

319 In any event, in interpreting the phrase as it is used in s. 138.8 of the OSA, the point of departure is to consider the words that the legislature has chosen, in their ordinary and grammatical sense.

320 A "possibility" is something that is possible. "Possible" has been defined as "capable of existing, happening or being achieved" and "that may exist or happen, but that is not certain or probable".[123] Unlike a "probable" event, a possible event does not have to be more likely than not to occur, and may in fact be unlikely or improbable. If one were dealing only with the plaintiff's possibility of success at trial, one would ask whether the plaintiff "may" or "could" be successful. That is, is there evidence that, if believed, would support the plaintiff's action?

321 The word "possibility" in s. 138.8 is modified by the adjective "reasonable". There are two alternative meanings of the adjective "reasonable" that may be applicable. First, "reasonable" may relate to the degree of possibility of success that the plaintiff is required to establish at the motion -- as the respondents contend, "reasonable" could be considered "fair, proper, just or moderate,"[124] or more than a "mere possibility" and equivalent to a "serious possibility".[125]

322 One might also consider the term "reasonable" as it is used in other legal contexts, as tied to reason, evidence and common sense. For example, a "reasonable doubt" in the criminal context is described as "not an imaginary or frivolous doubt, [not] based on sympathy or prejudice. A reasonable doubt is a doubt based on reason and common sense, which must logically be derived from the evidence or absence of evidence."[126]

323 In *RJR-MacDonald Inc. v. Canada*, [1995] 3 S.C.R. 199 at para. 127, the Supreme Court of Canada in interpreting of s. 1 of the *Charter,* noted that, "reason imports the notion of inference from evidence or established truths". In *Justice v. Cairnie Estate* (1993), 105 D.L.R. (4th) 501 (Man. C.A.), leave to appeal to the S.C.C. refused (1994), [1994] S.C.C.A. No. 431, 109 D.L.R. (4th) vii (S.C.C.), the Manitoba Court of Appeal, in considering a similar phrase in a judge-made rule (at pp. 513-14) stated:

> In this context, a "reasonable chance of success" means more than simply disclosing a cause of action sufficient to successfully resist an application to strike out the statement of claim. .... It must be shown that there is something to the case so that if sent on to trial there is some realistic prospect that the action will succeed.

324 The word "reasonable" as it is used in s. 138.8 captures both meanings. "Reasonable" is used instead of "mere" to denote that there must be something more than a *de minimis* possibility or chance that the plaintiff will succeed at trial. The adjective "reasonable" also reminds the court that

the conclusion that a plaintiff has a reasonable possibility of success at trial must be based on a reasoned consideration of the evidence.

325 There are other factors that in my view inform the test that the court should apply. First there is the context in which the determination is made, in a motion based on affidavit evidence and transcripts of examinations. The merits are to be evaluated at the motion for leave stage, with a view to determining whether there is a reasonable possibility of success *at trial*.

326 In undertaking this evaluation the court must keep in mind that there are limitations on the ability of the parties to fully address the merits because of the motion procedure. There is no exchange of affidavits of documents, no discovery (although affiants may be cross-examined) and witnesses cannot be summoned.[127] The credibility of a witness' evidence given by affidavit in a motion, irrespective of how searching an out-of-court cross-examination may be, can only be fully determined when it is tested in open court. As Master McLeod noted in *Caputo v. Imperial Tobacco Ltd.*, [2002] O.J. No. 3767 (S.C.) at para. 19:

> A judge weighing affidavit evidence does not have the same opportunity as a trial judge to look the witness in the eye and assess whether he or she is forthright and believable. There is, of course, opportunity to reject affidavit evidence because it is internally inconsistent, illogical, wanting in detail, contrary to documentary evidence, or otherwise contradicted.

327 As a result, the court must evaluate and weigh the evidence at hand, keeping in mind the restrictions of the motions process and what may be available to the parties in a trial. This does not mean that the court should speculate about what better evidence a party may advance when the matter reaches trial, or fill obvious gaps in a party's case; it does however require the court to assess the evidence realistically, having regard to which party has the burden of proof and access to evidence that may be brought forward at the preliminary stage, and paying attention to conflicts in the evidence that may not be capable of being determined in a motion, without a full assessment of a witness' testimonial credibility.

328 The respondents' counsel argued that a more onerous threshold is required in evaluating the merits as part of the statutory leave test because the overall purpose of these provisions is not to provide compensation, but to act as a deterrent to non-compliance with statutory disclosure requirements.

329 In my view, this argument cuts both ways. A threshold that is too difficult to meet will eventually have little deterrent value. An onerous threshold may unduly lengthen and complicate the leave procedure, resulting in the very litigation costs that the drafters of the legislation were seeking to avoid. The emphasis on deterrence over "a fully compensatory model" is in any event, reflected in the limits on damages[128]. The "deterrent" objective of the statutory remedy does not inform the leave standard; any class proceeding, by reason of the aggregation of claims that may be very small or even nominal, will serve both compensatory and deterrent functions.

330 The statutory leave provision is designed to prevent an abuse of the court's process through the commencement of actions that have no real foundation, actions that are based on speculation or suspicion rather than evidence.

331 The leave provision, working with the definition of the statutory cause of action and defences, requires plaintiffs to put forward the evidence they rely on as to the misrepresentation, and

the extent of knowledge or participation required for non-core documents and liability for officers, and permits each proposed defendant to offer an account that may contradict the plaintiffs' allegations, or would fall within the terms of one or more of the defences afforded by the statute.

332 The evidence must be considered at the leave stage to determine whether the plaintiffs' action, after the respondents have had the opportunity to put forward evidence to support their defences and the positions of the parties have been explored in cross-examination, has a reasonable possibility of success.

333 In this regard it is not sufficient (as the respondents contend) to put forward defences which the plaintiffs must "overcome". Nor is the court required (as the plaintiffs assert) to leave any assessment of the defences to a trial. The court must consider all of the evidence put forward in the leave motion, including evidence supportive of any statutory defence. Because the onus of proof of a statutory defence is on the respondents, the court must be satisfied that the evidence in support of such a defence at the preliminary merits stage will foreclose the plaintiffs' reasonable possibility of success at trial.

334 Considering all of the factors noted above, I have approached part two of the leave test by asking myself whether, on the evidence that is before the court on this motion -- that is the affidavits and transcripts of examinations, as well as the various documents that have been tendered as exhibits, and produced in response to undertakings and ordered to be produced during the cross-examination process -- as well as reasonable inferences to be drawn from such evidence, and considering the onus of proof for each of the cause of action and the defences, as well as the limitations of evaluating credibility in a motion, is there a reasonable possibility that the plaintiffs will succeed at trial in proving:

(i) that IMAX's Form 10-K/Annual Report and/or its February and March press releases contained a misrepresentation as alleged by the plaintiffs;
(ii) with respect to Joyce and Gamble, that they authorized, permitted or acquiesced in the release of a document containing the misrepresentation;
(iii) if the alleged misrepresentations were contained only in the press releases (as non-core documents), that the Individual Defendants and Gamble knew of the misrepresentation, deliberately avoided acquiring knowledge or were guilty of gross misconduct in connection with their release;

and, with respect to the defences relied upon by each respondent, is there a reasonable possibility that such respondent will not be able to establish at trial both elements of the defence of "reasonable investigation"; namely:

(i) that the respondent conducted or caused to be conducted a "reasonable investigation"; and
(ii) at the time of the release of the document the respondent had no reasonable grounds to believe that the document contained the misrepresentation;

or, to the extent the expert reliance defence is applicable:

(i) that the respondent did not know that there had been a misrepresentation in the part of the document made on the authority of the expert; and

(ii) the respondent had no reasonable grounds to believe that there had been a misrepresentation in the part of the document made on the authority of the expert.

335 With respect to the loss causation defence in s. 138.5(3), is there a reasonable possibility that the respondents will not be able to establish that the plaintiffs' entire loss is attributable to a change in the market price of securities that is unrelated to the misrepresentation?

336 While the statute speaks of leave in the general sense, that is leave to proceed with the action, I have approached this task individually with respect to each respondent. If on the evidence at this stage, the plaintiffs do not have a reasonable possibility of success at trial against a specific Individual Defendant or proposed defendant, the statutory action will not be permitted to proceed against that person.

337 I reach this conclusion because of the requirement under s. 138.8(2) for each defendant to deliver an affidavit setting forth the material facts upon which he or she intends to rely, and s. 138.8(3) providing for the examination of each affiant. Indeed in this case, each respondent filed an affidavit and has been cross-examined with respect to the statutory defences, and an examination of the defences as they would apply to each individually is possible and appropriate.

338 With respect to the application of the damages cap, the respondents assert that the court must consider whether to grant leave to assert a claim exceeding the damages cap for the individual respondents based on whether they authorized, permitted, acquiesced in or influenced the making of the misrepresentation while knowing that it was a misrepresentation (s. 138.7(2)).

339 As noted, the plaintiffs have pleaded facts that would exceed the damages cap only in respect of the Individual Defendants and Gamble. It is unnecessary at the leave stage to determine whether there is a reasonable possibility that the damages cap will be exceeded. The statutory threshold speaks of a reasonable possibility of success at trial, and does not invite the court to make specific findings with respect to the measure of success the plaintiffs might hope to achieve against a particular respondent. Provided that there is a reasonable possibility that the action will succeed against a particular respondent, the claim against that person should be permitted to proceed.

2. A Proposed "Part Three" of the Leave Test: Is it Necessary for the Plaintiffs to Plead Fraud or "*Scienter*"?

340 The respondents assert that, as part of the consideration of whether to grant leave to proceed with the statutory claim, the court must be satisfied that all of the elements of the statutory cause of action are properly pleaded. As part of their argument, the respondents assert that the plaintiffs have neglected to properly plead fraud, which they contend is an essential part of the statutory cause of action.

341 The Claim on its face pleads all of the elements of the statutory cause of action that are provided for in s. 138.3 of the OSA. That is, the Claim identifies the defendants as the Company and directors and officers of IMAX. The Claim pleads the making of the Representation, as well as other misstatements which are specifically identified, and alleges that they were made in the Annual Report, Form 10-K, and three press releases. The plaintiffs plead in what respect the Representation and misstatements were false or materially misleading. They plead that the August 9, 2006 press release revealed the truth about IMAX's revenue recognition for theatre systems. Finally, they plead the drop in IMAX's share price, which they allege to have resulted from August 9th disclosure.

342 All of the necessary elements for statutory liability for a misrepresentation by IMAX in its annual financial statements and Form 10-K (as core documents) are pleaded against all of the Individual Defendants and the proposed defendants. As against the Individual Defendants and Gamble are pleaded the additional elements of knowledge and participation necessary for their liability in respect of the press releases (as non-core documents) and to claim damages against them exceeding the damages cap.

343 The respondents assert that, as part of the pleading of the statutory cause of action, the plaintiffs must plead fraud, and in this regard, they must meet the more rigorous pleadings standard required when fraud is alleged. The respondents point to the requirement in respect of non-core documents, for the plaintiffs to prove, as an element of the offence, that the defendant possessed one of the required mental states set out in s. 138.4(1) (i.e., knowledge, wilful blindness or gross misconduct), and assert that such allegations are tantamount to the moral culpability required to establish fraudulent misrepresentation.

344 The respondents in effect are urging the court to adopt, in addition to the statutory leave test, the requirement for pleading "*scienter*" in fraud on the secondary market claims, as they are put forward in U.S. jurisdictions. They make reference to the statutory requirement in such actions requiring plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind", and case law, such as the decision of the U.S. Supreme Court in *Tellabs Inc v. Makor Issues & Rights Ltd.*, (2007), 127 S. Ct. 2499, interpreting the pleadings standard as requiring a factual pleading which establishes an inference of fraudulent intent that is as strong as any competing inferences of non-fraudulent intent.

345 As noted above, the legislative history of the Ontario statutory remedy reflects an informed decision to put in place a screening mechanism that differs from the U.S. pleadings-based approach. The CSA noted that the Ontario proposed legislation, as a specific and comprehensive code, was fundamentally different from Rule 10b-5, which is a general anti-fraud rule from which the courts have implied a right of action. The key element of intent or recklessness that a plaintiff must establish to succeed in a Rule 10b-5 action need not be proved in an Ontario statutory proceeding, where the mental element is the absence of due diligence.[129]

346 Accordingly, the respondents' argument that the Claim fails to properly plead all necessary elements of the statutory cause of action is rejected.

3. Applying Part Two of the Leave Test in this Case

347 In this part of the reasons, with reference to the evidence on the motion, I will consider whether the plaintiffs have established that they have a reasonable possibility of success at trial in their claims against IMAX and the individual respondents.

(a) The Misrepresentations

348 On July 20, 2007, IMAX filed its Form 10-K for the fiscal year ending December 31, 2006 which included a restatement of its financial results for the period 2002 to the third quarter of 2006 (the "Restatement"). IMAX acknowledged, among other things, that the use of MEA accounting in its theatre system sales and lease transactions was an error under GAAP, and that each theatre system ought to have been viewed as a single deliverable, with revenues deferred until the entire system had been installed and was fully operational. According to the Form 2006 10-K, theatre system

revenues of US $17.5 million (and net earnings of US $9.7 million) were prematurely recorded in fiscal 2005.

349 The Restatement resulted in revenue relating to 14 theatre system installations being moved to later periods. Ten installations from Q4 2005 on which revenue had been recognized in the 2005 10-K were moved to later years; eight were moved to 2006, and two to subsequent periods.

350 IMAX's EPS for 2005 went from US $0.40, as reported in the 2005 10-K, to US $0.20 following the Restatement.

351 The fact that IMAX restated its financials for 2005 and admitted that it had not complied with GAAP supports the plaintiffs' claim of misrepresentation. The evidence in the motion for leave was uncontradicted that IMAX's assertions in its 2005 Form 10-K and March 2006 press release, that its revenues for 2005 were prepared and reported in accordance with GAAP and that such revenues met or exceeded the earnings guidance previously issued by IMAX, were false, and having been corrected in the Restatement, were material. Accordingly, the plaintiffs will have a reasonable possibility of success at trial in establishing a misrepresentation.

352 It is also uncontested that each of the respondents (except for Joyce and Gamble) was a director of IMAX at the material time, and would accordingly, together with the Company, be liable for the misrepresentations in the 2005 Form 10-K, unless a statutory defence is available.

353 With respect to Joyce and Gamble, it is necessary for the plaintiffs to establish that there is a reasonable possibility that they will prove at trial that these individuals permitted, authorized or acquiesced in the release of the 10-K. In view of their roles as CFO and Vice-President, Finance and the evidence of their direct involvement in IMAX's year-end accounting and that they signed the document, this hurdle is met.

354 In the present case, misrepresentations are alleged to have been communicated in the February and March press releases. Liability for misrepresentation in a non-core document would require evidence that a defendant knew, deliberately avoided knowledge or was guilty of gross misconduct in relation to the misrepresentation.

355 However, the same alleged misrepresentations were communicated in the 2005 10-K, which is a "core document". As such, statutory liability would follow from the misrepresentations in the Form 10-K, and it is unnecessary to consider for the purpose of this motion whether the misrepresentations were in fact contained in the February and March press releases, and whether the requisite mental element was present in respect of the respondents.

(b) The "Reasonable Investigation" Defence

356 The position of the defendants and proposed defendants is that these proceedings arise out of an accounting judgment made by IMAX in completing its financial statements for 2005. The respondents assert that the accounting issues are complex and that they conducted a reasonable investigation and reasonably relied on the advice of IMAX's auditors when the Company recognized revenue from the sale and lease of theatre systems and reported its financial performance for fiscal 2005, even if ultimately it erred in its financial reporting and revenue recognition for that year.

357 The bulk of the evidence in the leave motion was directed toward the conduct of IMAX and each of its directors as well as Mr. Joyce and Ms Gamble as officers, relevant to the reporting of IMAX's financial results for Q4 2005, in comparison with its reporting in prior periods, in particular

in relation to revenue recognition for theatre system sales and leases. Such evidence is relevant to the "reasonable investigation" and "expert reliance" defences.

(i) The Reasonable Investigation Defence Defined

358 Each of the respondents relies on s. 138.4(6) of the OSA, which provides that it is a defence to an action in relation to a misrepresentation if the defendant proves that (i) before the release of the document containing the misrepresentation, he *conducted or caused to be conducted a reasonable investigation*; and (ii) at the time of the release of the document he had *no reasonable grounds to believe that the document contained the misrepresentation* (emphasis added).

359 The "reasonable investigation" defence requires the application of objective criteria on two points. The defendant must establish that an investigation that he undertook or caused to be undertaken was reasonable in the circumstances, and he must have had no reasonable grounds to believe that there was a misrepresentation.

360 In determining whether an investigation was reasonable, the court is directed to consider all relevant circumstances, including a non-exhaustive list of relevant circumstances (s. 138.4(7)), which include (as they are applicable in this case):

> (b) the knowledge, experience and function of the [defendant];
> (c) the office held, if the person was an officer;
> (d) the presence or absence of another relationship with the responsible issuer, if the person was a director;
> (e) the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations;
> (f) the reasonableness of reliance by the [defendant] on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts;
>
> ...
>
> (h) in respect of a report, statement or opinion of any expert, any professional standards applicable to the expert;
> (i) the extent to which the [defendant] knew, or should reasonably have known, the content and medium of dissemination of the document ...; [and]
> (j) ... the role and responsibility of the [defendant] in the preparation and release of the document ... or the ascertaining of the facts contained in that document.

361 The first part of the "reasonable investigation" defence involves a consideration of such matters as the measures and systems in place at the Company respecting the recognition of revenue for financial reporting, the roles and responsibilities of various persons in the revenue recognition and reporting processes, policies and procedures, and oversight and assurance measures, including the performance of audit functions by PwC.

362 Factors applicable to the individual respondents are also relevant, including their qualifications, knowledge and experience and their roles and responsibilities within or in relation to the organization and in connection with the Company's financial reporting.

363 The second part of the "reasonable investigation" defence involves a consideration of the specific knowledge of each respondent and the knowledge someone in his or her position ought to have had with respect to the misstatement of the Company's financial results. The second part of the test focuses on a consideration of the true state of affairs -- what was known to whom, and which of the respondents, if any, ought to have known that when the Representation and misstatements were made, they were untrue?

364 In the present case, there is the added fact that revenue recognition had been elevated to an issue of concern within IMAX by reason of the Delhi Post. The accusations contained in the Delhi Post, which were known to all of the respondents, as well as the actions that followed, are part of the overall circumstances that must be considered, in evaluating both the reasonableness of the investigation associated with the financial reporting for 2005, and the knowledge and conduct of the individual respondents.

(ii) Does the Business Judgment Rule Apply to the Reasonable Investigation Defence?

365 The business judgment rule is a deferential standard of review that courts apply to business decisions. In *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, the Supreme Court concluded that the business judgment rule is relevant to determining whether directors have satisfied their statutory duty of care under s. 122(1)(b) of the CBCA.[130]

In respect of a director's duty to act reasonably and fairly, deference will be accorded to the board's decision where the decision taken is within a range of reasonableness (at paras. 63-67 and citing Weiler J.A.'s description of the business judgment rule in *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 at 192 (C.A.)).

366 The business judgment rule was most recently affirmed in the Supreme Court's reasons in *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560, where the Court considered an appeal of court approval of a plan of arrangement for the purchase of its shares through a leveraged buy-out, that was opposed by debentureholders claiming oppression. The business judgment rule was applied to afford deference to directors where they had to make decisions involving competing interests. In discharging their statutory duty under s. 122(1)(a) of the CBCA to act honestly and in good faith with a view to the best interests of the corporation, it was sufficient that the directors had considered the interests of the debentureholders, even if the ultimate decision prejudiced them. The Court emphasized that the duty owed by directors is to the corporation, not to stakeholders. While these interests may coincide, where they do not, stakeholders have a reasonable expectation that the directors act in the best interests of the corporation, not to a particular group of stakeholders (para. 66).

367 In *Kerr v. Danier Leather*, the Supreme Court rejected the application of the business judgment rule to the legal duty of disclosure in the context of a forecast contained in the prospectus of the defendant. Binnie J. noted, at paras. 54 and 55:

> On the broader legal proposition, however, I agree with the appellants that while forecasting is a matter of business judgment, disclosure is a matter of legal obligation. The Business Judgment Rule is a concept well-developed in the context of *business* decisions but should not be used to qualify or undermine the duty of disclosure.
>
> ...

However, the disclosure requirements under the Act are not to be subordinated to the exercise of business judgment .... It is for the legislature and the courts, not business management, to set the legal disclosure requirements. [Emphasis in original.]

368 The Court in *Kerr v. Danier Leather* concluded that the justifications for the application of the business judgment rule, namely the relative expertise of managers and the need for reasonable risk-taking, do not apply to decisions concerning disclosure (at para. 58), and observed that the business judgment rule had been rejected by U.S. courts in the context of proxy and supplemental disclosures.[131]

369 In the present case, the respondents seek to supplement the statutory reasonable investigation defence under s. 138.4(6) of the OSA with the protection of the common law business judgment rule as set out in *Peoples*. While they acknowledge that the Supreme Court has "curtailed the application" of the rule to statutory disclosure obligations, they submit that the rule would be applicable in considering the "reasonableness of the process which [was] followed in determining the proper revenue recognition for Q4 2005". The respondents submit that the due diligence defence should be interpreted consistently with the statutory duties of directors under s. 122(1) of the CBCA[132] and s. 134(1)[133] of the Ontario *Business Corporations Act* R.S.O. 1990, c. B. 16 ("OBCA"), and that the deference afforded by the business judgment rule should apply to the OSA as it has been applied in interpreting these statutory duties.

370 The defect in this argument is that the OBCA and CBCA statutory duties referred to by the respondents are duties that are owed to the corporation, while the disclosure obligations under the OSA protect the interests of shareholders, prospective investors and the investment market. The business judgment rule has been applied in determining whether directors have acted reasonably and fairly in the interests of the corporation; that is, in discharging their statutory and common law duties of good faith and diligence that they owe as directors to the corporation.

371 The secondary market misrepresentation regime creates strict liability for material misrepresentations by a reporting issuer, with a reverse onus on defendants to establish a reasonable investigation or other defence. The defences are defined in the OSA, which provides a non-exhaustive list of factors that the court is to consider in determining whether a defence is made out.

372 To "read in" the business judgment rule is both unnecessary and inconsistent with the legislative approach to the statutory remedy and defences.

373 In an article commenting on *Kerr v. Danier Leather*, Jeremy D. Fraiberg and Robert Yalden suggest that the business judgment rule has the potential to conflict with the s. 138.4(6) reasonable investigation defence. They note three important distinctions between the rule and the statutory defence:

> First and most importantly, the reasonable investigation defence applies *after* there has been a determination that a document or public oral statement contains a misrepresentation or that there has been a failure to make timely disclosure. The business judgment rule would normally be thought to apply in determining whether there has in fact been a disclosure violation (*i.e., before* the defence needs to be invoked). Second, under the business judgment rule, deference is due if the impugned decision falls within a range of reasonableness. Under the reasonable investigation defence, however, a person or company must prove that

> they had *no* reasonable grounds to believe that there was a disclosure violation -- arguably a stricter standard. Third, were the business judgment rule to apply, the burden of proof would typically be on the plaintiff to establish that no reasonable decision-making process was followed, whereas the burden of proof is on the defendant in invoking the reasonable investigation defence.[134]

374 While the authors conclude that the extension of the rule would not render the statutory defence moot in all circumstances, they suggest that it would be moot in many cases.[135]

375 I agree with these observations. The business judgment rule, that recognizes that business decisions of directors are entitled to deference, has a role to play in cases involving the fiduciary and statutory duties of directors owed to a corporation, in evaluating the reasonableness of the business decisions that directors are called upon to make from day to day. Such decisions are entitled to deference, even if subsequent events prove that they were harmful to the corporation or to certain corporate stakeholders, provided that they fall within a range of reasonableness.

376 There is no compelling reason for a court to apply the business judgment rule when considering the reasonable investigation defence in the context of a statutory remedy for secondary market misrepresentation. Statutory disclosure obligations exist to protect investors and the capital markets. There is a mandatory obligation to issue accurate financial statements, with strict liability for any material misrepresentation subject to the prescribed defences. The onus of establishing the defences is on the defendants, and the terms of the defences are prescribed by the statute. Reading in a standard of deference to a director's decisions would be both unnecessary and inconsistent with the scheme and purpose of the statutory remedy.

(iii) Positions of the Parties: Reasonable Investigation Defence

377 Turning to the evidence, the respondents assert that the defence of "reasonable investigation" has been established to the extent that there is no reasonable possibility that the plaintiffs could succeed in this action at trial.

378 They contend that the Company had in place a "well-organized and diligent internal accounting process", with written revenue recognition policies that were revised from time to time and approved by PwC. They rely on the audit process, which involved extensive dialogue between IMAX management (including Ms Gamble and Mr. Joyce) and PwC, which they characterize as "active and transparent", and management's full response to PwC's request for extensive explanation and documentation for the Company's proposed revenue recognition treatment of the Q4 2005 installations.

379 With respect to the Delhi Post, the respondents contend that appropriate steps were taken by the Company and the audit committee to conduct investigations, which concluded that the Company's recognition of revenue for the Delhi installation in Q3 2005 was appropriate, despite the fact that the silver screen was not in place.

380 The respondents rely on the involvement of PwC throughout the process. PwC suggested the application of MEA accounting, which was accepted. PwC had approved the Company's most recent policy on revenue recognition and had provided its opinion that internal controls over financial reporting were effective. PwC gave a "clean" audit opinion.

381 The plaintiffs rely on the fact that IMAX and its auditors acknowledged in the Restatement that IMAX's internal accounting controls were in fact deficient. Management had come to a "final

decision" to recognize revenue on all 14 theatre systems, an approach that the respondents did not in this motion seek to justify as correct, and only adopted the MEA accounting approach when it was apparent that the impact on reported revenue would still permit the Company to achieve its projected earnings. The accounting that was ultimately applied was inconsistent with IMAX's internal policies and past accounting practices. Even the Company's revised policy on revenue recognition after the Dehli Post investigation was inconsistent with the MEA accounting treatment that was applied.

382 With respect to reliance on the Company's auditors, the plaintiffs argue that responsibility for the accounting was on IMAX management and not on the auditors, as reflected in the management representation letter, and acknowledged in the Copland Affidavit. There were deficiencies in management's approach that were identified by PwC, and it was only at their insistence that fulsome transaction memos were prepared, that oral agreements with customers were documented and that the recognition of revenue on all 14 theatre installations in Q4 2005 was reconsidered.

383 The plaintiffs point to evidence that management was aware of the true status of the installations, which included buildings that were not yet fully constructed and a requirement to move a system to another location. While PwC required proper documentation of revenue recognition on theatre systems, they were not provided with all relevant information on the status of the installations until the following year, during the Restatement process. Ms Coulman acknowledged that having this additional information might have affected PwC's opinion with respect to revenue recognition for 2005.

384 The plaintiffs contend that the Delhi Post had raised concerns about the proper recognition of revenue where a theatre was not yet open. While investigations were undertaken, they did not include contact with anyone outside the Company, including the customer. Although the investigation reports concluded that there had been no wrongdoing, they confirmed that the Company had not been following its own written policies for revenue recognition. The fact that the anonymous posting had been made is important, as it raised the matter of revenue recognition to a matter of heightened concern, including at the level of the Board.

(iv) Analysis of the "Reasonable Investigation" Defence

385 The function of the court at the leave stage is not to determine the action on the merits, but to consider the evidence on a preliminary basis to evaluate whether the plaintiffs have a reasonable possibility of success. If the matter progresses to trial, the discovery process will expand the information and evidence that is ultimately available to the trial judge, who will in any event have the advantage of hearing the witnesses, including persons whose evidence may not have been before the court at the leave stage. The case may change substantially, as the matter proceeds toward trial.

386 Accordingly, it is not appropriate or necessary for the court to make specific findings. Any observations I make on the evidence at this stage are of necessity preliminary and any findings of fact provisional.

a. The Company, The Individual Defendants and Gamble

387 The first part of the "reasonable investigation" defence involves a consideration of whether the defendants "conducted or caused to be conducted a reasonable investigation". That is, considering all of the circumstances, including the particular factors in s. 138.4(7), was the investigation by or at the direction of the defendants of the substance of the misrepresentation reasonable? The sub-

stance of the misrepresentation in this case was the financial reporting as to revenue recognition and compliance with GAAP.

388 The Individual Defendants and Gamble were directly involved in the financial accounting process. The CEO and CFO have affirmative obligations in relation to the financial reporting of the corporation and its disclosure. In accordance with regulatory requirements[136] Mr. Gelfond, Mr. Wechsler and Mr. Joyce certified that the 2005 10-K presented fairly, in all material respects, IMAX's financial condition. The 10-K was also signed by Ms Gamble as Vice-President, Finance and Controller and Principal Accounting Officer. The CEOs and CFO also provided certifications in the 10-K respecting their responsibility for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting and the status of such controls.

389 According to Mr. Joyce the purpose of internal controls was to set up processes and procedures to safeguard the assets of the Company, to better assure proper financial reporting and accounting policies are adhered to and to make GAAP compliance more likely.[137]

390 Mr. Joyce and Ms Gamble were directly involved in the gathering of information and preparation of the IMAX financial statements and the transaction memos that were prepared for PwC. They were part of the management team that had arrived at a decision to recognize revenue on all 14 theatre systems, before PwC "pushed back" and recommended that MEA accounting be considered, and they were directly involved in discussions with PwC. They were responsible for providing a report to the audit committee on the 2005 accounting, which was presented by Ms Gamble on March 1, 2006.

391 The evidence at this stage suggests that there were deficiencies in the internal accounting at IMAX in respect of revenue recognition on theatre systems. The documentation of management's revenue recognition analysis initially was inadequate, notwithstanding that following the Delhi Post, the importance of proper documentation of the proposed revenue recognition had been emphasized by PwC, and the internal policy had been revised. Agreements with customers to ensure "installation" by year end were oral until PwC requested they be documented.

392 The lack of internal controls and effective communication between departments at IMAX during the 2005 year end accounting are admitted in the Restatement as having contributed to the accounting errors. The Individual Defendants and Gamble had direct responsibility for the Company's accounting and internal controls. All of this is evidence inconsistent with their having performed a "reasonable investigation" in connection with the subject of the alleged misrepresentations -- the status of theatre system installations, the recognition of revenue and compliance with GAAP.

393 The second branch of the "reasonable investigation" defence involves the actual knowledge or what a defendant should reasonably have known at the time of the alleged misrepresentation.

394 The evidence at this stage suggests that the Individual Defendants and Gamble were aware of the actual status of the theatre system installations from the email and other communications they received in Q4 2005. As such they knew that 14 theatre system installations had not been "completed" (as claimed in the February press release). As the persons directly responsible for the Company's accounting, these parties, and those under their supervision, controlled the information that was provided to PwC.

395 The accounting that was initially proposed, to recognize all revenues on theatre installations, even where the silver screen had not been installed, depended on a conclusion that the remaining

obligations were "perfunctory and inconsequential". PwC could not agree with the Company's conclusion in this regard. The adoption of EITF 00-21 was proposed by PwC, and accepted by IMAX management, notwithstanding that it appeared to be inconsistent with the Company's policies, past practices and disclosures, including a memo from IMAX's GAAP expert, during the Delhi Post investigation, that EITF 00-21 would not apply to IMAX's theatre systems.

396 With respect to all of the respondents, there will be an issue at trial as to the extent to which they were entitled to rely upon the opinions and actions of PwC.

397 For the Individual Defendants and Gamble and (as there is no doubt that these respondents were its "directing minds") for the Company, there is a reasonable possibility that they will not succeed in the defence by reason of their own participation in the accounting, the admitted lack of internal controls, their knowledge of the status of the installations and their knowledge and awareness of the Company's past practices, policies and disclosures respecting revenue recognition.

398 For these reasons, I have concluded that the evidence concerning the "reasonable investigation" defence is not sufficient to preclude the possibility of success at trial against the Company, the Individual Defendants and Gamble.

399 I have also concluded that, in respect of Joyce and Gamble, there is a reasonable possibility on the evidence, in particular as to their direct involvement in the 2005 accounting decisions and reporting, that the plaintiffs will succeed at trial in establishing that they "authorized, permitted or acquiesced" in the release of the documents containing the misrepresentation. This is an essential element for their potential liability under s. 138.3 as "officers".

b. The Outside Director Respondents

400 The other respondents, Braun, Copland, Fuchs, Girvan, Leebron and Utay, were outside directors of IMAX. They are named as proposed defendants only in respect of a remedy under s. 138.5 of the OSA, and there are no allegations that they authorized, permitted or acquiesced in the making of the misrepresentation or influenced the making of the misrepresentation while knowing that it was a misrepresentation. Accordingly, under s. 138.7, their liability for damages would be capped at the greater of $25,000 and 50% of the aggregate of their compensation from the responsible issuer in the year preceding the misrepresentation[138].

401 The question with respect to these respondents is whether there is a reasonable possibility that the defence of "reasonable investigation" will not succeed at trial for any or all of them. Again, the onus of proof under the OSA is on each person who relies on this defence. If the court accepts at this stage that the defence will be made out at trial, then leave will not be granted to proceed against the respondent. If the court determines that there is a reasonable possibility that the defence will not be made out, then the respondent will remain in the action as a defendant. The determination of this issue is not a final decision on the merits with respect to the potential liability of each of the external director respondents.

402 Again, there are two branches to the "reasonable investigation" defence: whether the individual conducted or caused to be conducted a "reasonable investigation", and whether at the time the misrepresentation was made, he or she had no reasonable grounds to believe that the document contained a misrepresentation.

403 The parties at this stage of the litigation did not offer any expert evidence as to the standard of care for board and audit committee members with respect to financial reporting and disclosure.

Indeed, there was little argument addressed to the relative potential liability of the various respondents, except for the respondents' assertion in their factum that the reasonable investigation defence is "particularly accessible" for the respondents who were outside directors, and who, under s. 138.4(7) had no day-to-day "other relationship with the responsible issuer".

404 In this regard, the respondents cite *Cadrin v. Canada*, [1998] F.C.J. No. 1926 (F.C.A.) which distinguished between inside and outside directors for liability under the *Income Tax Act* for failure to deduct or withhold remittances at source. DeCary J.A. noted at para. 5:

> The outside director who gets involved to the extent of his role in the business and his abilities meets the standard of care in principle. If he ensures that the business is viable before investing money in it, if he surrounds himself with reliable and competent people who undertake the day-to-day management of the business, if he stays generally informed about what is happening, if nothing happens which should arouse suspicion about the payment of the corporation's liabilities, if he acts quickly when problems arise, he should not as a general rule be held liable.

405 This statement emphasizes the ability of an external director to rely on management, except when something occurs that should arouse the director's suspicion, so that he should personally take action. While this statement is helpful in describing the standard of care of an external director in connection with such day-to-day matters that are the responsibility of management, such as the payment of taxes,[139] it may be insufficient to describe the standard of care of an outside director in respect of secondary market misrepresentation.

406 Unlike their indirect role in ensuring the proper payment of taxes, the audit committee and the board of directors have a specific and direct role to play in respect of an issuer's financial disclosure. Annual statements of public issuers must be approved by the board of directors before they are filed, and such approval may not be delegated to the audit committee of the board.[140] The IMAX 2005 Form 10-K was signed by all members of the Board personally or under power of attorney, and accordingly the financial statements of IMAX were approved by each of the external director respondents.

407 S. 138.4(7) includes as relevant circumstances to be considered when determining whether an investigation was reasonable, (b) the "knowledge, experience and function" of the person, and (j) his "role and responsibility" in the preparation and release of the document containing the misrepresentation.

408 In considering the potential application of the "reasonable investigation" defence to the remaining respondents, it is important to keep in mind that the external directors were not part of management and accordingly were not involved in gathering information or preparing the Company's accounting. According to the evidence available at this time, they had the same information as PwC as to the true status of the theatre system installations.

409 It is also important to note that, while each of the external director respondents filed an affidavit, the affidavits, except for that of Kenneth Copland, as chair of the audit committee, are *pro forma*, and do not address or differentiate between the specific circumstances or individual knowledge of each director; rather the deponents refer to and adopt as accurate the evidence contained in the Copland Affidavit as to IMAX's accounting, the processes followed and the PwC audit, and at-

test to their reliance on IMAX management and PwC to properly prepare IMAX's financial statements for public disclosure and regulatory filing.

* **Audit Committee Members and Girvan**

410 In contrast to the other Board members, the audit committee members, Copland, Braun and Leebron, had specific responsibilities for oversight of the Company's financial reporting.

411 Audit committee members are required by OSC rules[141] to be independent and financially literate[142]. The audit committee is "a committee of a board of directors to which the board delegates its responsibility for oversight of the financial reporting process", and its roles include helping directors meet their responsibilities and increasing the credibility and objectivity of financial reports. The audit committee is directly responsible for overseeing the work of the external auditors, including the resolution of disagreements between management and the external auditors regarding financial reporting.[143]

412 According to the affidavits of all of the respondents, the audit committee met regularly with PwC, including meetings without management (although the evidence in the cross-examinations was that there was only one meeting in 2006 prior to the release of IMAX's 2005 financial statements, which took place on March 1st).

413 While Mr. Girvan was not a member of the audit committee in 2005 and 2006 (he had been a member of the committee from September 1994 to June 2004), he attended their meetings regularly and, more importantly, he received and reviewed the information that was presented to the audit committee in connection with the year end accounting, in the form of the reports from management, PwC and Mr. Vance. Mr. Girvan was also notified of the Delhi Post and participated in the Company's response.

414 The audit committee and Mr. Girvan knew that there were outstanding obligations in respect of a number of the theatre systems where revenue was to be recognized in Q4 2005. These were disclosed in the report of management, presented by Ms Gamble, as well as the transaction memos, copies of which were provided to the members of the Board. That is, while they did not have all the details, they were aware that several of the theatre system installations were incomplete.

415 The audit committee and Mr. Girvan also knew that management had originally recognized all initial revenues on the installations, and that PwC disagreed with this approach. This was detailed in Ms Coulman's report, and recorded by Mr. Vance as a significant deficiency in his SOX report. The audit committee and Mr. Girvan were made aware that there was a change in the accounting approach for revenue recognition on theatre systems. Although Ms Coulman certified that the Company had not adopted any new accounting policies, both she and Mr. Vance observed that there were "changed circumstances" in the Company's theatre system installations.

416 The "changed circumstances" were that, of the 14 theatre systems in respect of which revenue was recognized in Q4 2005, ten had not been fully installed in the quarter. Whether or not these were in fact changed circumstances (the Company had recorded revenue for theatre system installations in a quarter on at least two occasions in 2005, when the silver screen had not been installed, including in respect of the Delhi installation), this was the reason offered for the change in approach.

417 The affidavits of the audit committee members do not address their specific roles and involvement in the year end accounting, except to say that they relied on management and PwC to complete their duties, and that "upon investigation" they were advised that management had used appropriate efforts to ensure that the Company properly applied GAAP, and that "upon investigation" the audit committee was advised by PwC during regular meetings that they had a full opportunity to advise the audit committee of any issues regarding management.

418 The evidence is that the audit committee met on March 1, 2006 for the purpose of reviewing the Company's financial statements. By that point the Company had already issued the February press release reporting its anticipated financial results.

419 The respondents refused in the motion proceedings to produce the minutes of audit committee and board meetings from November 10, 2005 up to and including the board meeting when the decision was made to restate financial results[144] (although audit committee and board minutes after August 6, 2006 were produced in response to a different undertaking).[145]

420 While they were not responsible for performing IMAX's accounting, the members of the audit committee nevertheless had an independent role to scrutinize the accounting decisions that were made, and Girvan, in attending their meetings and reviewing the information that the audit committee members received, had become part of the oversight process. The audit committee and Girvan were aware of the disagreement between IMAX management and PwC. They were also aware that the Company was facing what were described as "changed circumstances" where it was proposed to recognize revenue on numerous theatre system installations that had not been completed.

421 A critical factor in this case is that, at the time of their consideration and approval of 2005 IMAX's financial statements, the audit committee members and Girvan were aware of the allegations of improper revenue recognition, and practices by IMAX personnel that were contained in the Delhi Post. The Delhi installation had also involved a theatre system where certain outstanding obligations, including installation of the silver screen, had not been completed. The detailed investigation reports of Vance and Lister had been provided to the members of the audit committee; in fact Mr. Vance's investigation had been commissioned by the audit committee. Although the reports concluded that there had been no fraud, they disclosed that the Company had not been following its internal policies with respect to revenue recognition on theatre system installations.

422 The evidence was that revenue recognition had been a topic of discussion at numerous Board meetings. The audit committee members and Girvan were aware of the decision to market the Company for sale, and of the details of the Delhi Post allegations and investigations. The evidence of each of these individuals as to the "reasonable investigation" into the representations in IMAX's 10-K as to its revenue recognition and compliance with GAAP was limited to reliance on IMAX management and PwC. The circumstances that existed at the time may well have called for closer scrutiny on the part of the audit committee members and Girvan by reason of their positions, responsibilities and knowledge.

423 On the evidence that was available at the motion, I am satisfied that the plaintiffs have a reasonable possibility of success at trial against the respondents Copland, Leebron, Braun and Girvan. This does not mean that the plaintiffs are *likely* to succeed against some or all of these individuals; only that there is sufficient evidence to meet the threshold for including them as defendants in this action, or put another way, having regard to the reverse onus, these respondents have not persuaded me at this stage that their defence will of necessity succeed at trial. Again, there will be an impor-

tant issue as to the extent to which these respondents or any of them were entitled to rely upon the opinions and advice of PwC.

* **The Remaining Directors: Utay and Fuchs**

424 In their factum the plaintiffs did not seek to attribute to the remaining respondents Marc Utay and Michael Fuchs any actual or constructive knowledge of a misrepresentation. These individuals were Board members who were not on the audit committee. As such, they had a limited role in respect of the Company's financial reporting. They were not party to the discussions of the audit committee and did not see the reports provided to the audit committee by management and by PwC. Before they approved the financial statements they knew that both the audit committee and PwC were satisfied with the Company's revenue recognition for 2005.

425 With respect to the Delhi Post investigation, the Board members received a report from Mr. Copland as chair of the audit committee that did not contain details as to the specific accounting issue. The report concluded that there was no wrongdoing, and went on to affirm that "the Company's internal controls and reporting structure appear well-designed to discover these types of accounting fraud should they have occurred".

426 Considering all of the relevant circumstances in connection with the respondents Utay and Fuchs, I conclude that on the evidence that has been put forward in the motion for leave, there is no reasonable possibility of success against these individuals at trial.

(c) The Expert Reliance Defence

427 Section 138.4(11) provides for the expert reliance defence as follows:

> A person or company, other than an expert, is not liable in an action under section 138.3 with respect to any part of a document ..... that *includes, summarizes or quotes from a report, statement or opinion made by the expert* in respect of which the responsible issuer obtained the written consent of the expert to the use of the report, statement or opinion, if the consent had not been withdrawn in writing before the document was released ..., if the person or company proves that,
>
> (a) the person or company did not know and had no reasonable grounds to believe that there had been *a misrepresentation in the part of the document ... made on the authority of the expert*; and
> (b) the part of the document .... fairly represented the report, statement or opinion made by the expert. [Emphasis added.]

428 The respondents submit that the Representation pleaded in the Claim (that IMAX's 2005 revenue was reported in accordance with GAAP, and met or exceeded the earnings guidance) as it appears in the 2005 Form 10-K and March press releases can only have been inferred or repeated from the audited 2005 financial statements "prepared for the Company by PwC", and that accordingly the expert reliance defence would apply.

429 The respondents refer to the decisions in *Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493 (where the court endorsed a director's reliance on legal advice that may in fact turn out to be incorrect, provided that the advice was not given for an "illegal de-

sign"), and in *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755 at p. 775, where the court applied the "business judgment rule" and upheld a business decision made "in reasonable and informed reliance on the advice of financial and legal advisors appropriately retained and consulted in the circumstances". These cases stand for the proposition that reasonable reliance on legal or other professional advice will assist a director in establishing that he has met his statutory and fiduciary duties to the corporation.

430 However, the expert reliance defence under s. 138.4, like the "reasonable investigation" defence, is drafted in specific terms. It is not a general defence that is available whenever a misrepresentation is made by a person who has reasonably relied on expert advice, but is of much narrower application. In this regard, the cases cited by the respondents are not helpful in defining the particular defence.

431 By its terms, the expert reliance defence applies to any part of a document that "includes, summarizes or quotes from a report, statement or opinion made by the expert". Arguably, it is not available as the respondents suggest, as a general defence to representations of a reporting issuer that were "inferred or repeated from" a report of an expert.

432 The respondents are also incorrect in stating that the financial statements were prepared by PwC; they were prepared by IMAX management and then audited by PwC. While the Form 10-K attaches the report of IMAX's auditors, this is the only part of the 2005 10-K that appears to "include, summarize or quote from" an expert. The expert reliance defence would not appear to extend to the representations in IMAX's Form 10-K as to its revenues and compliance with GAAP.

433 Similarly, the expert reliance defence would not appear to apply to the press releases which did not "include, summarize or quote from" an opinion of PwC.

434 The wording of this section suggests that it is intended to apply where the misrepresentation at issue originates with the expert, in circumstances where it has been communicated to the secondary market by the person or company on the authority of the expert.

435 The expert reliance defence would not appear to apply to the alleged misrepresentations in this case, which originated with the Company. The question of reliance on PwC is more appropriately considered as part of the reasonable investigation defence, as noted above.

436 If I am wrong in this conclusion (and here it should be recalled that for the purposes of this motion, I am not deciding the case on its merits), and the expert reliance defence would be available as a defence to the misrepresentations in this case, it would only apply where a defendant establishes that he or she did not know and had no reasonable grounds to believe that there had been a misrepresentation. This would raise the same considerations as are applicable to the reasonable investigation defence; that is, as to the investigation carried out by or on the direction of each respondent, and his or her knowledge of the circumstances.

437 My analysis and conclusions when considering the expert reliance defence would accordingly be the same with respect to each of the respondents, as above with respect to the "reasonable investigation" defence. The evidence in this preliminary assessment of the merits would not foreclose the plaintiffs from a reasonable possibility of success at trial in their claim for secondary market misrepresentation against each of the respondents, except for Mr. Fuchs and Mr. Utay.

(d) Loss Causation

438 Section 138.5(1) of the OSA provides the method for assessing damages in favour of a person who acquired an issuer's securities after the release of a document containing a misrepresentation. Section 138.5(3) provides that "assessed damages shall not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the misrepresentation".

439 While the parties have put forward contradictory expert evidence on the "loss causation" issue, the respondents did not seriously contend that this is an issue on which the plaintiffs would fail to meet the leave threshold. The onus on this issue, under s. 138.5(3), is on the defendants to establish the extent to which any loss was due to a change in the market price of securities that was unrelated to the misrepresentation (including for example the respondents' assertion that the IMAX share price fell as a result of the announcement of its failed merger efforts, and not as a result of the revelation of a misrepresentation.)

440 The plaintiffs' expert Lawrence Kryzanowski offered the opinion that the decline in the price of IMAX's securities following the August 9, 2006 announcement was at least in part attributable to the disclosures concerning IMAX's accounting, and that the announcement that IMAX had not to date been successful in completing an acquisition or merger accounted for, at most, approximately 25% of the shareholder value lost following the August 9th press release,[146]

441 The plaintiffs' second expert, Robert Comment, observed that it was plausible that the reason that no acquirer was willing to pay the premium to market price sought by the Boad was that, in the course of their due diligence, potential acquirers examined the correspondence from the SEC, reviewed IMAX's application of MEA accounting, decided that IMAX had or may have overstated its earnings and revenue under GAAP, and concluded that IMAX may have exposed itself thereby to regulatory action.[147] He also noted that it was plausible that 100% of the stock-price drop immediately following the press release of August 9th was due to information corrective of the alleged fraud, in which case Professor Kryzanowki's assumption that only 75% was corrective of the alleged fraud would be conservative in the sense of being a pro-defendant assumption.[148]

442 The opinion of the respondents' expert, Denise Neumann Martin, is that there is no basis to conclude that any of the August 10th stock price reaction was attributable to a disclosure of the alleged misrepresentation. She concluded that a substantial majority of the price drop the drop in IMAX's securities resulted from the announcement that the Company had failed to find a merger partner.[149]

443 The onus on the issue of loss causation, under OSA s. 138.5(3), is on a defendant to establish the extent to which any loss was due to a change in the market price of securities that was unrelated to the misrepresentation. The evidence of the respondents (including the cross-examinations of the plaintiffs' experts) did not eliminate the force and effect of the plaintiffs' expert opinions, and accordingly the plaintiffs' reasonable possibility of success at trial on this issue.

IV. Conclusion

444 For the foregoing reasons I have concluded that the plaintiffs have met the test for leave under s. 138.8 of the OSA to pursue a statutory claim for misrepresentation in the secondary market against the defendants and the proposed defendants Braun, Copland, Girvan, Leebron and Gamble. An order will go granting leave to plead the causes of action contained in Part XXIII.1 of the OSA as against such persons, and permitting such proposed defendants to be added as defendants in the

existing action. The motion for leave with respect to the proposed defendants Utay and Fuchs is dismissed.

445 If the parties are unable to agree on costs of this motion, costs may be addressed in the attendance to be arranged through the court office that will be required to settle the terms of the certification order, as well as any directions necessary to implement the orders in these motions.

K.M. van RENSBURG J.

cp/e/ln/qlrxg/qlced/qlcas/qlisl/qlhcs

1 System for Electronic Document Analysis and Retrieval (SEDAR) is a filing system developed for the Canadian Securities Administrators.

2 IMAX adopted U.S. GAAP; all references in these reasons to GAAP relate to U.S. GAAP.

3 These are the estimated losses of the proposed representative plaintiffs, according to the opinion of the plaintiffs' expert: Affidavit of Lawrence Kryzanowski sworn May 30, 2007 ("Kryzanowski Affidavit"), Moving Parties' Supplementary Motion Record, Tab 2. The plaintiffs depose in their own affidavits that their losses are $2,026 (Silver) and $7,500 (Cohen), based on the difference between the purchase price of their IMAX shares and, in the case of Silver, their sale price, and in the case of Cohen, the value at the date he swore his affidavit in February 2007: Affidavit of Marvin Neil Silver sworn February 26, 2007 ("Silver Affidavit") and Affidavit of Cliff Cohen sworn February 21, 2007 ("Cohen Affidavit"), Moving Parties' Motion Record Tabs 3 and 4.

4 While all of the other provincial and territorial jurisdictions in Canada have now incorporated the statutory cause of action into their securities legislation, Ontario was the only province to have such provisions in force when these proceedings were commenced.

5 IMAX Corporation Form 10-K for the fiscal year ending December 31, 2005, Affidavit of Kenneth Copland sworn September 8, 2007 ("Copland Affidavit"), Exh. "I", Motion Record of the Responding Parties, Vol. V. ("IMAX 2005 10-K").

6 Annual Report pursuant to Section 13 or 15(d) of the *Securities Exchange Act of 1934*, 15 U.S.C. 78(a) filed with the United States Securities and Exchange Commission ("SEC").

7 Report of Rosen & Associates Limited, Exhibit A to the Affidavit of Lawrence Rosen sworn February 23, 2007 ("First Rosen Report"), p. 12, and Report of Rosen & Associates Limited, Exhibit A to the Affidavit of Lawrence Rosen sworn August 2, 2007 ("Second Rosen Report"), p. 17, in each case quoting CICA Handbook, *Revenue,* Section 3400 s. 20, Oct. 1986.

8 First Rosen Report, pp. 13-15; Second Rosen Report, pp. 17-20.

9 SEC Staff Accounting Bulletin No. 101, 17 CFR Part 211 ("SAB 101"), Copland Affidavit para. 40 and Exh. "L".

10 SAB 101, citing *Fraudulent Financial Reporting: 1987-1997 An Analysis of U.S. Public Companies*, sponsored by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

11 SEC Staff Accounting Bulletin No. 104, 17 CFR Part 211 ("SAB 104"), Copland Affidavit para. 48 and Exh. "M".

12 EITF 00-21, Copland Affidavit paras. 35, 36 and 40 and Exh. "Q".

13 The Financial Accounting Standards Board (FASB) establishes standards of financial accounting for the private sector that are recognized as authoritative by the SEC and the American Instituted of Certified Public Accountants.

14 First Rosen Report, p. 16; Second Rosen Report, p. 21.

15 Moving Parties' Fourth Supplementary Motion Record Vol. 6, p. 1812.

16 Moving Parties' Fourth Supplementary Motion Record Vol. 2, p. 635.

17 Moving Parties' fourth Supplementary Motion Record, Vol. 2, Tab 70, p. 52.

18 Copland Affidavit, para. 46.

19 Moving Parties' Fourth Supplementary Motion Record, Vol. 6, pp. 1833-1840.

20 IMAX 2004 10-K, Copland Affidavit, Exh. "H".

21 Copland Affidavit, paras. 51 and 52.

22 Cross-examination of Kathryn Gamble ("Gamble Cross-examination"), Q. 1152; Cross-examination of Francis Joyce ("Joyce Cross-examination"), pp. 145 and 255.

23 Copland Affidavit, Exh. "R".

24 Letter from the SEC to IMAX Corporation dated September 20, 2006, Moving Parties' Fourth Supplementary Motion Record, Vol. 1, Tab 19-I-B.

25 *Sarbanes-Oxley Act of 2002,* Pub. L. 107-204, [116 Stat. 745] ("Sarbanes-Oxley" or "SOX") is legislation introduced in July 2002 to provide for enhancements to corporate governance and disclosure obligations of publicly traded companies in the United States.

26 Moving Parties' Fourth Supplementary Motion Record, Vol. 2, Tab 55, p. 637D.

27 Vance Report to the Audit Committee, Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 145, p. 1476.

28 Moving Parties' Fourth Supplementary Motion Record, Vol. 2, Tab 55A.

29 R. 39.03 Examination of Lisa Coulman ("Coulman Examination"), pp. 34, 44, 48.

30 Coulman Examination, pp. 46-47.

31 Cross-examination of Richard Gelfond ("Gelfond Cross-examination"), pp. 45 and 46.

32 Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 76B.

33 Kathryn Gamble was included in the emails beginning in December 2005.

34 Amending Agreement No. 1 between IMAX Corporation and Lark International Multimedia Limited dated December 31, 2005, Plaintiffs' Fourth Supplementary Motion Record, Vol. 3, Tab 75-4-B, pp. 972-973; Amending Agreement No. 2 between IMAX Corporation and Suvar-Kazan Company Ltd. dated October 12, 2005, Moving Parties' Fourth Supplementary Motion Record, Vol. 3, Tab 75-5-B, pp. 1021-1022; Amending Agreement No. 4 between IMAX Corporation and Suvar-Kazan Company Ltd. dated December 31, 2005, Moving Parties' Fourth Supplementary Motion Record, Vol. 3, Tab 75-5-C, p. 1024; Amending Agreement No. 2 between IMAX Corporation and Evergreen Vintage Aircraft Inc., dated December 31, 2005, Moving Parties' Fourth Supplementary Motion Record, Vol. 3, Tab 75-8-C, pp. 1178-1179 and Amending Agreement No. 2 between IMAX Corporation and Jafif Penhos Elias dated November 29, 2005, Moving Parties' Fourth Supplementary Motion Record, Vol. 3, Tab 75-9-C, pp. 1237-1238.

35 Mr. Joyce suggested that these arrangements were not intended to ensure completion of theatre system installations in the fourth quarter (Joyce Cross-examination, pp. 266-268); Mr. Gelfond suggested that the incentives encouraged theatre owners to complete construction and open their theatres, with the result that the IMAX brand would be promoted, and to advance the date when film revenue would be received (Gelfond Cross-examination, pp. 91-92 and 306-308) In fact, the deferral of payments resulted in reduced cash flow to IMAX, and film royalties were not payable until training had been completed and the theatre was open to the public. The incentives did not appear to accelerate the opening of the theatres to the public (several of the theatres did not open until well into 2006 and even 2007). In his report on the Delhi Post, Mr. Lister had referred to the payments as "financial incentives for clients to install systems by dates prior to year-end".

36 Moving Parties' Fourth Supplementary Motion Record, Vol. 6, Tab 214.

37 Copland Affidavit, para. 67 (and as stated in the IMAX 2005 Form 10-K).

38 Moving Parties' Fourth Supplementary Motion Record, Vol. 2, Tab 27, pp. 481-493.

39 Coulman Examination, p. 195.

40 Copland Affidavit, paras. 80 and 81.

41 Joyce Cross-examination, p. 393.

42 Gamble Cross-examination, Q. 163 and 164.

43 Gamble Cross-examination, Q. 159.

44 In a memo to Mr. Joyce dated December 1, 2005 entitled "Revenue Recognition Policy Compliance", Ms Gamble noted that Company policy required the commissioner, the project manager and the Director to sign off on a theatre system installation close-out report where the technology department concluded that the installation of the theatre system was substantially complete, meeting full working standards according to the terms of Schedule A of the Agreement. She also noted however, "in the past, outstanding items such as the glass cleaning machine or the use of a white sheet were evaluated and deemed inconsequential to the overall installation" (Moving Parties' Fourth Supplementary Motion Record, Vol. 6, Tab 151).

45 In a memo dated January 16, 2006, Ms Gamble outlined the steps management considered in Q3 2005 in recognizing revenue on the New Delhi, India installation. She noted that the entire purchase price had been received, and that the theatre system installation report, signed by the commissioner, the project manager and the project director had been reviewed and indicated the installation was substantially complete. She also noted with respect to the two items outstanding that were IMAX's responsibility, the silver screen and glasses cleaning machine, "Management deemed the above two outstanding items as inconsequential since completing these obligations were immaterial from an overall cost perspective and perfunctory in terms of performance." There had been no client concerns expressed and the client had signed a certificate of acceptance (Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 119).

46 Joyce Cross-examination, p. 432.

47 Gamble Cross-examination, Q. 1273.

48 Moving Parties' Fourth Supplementary Motion Record, Vol. 6, Tab 214.

49 Gamble Cross-examination, Q. 212 and 534.

50 Gelfond Cross-examination, pp. 45 and 46.

51 Coulman Examination, Qs. 271-272.

52 Coulman Examination, Q. 325.

53 Answers to Undertakings, Qs. 152 and 153, Moving Parties' Fourth Supplementary Motion Record, Vol. 1, Tab 1-A.

54 Copland Cross-examination, p. 190.

55 Copland Affidavit, Exh. "R", pp. 1855-1866.

56 Copland Affidavit, Exh. "R", pp. 1867-1883.

57 Copland Affidavit, Exh. "S".

58 Cross-examination of Neil Braun ("Braun Cross-examination"), pp. 97-98.

59 Braun Cross-examination, pp. 110-111.

60 Braun Cross-examination, p. 56.

61 Cross-examination of David Leebron, pp. 63-66.

62 Cross-examination of Kenneth Copland ("Copland Cross-examination"), p. 56.

63 Cross-examination of Garth Girvan ("Girvan Cross-examination"), pp. 95-96.

64 Girvan Cross-examination, p. 76.

65 Cross-Examination of Bradley Wechsler ("Wechsler Cross-examination"), p. 129; Minutes of March 8, 2006 Board Meeting, Moving Parties' Fourth Supplementary Motion Record, Vol. I, Tab 7.

66 Gelfond Cross-Examination, pp. 120-122.

67 IMAX 2005 10-K, p. 100.

68 IMAX 2005 10-K, p. 55.

69 Emails of December 19, 2005; Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 76-B; IMAX Theatre Installation Close-Out dated October 19, 2006, Moving Parties' Fourth Supplementary Motion Record, Vol. 5, Tab 147-5-H.; Answer to Undertaking #219, Moving Parties' Fourth Supplementary Motion Record, Vol. 1, Tab 1-B.

70 Emails December 2005; Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 76-B.

71 Emails of December 6, 2005; Moving Parties' Fourth Supplementary Motion Record, Vol. 4, Tab 76-B.

72 Coulman Cross-examination, pp. 87-93.

73 Coulman Cross-examination, p. 138.

74 Gelfond Cross-examination, pp. 122-123.

75 Gelfond Cross-examination, p. 126.

76 Gelfond Cross-examination, pp. 124-126.

77 Answer to Undertaking #84, Moving Parties' Fourth Supplementary Motion Record, Vol. 1, Tab I-A.

78 Wechsler Cross-examination, pp. 150-157.

79 Wechsler Cross-examination, pp. 151-152.

80 Coulman Cross-examination, pp. 108-110.

81 Wechsler Cross-examination, pp. 152-154.

82 Moving Parties' Fourth Supplementary Motion Record, Tab 19-I-A.

83 Gelfond Cross-examination, p. 156

84 Wechsler Cross-examination, p. 155.

85 IMAX Press Release dated August 9, 2006, First Robb Affidavit, Exh. "M".

86 Copland Affidavit, Exhs. "U" and "V".

87 Affidavit of Scott Selig sworn August 2, 2007 ("Selig Affidavit"), Moving Parties' Second Supplementary Motion Record (#1), Tab 1, Exh. "K".

88 Copland Affidavit, para. 87.

89 IMAX 2006 10-K, Report of Independent Registered Public Accounting Firm, p. 70.

90 P. Anisman, J. Howard, W. Grover and J.P. Williamson, *Federal Proposals for a Securities Market Law of Canada,* 1979.

91 *Civil Liability for Continuous Disclosure Documents Filed under the Securities Act -- Request for Comments,* 7 OSCB 4910.

92 Letter from the President and CEO of the TSE in the Toronto Stock Exchange, Committee on Corporate Disclosure, *Final Report: Responsible Corporate Disclosure: A Search for Balance* (1997) ("Allen Report").

93 Canadian Securities Administrators Notice 53-302 Report of the Canadian Securities Administrators, *Proposal for a Statutory Civil Remedy for investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change"* (2000), 23 OSCB 1, at pp. 1-2.

94 Toronto Stock Exchange Committee on Corporate Disclosure, *Toward Improved Disclosure: A Search for Balance in Corporate Disclosure* (1995) ("Allen Interim Report").

95 *Supra,* note 92.

96 *Supra* note 93.

97 *Supra* note 93, Executive Summary.

98 *Supra* note 93 (2000), 23 OSCB 6.

99 See "Some Comparisons Between Class Actions in Canada and the U.S.: Securities Class Actions, Certification and Costs", Philip Anisman and Gary Watson, *The Canadian Class Action Review*, Vol. 3, No. 2, July 2006, 467-526, at p. 521: "An action brought in the United States Federal Court based on Rule 10b-5 under the *Securities Exchange Act of 1934* requires a plaintiff to allege that the misrepresentation was fraudulent and to satisfy the pleading standards of the PLSRA [*Private Securities Litigation Reform Act of 1995*]. The plaintiff's claim must identify each alleged misleading statement, the reasons why it was misleading and all facts informing an allegation made on information and belief and must state with particularity facts giving rise to a "strong inference" that each defendant acted with *scienter,* that is, fraudulently".

100 (2000), 23 OSCB 8.

101 (2000), 23 OSCB 9.

102 Allen Interim Report, para. 6.61.

103 (2000), 23 OSCB 1.

104 *Ontario Securities Commission Rule 52-801 -- Implementing National Instrument 51-102 Continuous Disclosure Obligations*, O.S.C. Rule 51-801, (April 2, 2004); *Companion Policy 51-801 CP -- To Ontario Securities Commission Rule 51-801 Implementing National Instrument 51-102 Continuous Disclosure Obligations*, O.S.C. 51-801CP, (2004), 27 OSCB 3476, at s. 1.2, *Securities Act* R.R.O. 1990, Reg. 1015, s. 3.

105 National Instrument 51-102 Continuous Disclosure Obligations, O.S.C. NI 51-102 (2004), 27 OSCB 3441, s. 1.1.

106 Silver Affidavit and Cohen Affidavit.

107 Affidavit of Michael Robb sworn February 22, 2007 ("First Robb Affidavit"), Moving Parties' First Motion Record, Tab 2; Affidavit of Scott Selig sworn August 2, 2007 ("Selig Affidavit"), Moving Parties' Second Supplementary Motion Record (#1), Tab 1; Affidavit of Michael Robb sworn January 25, 2008 ("Second Robb Affidavit"), Moving Parties' Second Supplementary Motion (#2), Tab 1; Affidavit of Michael Robb sworn February 12, 2008 ("Third Robb Affidavit"), Moving Parties' Third Supplementary Motion Record, Tab 1.

108 First Rosen Report.

109 Second Rosen Report.

110 Kryzanowski Affidavit, Moving Parties' Supplementary Motion Record, Tab 2.

111 Affidavit of Robert Comment sworn September 18, 2007 ("Comment Affidavit"), Moving Parties' Reply Motion Record, Tab 1.

112 The affidavits of the respondents other than Kenneth G. Copland are variously sworn September 10, 11 and 12, 2007 and are contained in the Motion Record of the Responding Parties, Vol. I, Tabs 1 to 9.

113 Copland Affidavit, Motion Record of the Responding Parties, Vol. III to VIII.

114 Affidavit of Denise Neumann Martin sworn September 7, 2007 ("Neumann Martin Affidavit"), Motion Record of the Responding Parties, Vol. I, Tab 10.

115 Affidavit of Margarette Livie sworn September 11, 2007, Motion Record of the Responding Parties, Vol. II.

116 Lax J. observed in *Ainslie v. CV Technologies Inc.* (2008), 93 O.R. (3d) 200 (leave to appeal to the Divisional Court granted on other grounds [2009] O.J. No. 730) that such examinations may not be compelled in proceedings under s. 138.8.

117 In that case the court referred to three Ontario committee reports, including the Allen Committee Report of 1997 to assist in the interpretation of the OSA provisions respecting prospectus disclosure, and in particular the distinction between material facts and material changes.

118 *Canada Business Corporations Act,* R.S.C. 1985, c. C-44, s. 239; *Business Corporations Act*, R.S.O. 1990, c. B. 16, s. 246(2).

119 Ontario Law Reform Commission, Report on Class Actions (1982) ("OLRC Report"), Vol. III, p. 862.

120 OLRC Report, pp. 312-313.

121 OLRC Report, p. 425; Respondents' Leave Factum, para. 181.

122 OLRC Report, p. 324.

123 Concise Oxford English Dictionary, 11th ed.

124 Black's Law Dictionary, 6th ed. (St. Paul: West, 1990).

125 See *Chan v. Canada,* [1995] 3 S.C.R. 593, where, in the context of a refugee claim and the determination of the objective test of whether the claimant would face persecution, the Supreme Court equated the phrase "reasonable possibility" with "serious possibility", and certainly more than a "mere possibility".

126 *R. v. Lifchus*, [1997] 3 S.C.R. 320.

127 In this case the parties agreed to a Rule 39.03 examination of a non-party, however there is no right to such an examination (*Ainslie v. CV Technologies, Inc., supra* note 115).

128 See OSA, s. 138.7.

129 See also Winkler J.'s decision in *Carom* at pp. 787-790 for a description of the development of and specific requirements of U.S. 10b-5 actions.

130 S. 122(1) of the CBCA provides: Every director and officer of a corporation in exercising their powers and discharging their duties shall (a) act honestly and in good faith with a view to the best interests of the corporation; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

131 Binnie J. cited *Re Anderson, Clayton Shareholders' Litigation*, 519 A. 2d 669 (Del. Ch. 1986).

132 See note 130.

133 S. 134(1) of the OBCA provides: Every director and officer of a corporation in exercising his or her powers and discharging his or her duties to the corporation shall, (a) act honestly and in good faith with a view to the best interests of the corporation; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

134 Jeremy D. Fraiberg and Robert Yalden, "*Kerr v. Danier Leather Inc.*: Disclosure, Defence and the Duty to Update Forward-Looking Information" (2006), 43 Can. Bus. L.J. 106 at 128.

135 Fraiberg and Yalden, at 129.

136 Ss. 906 and 302 of the *Sarbanes-Oxley Act of 2002*.

137 Joyce Cross-examination, p. 30.

138 OSA, s. 138.7.

139 *Income Tax Act*, s. 227.1(3) provides "[a] director is not liable ... where he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."

140 See note 104.

141 Multilateral Instrument 52-110 *Audit Committees* (2004), 27 OSCB 3252, Joint Book of Exhibits, Vol 1, Tab 1 ("Multilateral Instrument 52-110").

142 Financial literacy is defined as having "the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements", however "it is not necessary for a member to have a comprehensive knowledge of GAAP and GAAS to be considered financially literate." *Ibid.* (2004), 27 OSCB 3266.

143 Multilateral Instrument 52-110, ss. 2.1 and 2.2.

144 Answers to Undertakings, Q. 101, Moving Parties' Fourth Supplementary Motion Record, Tab 1-A.

145 Moving Parties' Fourth Supplementary Motion Record, Tab 23A-K.

146 Kryzanowski Affidavit, para. 37.

147 Comment Affidavit, paras. 22-25.

148 Comment Affidavit, para. 20.

149 Neumann Martin Affidavit, para. 24.

TAB 8

Case Name:

McKenna v. Gammon Gold Inc.

Between
Ed J. McKenna, Plaintiff, and
Gammon Gold Inc., Russell Barwick, Colin P. Sutherland, Dale M. Hendrick, Fred George, Frank Conte, Kent Noseworthy, Canek Rangel, Bradley Langille, Alejandro Caraveo, BMO Nesbitt Burns Inc., Scotia Capital Inc. and TD Securities Inc., Defendants
Proceeding under the Class Proceedings Act, 1992

[2010] O.J. No. 1057

2010 ONSC 1591

Court File No. 08-0036143600CP

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: December 14-16, 2009.
Judgment: March 16, 2010.

(187 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Common interests and issues -- Definition of class -- Sub-class -- Members of class or sub-class -- Representative plaintiff -- Motion by plaintiff to certify class action allowed in part -- Plaintiff claimed defendants made misrepresentations in connection with sale of securities, which caused decline in share price when true state of affairs disclosed -- Action certified with respect to two claims and certification of third claim adjourned -- Pleading disclosed causes of actions for misrepresentation in prospectus, unjust enrichment, conspiracy and other claims -- Clear connection to Ontario -- Class action preferable procedure -- Proposed plaintiff could fairly and adequately represent class, but there should be sub-class of those who had sold securities and representative for non-resident class members.

Motion by the plaintiff to certify a class action. The plaintiff purchased shares in the defendant, Gammon Gold Inc. ("Gammon"), a gold and silver producer. Under a short-form prospected dated April 2007, Gammon made a public offering of 10 million common shares at a price of $20 per

share. The plaintiff purchased 1000 shares of Gammon in the public offering. The plaintiff claimed that the defendants made misrepresentations, in public filings and other forms, the effect of which was to overestimate the actual and anticipated production rate at Gammon's Mexican mines and to misrepresent the real state of Gammon's business, which resulted in the inflation of the value of the shares. The plaintiff further claimed that when the true state of affairs was disclosed, in August 2007, the share price declined and he and other investors lost money. Although the plaintiff did not purchase shares on the secondary market, he claimed that certain continuous disclosure documents issued by Gammon between April 2006 and October 2007, and oral statements made by some of Gammon's officers and directors also claimed misrepresentations and, accordingly, he sought to represent all shareholders who acquired Gammon securities, whether under the prospectus or in the secondary market, at any time between April 2006 and August 2007. The plaintiff asserted claims for prospectus misrepresentation, negligent misrepresentation, negligence, reckless misrepresentation, conspiracy unjust enrichment and waiver of tort.

HELD: Motion allowed in part. Action certified with respect to Securities Act claim and unjust enrichment claim, and certification of conspiracy claim was adjourned. The pleading disclosed causes of actions for misrepresentation in the prospectus, negligent misrepresentation, conspiracy, unjust enrichment and waiver of tort. There was clearly a connection between Ontario and the plaintiff's claim as the plaintiff was a resident of Ontario and acquired his shares in Ontario and it was a reasonable assumption that a number of other share purchases were also residents of Ontario. There was on unfairness in subjecting the defendants to Ontario jurisdiction, but it would be unfair to require the plaintiff to pursue his claim elsewhere. Furthermore, it was appropriate to certify a class that included non-residents residents who engaged in a cross-border transaction because in acquiring securities of a Canadian company, they could reasonably expect that their legal rights in relation to that acquisition would be subject to Canadian jurisdiction, however it was not appropriate to include non-residents who purchased securities outside Canada. In addition, it was not appropriate to certify the secondary market claim. A class action was the preferable procedure as it would promote the goals of access to justice, judicial economy and behaviour modification. The proposed plaintiff could fairly and adequately represent the class, had no conflict with the class and was represented by experienced counsel who produced a workable litigation plan, however, there should be a subclass of those who had sold their securities as well as a representative on behalf of non-resident class members.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 5, s. 5(1), s. 8

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 17.02, Rule 17.02(a), Rule 17.02(f), Rule 17.02(g), Rule 17.02(h), Rule 17.02(o), Rule 17.02(p), Rule 21.01(1)(b), Rule 25.06(8)

Securities Act, S.O. 1990, c. S. 5, s. 130, s. 130(1), s. 130(1)(c), s. 130(7), s. 131, s. 131.1(1), s. 138(b)(i), s. 138.3, s. 138.3(1), s. 138.8, s. 138.8(1), s. 138.13

Securities Exchange Act of 1934,

Counsel:

A. Dimitri Lascaris, Michael J. Peerless and Monique Radlein, for the plaintiff.

Ronald Slaght Q.C. and Nadia Campion, for the defendants BMO Nesbitt Burns Inc., Scotia Capital Inc., and TD Securities Inc.

Paul J. Martin and Laura F. Cooper, for the defendants Gammon Gold Inc., et al.

DECISION ON CERTIFICATION

1 G.R. STRATHY J.:-- This is a motion by the plaintiff, Ed McKenna, to certify a proposed class action pursuant to s. 5(1) of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the "*C.P.A.*"). He claims that the defendants made misrepresentations in connection with the sale of the securities of Gammon Lake Resources Inc., now known as Gammon Gold Inc. ("Gammon"). He seeks to represent all persons (the "Class" or "Class Members") who acquired Gammon's shares between October 10, 2006 and August 10, 2007 (the "Class Period").

2 Gammon is a gold and silver producer. It is a reporting issuer under the *Securities Act,* S.O. 1990, c. S. 5 (the *"Securities Act"*). During the Class Period, Gammon's common shares were traded on the Toronto Stock Exchange (the "TSX"), the AMEX Stock Exchange in the United States (the "AMEX"), and elsewhere.

3 Under a short-form prospectus dated April 19, 2007 (the "Prospectus") Gammon made a public offering of 10 million common shares at a price of $20 per share, for gross proceeds of $200 million. Mr. McKenna purchased 1,000 shares of Gammon in the public offering.

4 Mr. McKenna claims that the value of Gammon's shares was inflated by the defendants' misrepresentations and that when the true state of affairs was disclosed, in early August 2007, the share price declined and he and other investors lost money. While Mr. McKenna did not buy Gammon shares in the secondary market, that is, through the stock exchange, he seeks to represent all shareholders who acquired Gammon securities, whether under the Prospectus or in the secondary market, at any time during the Class Period.

I. Background

5 Gammon is incorporated in Quebec. Its registered office is in Montreal and its head office is in Halifax. Its mining operations are based in Mexico, where it has three operating mines, including its flagship mining property, the Ocampo Project in Chihuahua State ("Ocampo").

6 The individual defendants were senior officers and/or directors of Gammon during some or all of the Class Period. Gammon and these individual defendants will be referred to as the "Gammon Defendants." The remaining defendants, BMO Nesbitt Burns Inc., Scotia Capital Inc. and TD Securities Inc. (the "Underwriters") were members of the syndicate that underwrote the securities offered under the Prospectus. BMO Nesbitt Burns Inc. was the lead underwriter.

7 As a reporting issuer under the *Securities Act,* Gammon was subject to various public disclosure obligations, including the obligation to file reports of any material changes in its financial position with the Ontario Securities Commission, as well as interim and annual consolidated financial statements. It also had an obligation to ensure that the Prospectus provided full and accurate disclosure of all material facts relating to the securities proposed to be issued.

8 The commencement of the Class Period on October 10, 2006 is marked by the date of a press release issued by Gammon in which it was stated, among other things, that Gammon was on track to attain annual production of 400,000 gold equivalent ounces ("GEO") by the end of the 2006 calendar year. The plaintiff claims that this announcement caused the price of Gammon's stock to rise from $11.88 on October 6, 2006 to $12.50 on October 10, 2006, on high trading volumes. Gammon's stock price continued to climb for the balance of October and closed at $14.75 on October 31, 2006, an increase of 18% over the closing price on the last trading day before the commencement of the Class Period.

9 Mr. McKenna claims that the press release contained a misrepresentation, as Gammon was not in fact on track to achieve the stated production rate. He claims that the defendants made additional misrepresentations during the Class Period, in public filings and in other forms, the effect of which was to overestimate the actual and anticipated production rate at Gammon's Mexican mines and to misrepresent the real state of Gammon's business.

10 Mr. McKenna alleges that in the Prospectus, and in Gammon's regulatory disclosure documents during the Class Period, the defendants made the following misrepresentations, among others:

(a) they materially overstated Gammon's GEO production rate at Ocampo and another gold and silver mine;
(b) they falsely stated that Gammon maintained adequate internal disclosure controls and procedures to ensure, among other things, that management did not make unreasonable projections;
(c) they materially understated Gammon's stock option expense for the fiscal years that ended on July 31st in 2004 and 2005, the five month period that ended December 31, 2005, and the fiscal year that ended on December 31, 2006;
(d) they falsely stated that Gammon's financial reports had been prepared in accordance with generally accepted accounting principles;
(e) they unreasonably projected that Gammon would produce 400,000 GEO in 2007, and 480,000 GEO in 2008;
(f) they failed to disclose that a company from which Gammon procured its Mexican labour force was controlled by the brother of Gammon's President and Chairman of the Board, and that Gammon was being overcharged for labour;
(g) they failed to disclose, on a timely basis, that Gammon was experiencing severe equipment failures and other technical difficulties at Ocampo in the first and second quarters of 2007; and
(h) they failed to disclose that Gammon's reported production figures were improperly calculated.

11 The end of the Class Period, August 9, 2007, is the date on which Gammon made certain regulatory filings for the second quarter of 2007. Mr. McKenna alleges that, on that day, and during a conference call with analysts on the following day, Gammon and its officers disclosed for the first time that Gammon was unlikely to meet its 2007 production projection of 400,000 GEO. This disclosure allegedly corrected the misrepresentations that had been made during the Class Period, in the Prospectus, regulatory filings and public statements.

12 The corrective information that was allegedly revealed for the first time on August 9 and 10, 2007 included the following:

(a) Gammon had experienced severe equipment failures at Ocampo in the first and second quarters of 2007;
(b) Gammon's GEO production had fallen by 16% from the first quarter to the second quarter of 2007, making it highly unlikely that Gammon's previous production estimates would be met; and
(c) Gammon had been including zinc precipitate in its GEO production totals, thus causing those production totals to be materially overstated.

13 The plaintiff claims that Gammon's stock price fell as a result of these disclosures. Prior to the release of the information on August 9, 2007 Gammon's shares traded at $11.22 per share. Over the next five trading days, the shares fell to a low of $8.10 per share, a decrease of $3.12, or 28%. Moreover, the share price of $8.10 constituted roughly a 60% decline from the price at which Gammon had sold shares under the Prospectus less than four months earlier.

14 Mr. McKenna alleges that the defendants' misrepresentations caused the shares offered under the Prospectus to be offered at an inflated price, and claims that he, and the other Class Members who purchased Gammon shares under the Prospectus, relied upon those misrepresentations to their detriment.

15 He further alleges that certain continuous disclosure documents issued by Gammon during the Class Period, and oral statements made by some of Gammon's officers and directors also contained misrepresentations. Accordingly, he asserts claims against the Gammon Defendants not only on behalf of primary market purchasers, but also on behalf of persons who acquired Gammon securities in the secondary market, who allegedly relied to their detriment on the misrepresentations and purchased Gammon securities at inflated prices.

16 The Plaintiff asserts various causes of action. His claims against the Gammon Defendants overlap with, but are not the same as, the causes of action asserted against the Underwriters.

17 The Plaintiff asserts against the Gammon Defendants claims on behalf of both primary and secondary market purchasers. On behalf of primary market purchasers, the Plaintiff asserts claims for: (1) prospectus misrepresentation under s. 130 of the *Securities Act*; (2) negligent misrepresentation; (3) negligence; (4) reckless misrepresentation; and (5) conspiracy. On behalf of secondary market purchasers, the Plaintiff asserts all these causes of action against the Gammon Defendants, except for s. 130 of the *Securities Act*.

18 The Plaintiff asserts against the Underwriters claims only on behalf of primary market purchasers. The causes of action asserted are: (1) prospectus misrepresentation under s. 130 of the *Securities Act*; (2) negligence; (3) negligent misrepresentation; (4) unjust enrichment; and (5) waiver of tort.

II. The Issues

19 The primary issue in the motion before me is whether this action should be certified as a class action. The test is set out in s. 5 of the *C.P.A.* and I will discuss and apply it in the course of these reasons. The motion raises two overarching additional issues, which have been problematic in class actions, and which I will briefly explain in order to put the principal issues in context.

20 The first important issue is whether it is appropriate to certify this proceeding as a "global" class action on behalf of all purchasers of Gammon securities during the Class Period, wherever they may be situated. The purchasers of Gammon securities are widely dispersed around the world. The issue raises important questions concerning the court's jurisdiction and the recognition and enforceability of the court's judgment which would, of course, purport to bind all members of the Class who do not opt out. I will discuss this issue when I consider the Class definition under s. 5(1)(b) of the *C.P.A.*

21 The second important issue is whether a plaintiff claiming negligent misrepresentation must prove that he or she actually *relied* on the alleged misrepresentation and suffered damages as a result. This issue does not arise in connection with the plaintiff's claim for prospectus misrepresentation under s. 130(1) of the *Securities Act*, because that section provides a remedy "without regard to whether the purchaser relied on the misrepresentation." The statute makes it unnecessary for the purchaser under a prospectus to prove that he or she relied on the alleged misrepresentation. The issue is, however, important in the plaintiff's common law claim for negligent misrepresentation, which is advanced as an independent cause of action in relation to the Prospectus, and also in the secondary market claim. If the claim for misrepresentation requires proof of actual reliance, as the defendants assert, then it arguably gives rise to a need to examine whether each purchaser relied upon the alleged misrepresentations and, if so, which ones. The defendants say that these individual issues would make this proceeding unmanageable and unsuitable for certification as a class action. I will examine this question when I discuss the common issue that the plaintiff proposes in relation to the misrepresentation claim.

22 Against this background, I turn to the test for certification.

III. The Test for Certification

23 The requirements of certification of a class action are set out in s. 5 of the *C.P.A.*:

> 5.(1) The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,
>
> (a) the pleadings or the notice of application discloses a cause of action;
> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
> (c) the claims or defences of the class members raise common issues;
> (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
> (e) there is a representative plaintiff or defendant who,
>
> (i) would fairly and adequately represent the interests of the class,
> (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
> (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

24 There must be a cause of action, shared by an identifiable class, from which common issues arise, that can be resolved in a fair, efficient, and manageable way that will advance the proceeding

and achieve access to justice, judicial economy, and the modification of behaviour of wrongdoers: *Sauer v. Canada (Attorney General)*, [2008] O.J. No. 3419 (S.C.J.) at para. 14, leave to appeal to Div. Ct. refused, [2009] O.J. No. 402 (Div. Ct.). The motion is procedural not merits-based. The question is whether the claims can appropriately be prosecuted as a class proceeding: *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158 at paras. 16, 25, 28-29. The plaintiff must show "some basis in fact" for each of the certification requirements, other than the requirement that the pleading disclose a cause of action: *Hollick v. Toronto (City)*, above, at para. 25; *Taub v. Manufacturers Life Insurance Co.* (1998), 40 O.R. (3d) 379 (Gen. Div.), aff'd (1999), 42 O.R. (3d) 576 (Div. Ct.).

25 I will consider each of the s. 5 requirements in order.

(a) Causes of Action Asserted

26 The first criterion for certification is that the pleading must disclose a cause of action. The test in *Hunt v. Carey Canada*, [1990] 2 S.C.R. 959, 1990 CarswellBC 216, which applies to motions under Rule 21.01(1)(b) of the *Rules of Civil Procedure,* R.R.O. 1990, reg. 194, is applicable for this purpose as well. The pleading will be acceptable unless it contains a radical defect or it is "plain and obvious" that it could not succeed: *Anderson v. Wilson* (1999), 44 O.R. (3d) 673 (C.A.) at p. 679, leave to appeal to S.C.C. denied, [1999] S.C.C.A. No. 476; *1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd.* (2002), 62 O.R. (3d) 535 (S.C.J.) at para. 19, leave to appeal granted, 64 O.R. (3d) 42 (Div. Ct.), aff'd (2004), 70 O.R. (3d) 182 (Div. Ct.); *Healey v. Lakeridge Health Corp.*, [2006] O.J. No. 4277 (S.C.J.) at para. 25. No evidence is admissible on this aspect of the motion, and the material facts pleaded are accepted as true, unless patently ridiculous or incapable of proof.

27 The pleading must be read generously to allow for drafting inadequacies and the lack of information available to the plaintiff in the early stages of the action: *Hunt v. Carey Canada Inc.*, above, at 980; *Anderson v. Wilson*, above, at 679. It will be struck only if it is plain, obvious, and beyond reasonable doubt that the plaintiff cannot succeed: *Hollick v. Toronto (City)*, above, at para. 25; *Cloud v. Canada (Attorney General) v. Canada (Attorney General),* above, at para. 41; *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.) at p. 469. Matters of law not fully settled in the jurisprudence must be permitted to proceed: *Ford v. F. Hoffmann-LaRoche Ltd.* (2005), 74 O.R. (3d) 758 (S.C.J.) at para. 17(e).

28 The plaintiff asserts multiple causes of action in the Amended Amended Fresh as Amended Statement of Claim (the "Statement of Claim"). These include:

(i) a claim under s. 130 of the *Securities Act* against all defendants in relation to the Prospectus;
(ii) negligent misrepresentation against all defendants;
(iii) reckless misrepresentation against the Gammon Defendants;
(iv) negligence against all defendants;
(v) conspiracy against the Gammon Defendants; and
(vi) unjust enrichment and waiver of tort against the Underwriters.

29 I will now examine whether the pleading discloses each of these causes of action.

(i) Section 130 of the *Securities Act*

30 As noted earlier, s. 130 of the *Securities Act* provides a purchaser of a security under a prospectus with a remedy for misrepresentation, regardless of whether the purchaser relied on the misrepresentation. The remedy is available against the issuer and underwriters of the security as well as directors of the issuer and others who have signed the prospectus or have allowed their reports or statements to be used in the prospectus. The remedy is significant in the context of a class action, because it dispenses with the requirement that each class member prove that he or she relied on the misrepresentation, a requirement that frequently makes misrepresentation claims unsuitable for certification.

31 Section 130 provides:

> (1) Where a prospectus together with any amendment to the prospectus, contains a misrepresentation, a purchaser who purchases a security offered by the prospectus during the period of distribution has, *without regard to whether the purchaser relied on the misrepresentation*, a right of action for damages against,
>
> (a) the issuer or a selling security holder on whose behalf the distribution was made;
> (b) each underwriter of the securities who is required to sign the certificate required by section 59;
> (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed;
> (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and
> (e) every person or company who signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d),
>
> or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter, in which case the purchaser shall have not right of action for damages against such person, company or underwriter [emphasis added].

32 A "misrepresentation" is defined as an untrue statement of material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading. A "material fact" is a fact that would reasonably be expected to have a significant effect on the market price of the securities.

33 The defendants do not dispute that the plaintiff could have a valid cause of action under s. 130 of the *Securities Act.* They say, however, that the claim is time-barred by s. 138(b)(i), which provides that no such action shall be commenced more than "180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action." This assertion is based on a pleading that on May 10, 2007 Gammon issued and filed with the securities regulators a quarterly report that disclosed a first quarter loss of over US$10 million and other information that, collectively, was a partially corrective disclosure of the previous misrepresentations. This resulted in a significant negative

impact on Gammon's share price on May 11 and 14, 2007, the trading days following this disclosure.

34 The defendants say that a large proportion of Gammon shareholders would have acquired actual knowledge of these facts and that *all* of Gammon's shareholders ought reasonably to have known of the fact at that time. The Gammon Defendants therefore say that the limitation period began to run on May 14, 2007, and expired on November 10, 2007, approximately three months before the commencement of this action. They say that the statutory misrepresentation claim of every Class Member is barred by the expiry of the limitation period.

35 In addition, the Underwriters rely on statements made by Mr. McKenna on his cross-examination to the effect that he formed the belief in May or June of 2007 that Scotia Capital had failed to conduct adequate due diligence in connection with the public offering. They say that Mr. McKenna knew or ought to have known of the alleged misrepresentations as of that date and that his claim is time-barred for that reason as well. They also say that, for this reason, he is not a suitable representative plaintiff on behalf of Prospectus purchasers.

36 Prior to the hearing of the certification motion, counsel for the Underwriters sought leave to bring a motion for, among other things, summary judgment dismissing the plaintiff's s. 130 *Securities Act* claim on the ground that it was time-barred. I refused the request on several grounds. In particular, I was not satisfied that hearing the motion prior to certification would promote litigation efficiency: *McKenna v. Gammon Gold Inc.*, [2009] O.J. No. 5151.

37 There is no doubt that a putative class action can be dismissed, even prior to certification, where the claim of the proposed representative plaintiff is time-barred on the face of the pleading: *Stone v. Wellington County Board of Education* (1999), 120 O.A.C. 296, [1999] O.J. No. 1298 (C.A.); *Farquar v. Liberty Mutual Insurance Co.* (2004), 43 C.P.C. (5th) 361, [2004] O.J. No. 148 (S.C.J.). I note that in both these cases, however, while the motion was brought prior to certification, the defendants had delivered statements of defence pleading the limitations issue.

38 Where the resolution of the limitations issue depends on a factual inquiry, such as when a plaintiff knew or ought to have known of the facts constituting the action, the issue should not be resolved at certification: *Serhan (Trustee of) v. Johnson & Johnson* (2006), 85 O.R. (3d) 665, [2006] O.J. No. 2421 (Div. Ct.) at paras. 140-145. Accordingly, it is not plain and obvious in this case that the claims of the class generally, or of Mr. McKenna personally, are statute barred due to limitations.

39 If the defendants consider that the limitation period is an issue that can be resolved on a common basis, they may move to have it added as a common issue. Alternatively, the defendants may bring a motion for summary judgment on this issue, if so advised, at a future date. If necessary and appropriate, the plaintiff may move to add another representative plaintiff.

40 It is pleaded that Mr. Langille resigned as a director of Gammon on or about April 3, 2007, a date before the Prospectus was filed. The remedy under s. 130(1)(c) of the *Securities Act* only applies to persons who were directors at the time the prospectus was filed. It is plain and obvious on the face of the pleading that the claim against Mr. Langille cannot succeed and it should be dismissed.

(ii) Negligent Misrepresentation

41 The plaintiff pleads a cause of action in negligent misrepresentation against both the Gammon Defendants and the Underwriters. He pleads that the Gammon Defendants intended that the Class Members would rely on the misrepresentations, which they did to their detriment by purchasing Gammon securities at inflated prices under the Prospectus and in the secondary market. He also pleads that the plaintiff "directly or indirectly" relied upon the misrepresentations. He makes similar allegations against the Underwriters in connection with the Prospectus.

42 The requirements of a claim for negligent misrepresentation were summarized by the Supreme Court of Canada in the leading case of *Queen v. Cognos Inc.,* [1993] 1 S.C.R. 87, [1993] S.C.J. No. 3 ("*Cognos*") at para. 33:

> ... (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making said misrepresentation; (4) *the representee must have relied, in a reasonable manner*, on said negligent misrepresentation; and (5) *the reliance must have been detrimental* to the representee in the sense that damages resulted. [emphasis added]

43 The plaintiff has properly pleaded the essential ingredients of negligent misrepresentation. As I will explain later in these reasons, I do not accept the "non-reliance theory of misrepresentation" advanced by plaintiff's counsel and set out as follows in his factum:

> ... Canadian and other common law Courts have increasingly recognized that, in appropriate circumstances, reliance per se is not an essential element of a common law misrepresentation claim. ... If causation can be established by some means other than reliance, then the plaintiff can state a valid cause of action.

44 In my respectful view, for reasons I will explain under the common issues analysis, this is not the law of Canada. While reliance can be established by inference, it remains a necessary ingredient of the cause of action of negligent misrepresentation.

(iii) Reckless Misrepresentation

45 The Statement of Claim includes a heading before para. 202 entitled "Reckless Misrepresentation, Negligence and Negligent Misrepresentation of the Gammon Defendants." The plaintiff pleads that those defendants owed a duty to the Class to disseminate accurate information, that the information disseminated by the defendants, including the Prospectus, contained misrepresentations, that the defendants knew that the misrepresentations were false and that the plaintiff and investors would rely on them, which they did to their detriment by purchasing Gammon's securities. Apart from the heading itself, there is no pleading that the Gammon Defendants acted recklessly or not caring whether the representations were true or false.

46 Reckless misrepresentation is not itself a cause of action: *Hurst v. PriceWaterhouseCoopers (PWC) LLP, Canada*, [2009] O.J. No. 1415 (S.C.J.). A pleading of "reckless misrepresentation" may be regarded as being, in substance, a pleading of fraudulent misrepresentation, if the necessary elements of that cause of action are pleaded. Some claims have been allowed to proceed on that basis: *Canadian Imperial Bank of Commerce v. Deloitte & Touche* (2003), 33 C.P.C. (5th) 127, [2003]

O.J. No. 2069 (Div. Ct.); *Silver v. Imax Corp.* [2009] O.J. No. 5585 ("*Silver v. Imax - Certification*") at paras. 76-80; *McCann v. CP Ships*, [2009] O.J. No. 5182 (S.C.J.) at paras. 39-43.

47 A pleading of fraudulent misrepresentation requires that there be: (a) a false representation of fact; (b) made with knowledge of its falsehood or recklessly, without belief in its truth; (c) with the intention that it should be acted upon by the plaintiff; and (d) actually inducing the plaintiff to act on it to his or her detriment: *Parna v. G & S Properties Ltd.* [1971] S.C.R. 306, (1970), 15 D.L.R. (3d) 336.

48 In *Mondor v. Fisherman* (2002), 22 C.P.C. (5th) 346, [2002] O.J. No. 1855, Cumming J. permitted a claim to proceed in a class action where the plaintiff alleged that the defendants were "willfully blind" and that they were reckless in their negligent misrepresentation, "not caring whether it was true or false." There is no such pleading in this case. Apart from the request in para. 3(e) of the statement of claim for a declaration that the misrepresentations were made recklessly, and the heading before para. 202, there is no pleading of recklessness or willful blindness and certainly no pleading of fraud.

49 The rule remains that fraud is a serious allegation and it must be pleaded with particularity: see Rule 25.06(8) of the *Rules of Civil Procedure,* R.R.O. 1990, reg. 194; *Lo Faso v. Ferracuti*, [2009] O.J. No. 4568 (S.C.J.). Pleadings of fraud may raise issues for insurers and regulators and they have, of course, serious costs consequences if not made out. When it comes to fraud, a plaintiff is required to fish or cut bait. A defendant is entitled to know if fraud is being alleged and a plaintiff cannot hide behind ambiguous pleadings to avoid the consequences of an unsuccessful pleading of fraud.

50 While the authorities to which I have referred indicate that some measure of flexibility will be permitted in allowing a claim for reckless misrepresentation to proceed where it is in substance a pleading of fraudulent misrepresentation, counsel for the plaintiff did not suggest that a claim for fraud is being made. The pleading in this case does not contain the necessary elements of fraudulent misrepresentation and therefore does not disclose a cause of action.

(iv) Negligence

51 The statement of claim alleges that the Underwriters owed a duty to the Class, at common law and under the *Securities Act*, to ensure that the Prospectus provided full, true and plain disclosure of material facts and that the Underwriters failed to exercise appropriate diligence in connection with the Prospectus. In the course of the submissions, reference was made to the decision of Van Rensburg J. in *Silver v. Imax - Certification,* above, at paras. 81-88, in which it was held that a similar pleading was in substance a claim for negligent misrepresentation without the element of reliance and the claim was not certified; see also *Deep v. M.D. Management* (2007), 35 B.L.R. (4th) 86, [2007] O.J. No. 2392 (S.C.J.).

52 Plaintiff's counsel acknowledged that the claim for negligence was really subsumed by the negligent misrepresentation claim and said that it would be abandoned. Counsel for the plaintiff requested leave to amend but was unable to identify any basis or theory on which a claim for negligence could be asserted. For this reason, I do not propose to grant leave at this time.

(v) Conspiracy

53 The plaintiff pleads that:

* the Gammon Defendants "wrongfully, unlawfully, maliciously and lacking *bona fides*" agreed to conceal from investors material facts relating to Gammon's mining operations and stock options practices;
* the predominant purpose of some but not all of the Gammon Defendants was to inflate the price of Gammon's shares and increase the value of their own holdings;
* various acts were carried out allegedly in furtherance of the conspiracy, including misstating, distorting or withholding material facts;
* the conspiracy was unlawful because the Gammon Defendants knowingly and intentionally committed those acts when they knew that there was no reasonable assurance that their misrepresentations were accurate, and in so doing they violated the *Securities Act*, the United States *Securities Exchange Act of 1934,* and the reporting requirement of the TSX and AMEX; and
* the conspiracy was directed towards the plaintiff and other Class Members and the Gammon Defendants knew in the circumstances that it would, and it did in fact, cause loss to the plaintiff and the other Class Members.

54 A pleading of conspiracy must include particulars of: (1) the parties and their relationship; (2) an agreement to conspire; (3) the precise purpose or objects of the alleged conspiracy; (4) the overt acts that are alleged to have been done by each of the conspirators; and (5) the injury and particulars of the special damages suffered by reason of the conspiracy: see Perell J. in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, (2008), 89 O.R. (3d) 252, [2008] O.J. No. 833 at para. 90 (*"Quizno's - S.C.J."*), rev'd on other grounds (2009), 96 O.R. (3d) 252, [2009] O.J. No. 1874 (Div. Ct.)(*"Quizno's - Div. Ct."*), referring to *Aristocrat Restaurants Ltd. v. Ontario*, [2003] O.J. No. 5331 (S.C.J.); *Normart Management Ltd. v. West Hill Redevelopment Co.* (1998), 37 O.R. (3d) 97 (C.A.); *D.G. Jewelry Inc. v. Cyberdiam Canada Ltd.*, [2002] O.J. No. 1465 (S.C.J.); *Cineplex Corporation v. Viking Rideau Corporation* (1985), 28 B.L.R. 212, [1985] O.J. No. 304 (Ont. H.C.J.).

55 In *Silver v. Imax - Certification*, Van Rensburg J. referred to the requirements of a pleading of conspiracy as set out in the leading case of *Normart Management Limited v. West Hill Redevelopment Company Limited et al.,* above, at p. 98:

> [T]he statement of claim should describe who the several parties are and their relationship with each other. It should allege the agreement between the defendants to conspire, and state precisely what the purpose or what were the objects of the alleged conspiracy, and it must then proceed to set forth, with clarity and precision, the overt acts which are alleged to have been done by each of the alleged conspirators in pursuance and in furtherance of the conspiracy; and lastly, it must allege the injury and damage occasioned to the plaintiff thereby.

56 The pleading of conspiracy in this case is very similar to (and in some instances tracks word-by-word), the pleading in *Silver v. Imax - Certification*, in which the plaintiffs were represented by the same counsel. Some of the objections made by the defendants to the pleading in that case are similar to the objections made here.

57 The defendants say that the pleading in this case is deficient because it lacks particularity with respect to the overt acts committed by each conspirator, the alleged agreement between the parties, when the agreement was entered into and what its terms were. They say there is a duty to plead the cause of action with particularity: *OZ Merchandising Inc. v. Canadian Professional Soccer League Inc.*, [2006] O.J. No. 2882 (S.C.J.) at para. 14, 24-25; *Noldin v. Prince*, [1999] O.J. No. 2148, 1999 CanLII 37350 (C.A.) at paras. 3-5; *Research Capital Corporation v. Skyservice Airlines Inc.*, [2008] O.J. No. 2526, 2008 CanLII 30703 (S.C.J.) at paras. 48, 50 varied on other grounds 2009 ONCA 418.

58 They also say that the pleading is deficient because it fails to particularize the damage or injury allegedly caused by the conspiracy: *Aristocrat Restaurants Ltd. v. Ontario*, [2004] O.J. No. 5164 (S.C.J.) at para. 41. The pleading of special damage is an indispensable element of a legally sufficient conspiracy pleading, absent which the claim should be struck: *Robinson v. Medtronic Inc.*, [2009] O.J. No. 4366 (S.C.J.) at paras. 107, 111; *Apotex Inc. v. Plantey USA Inc.*, [2005] O.J. No. 1860 (S.C.J.) at paras. 61-63.

59 The defendants also say, as was asserted in *Silver v. Imax - Certification*, that the claim for conspiracy must fail because the alleged conspirators are Gammon and its officers and directors. Since a corporation must necessarily act through its directing minds, the actions of those individuals, in reaching an agreement on a course of action within the scope of their responsibilities, cannot give rise to an actionable conspiracy: *Normart Management Ltd. v. West Hill Redevelopment Co.*, above; *Craik v. Aetna Life Insurance Co. of Canada*, [1995] O.J. No. 3286 (Gen. Div.) at para. 23, aff'd [1996] O.J. No. 2377 (C.A.); *Accord Business Credit Inc. v. Bank of Nova Scotia*, [1997] O.J. No. 2562 (Gen. Div.) at para. 34.

60 In *Silver v. Imax - Certification*, Van Rensburg J. referred to the decision of the Court of Appeal in *Normart Management Limited v. West Hill Redevelopment Company Limited et al.*, above, at para. 92:

> It is well established that the directing minds of corporations cannot be held civilly liable for the actions of the corporations they contract and direct *unless there is some conduct on the part of those directing minds that is either tortious in itself or exhibits a separate identify or interest from that or the corporations* such as to make the acts or conduct complained of those of the directing minds [emphasis added].

61 She found that that the conspiracy claim was properly pleaded, at paras. 94-96:

> In the present case, while the plaintiffs have alleged that the acts or omissions alleged in the Claim were authorized, ordered and done by the Individual Defendants while engaged in the management, direction, control and transaction of its business affairs and are therefore acts and omissions for which IMAX is vicariously liable (paras. 85 and 86), the plaintiffs have also alleged that the actions of the Individual Defendants are independently tortious and that such defendants are personally liable (para. 87).
>
> The allegations against the Individual Defendants in the Claim include the assertion that they were acting "wrongfully, unlawfully, maliciously and lacking bona

> fides" (para. 52) and that they were motivated to increase the value of their own holdings in IMAX (para. 53(e)).
>
> The Claim pleads all of the necessary elements of the cause of action of conspiracy. There are allegations in the Claim that may, if true, give rise to personal liability on the part of the Individual Defendants. Their conduct is at issue both as agents for the Corporation and in their personal capacities. It is not therefore plain and obvious that the conspiracy claim is deficient, and accordingly such claim will not be struck.

62 The defendants say that the plaintiff has not appropriately pleaded simple motive conspiracy -- i.e., that the predominant purpose of the defendants' conduct, whether or not the conduct is unlawful in itself, was to cause injury to the plaintiff: *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, [1983] 1 S.C.R. 452, 1983 CarswellBC 812. The defendants say that the pleading fails to assert a predominant purpose to injure. The defendants say that the plaintiffs must plead that the Gammon Defendants committed one or more unlawful acts in furtherance of the alleged conspiracy: *Starkman v. Canada (Attorney General)*, [2000] O.J. No. 3764 (S.C.J.) at para. 11; *Apotex Inc. v. Plantey USA Inc.*, above, at paras. 58-59.

63 The plaintiff says that he has pleaded both simple motive conspiracy and unlawful means conspiracy in the alternative. The pleading of the latter is that the defendant's conduct was unlawful, was directed at the plaintiff, and the defendant knew or ought to have known that injury to the plaintiff would result: *Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd.*, above, at paras. 33-34; *Hunt v. Carey Canada Inc.*, at paras. 42-43. The plaintiff says that there is a proper pleading of unlawful means conspiracy because he alleges that the Gammon Defendants' conduct in making the misrepresentations and manipulating the Gammon stock options was unlawful, that it was directed at the public and in particular the plaintiff and the Class and in the circumstances the Gammon Defendants knew or ought to have known that injury to the Plaintiff and the other Class Members would result.

64 In this case, as in *Silver v. Imax - Certification*, the facts pleaded amount to an assertion that the individual defendants were acting not only for Gammon's benefit, but also for their own benefit, and to that extent, to the detriment of Gammon. Specifically, the individual defendants are alleged to have enriched themselves by manipulating the grant dates of Gammon stock options, thereby enabling themselves to exercise options, to the detriment of Gammon, at impermissibly low prices. It is not plain and obvious that the conspiracy claim must fail. The tort of conspiracy has been properly pleaded. The pleadings allege that the Gammon Defendants:

(a) reached an agreement;
(b) with a common intention (to inflate the share price);
(c) to commit acts that were either unlawful (under the *Securities Act* and other statutes) and likely to cause injury to the class members, or had the predominant purpose of causing injury to the class members; and
(d) thereby caused damage to be suffered by the class members.

65 Moreover, the plaintiff has provided sufficient particulars of the overt acts (the misrepresentations) that were allegedly undertaken in furtherance of this conspiracy. The plaintiff has pleaded facts to establish that the conduct of the defendant directors and officers of Gammon was either tor-

tious in itself, or exhibited a separate interest from that of the corporation. Lastly, the plaintiff has pleaded facts to ground the vicarious liability of the corporation for the acts of the defendant directors and officers. These factual assertions, if proven, would entitle the plaintiff to relief against the Gammon Defendants under the tort of conspiracy: *Canada Cement Lafarge Ltd. v. British Columbia Lightweight Aggregate Ltd.,* above; see also, G.H.L. Fridman, *The Law of Torts in Canada,* 2nd ed. (Toronto: Carswell, 2002) at pp. 765-772 and *Normart Management Ltd. v. West Hill Redevelopment Co.,* above.

66 It is, however, fundamental to a proper pleading of conspiracy that the plaintiff must allege damages that are separate and distinct from the damages suffered from the underlying tort itself. In *Quizno's - S.C.J.*, Perell J. found that the pleading lacked particulars in this regard. As he did not certify the action, which was allowed to continue as an ordinary action, he ordered the plaintiff to provide particulars of the special damages. He stated that, had he certified the action, he would not have ordered particulars beyond those sustained by the representative plaintiff. Special damages suffered by the class would be an individual issue. In *Quizno's - Div. Ct.,* the decision of Perell J. was reversed and the action certified as a class action.

67 In *McCann v. CP Ships Ltd.* above, Rady J. found that there was no pleading of special damages in relation to the conspiracy claim which were distinct from those flowing from the pleading of negligence or negligent misrepresentation. She granted leave to amend to provide particulars of the special damages.

68 I propose to follow the course adopted by my colleagues and to order the plaintiff to provide particulars of the special damages suffered by the representative plaintiff.

(vi) Unjust Enrichment and Waiver of Tort

69 The plaintiff pleads that the Underwriters have been unjustly enriched at the expense of the Class Members and that there is no juristic reason for the enrichment. He also pleads, in the alternative to a claim for damages, that Class Members are entitled to waive the tort claim and instead "elect to claim payment of the underwriting commissions generated by the Underwriters as a result of their failure of diligence and care." The plaintiff relies upon *Garland v. Consumers Gas Co.,* [2004] 1 S.C.R. 629, [2004] S.C.J. No. 21, and says that the pleading contains the necessary allegations of (a) enrichment of the defendant; (b) a corresponding deprivation of the plaintiff; and (c) an absence of juristic reason for the enrichment. The Underwriters acknowledge that the claims are adequately pleaded and I agree.

Summary with respect to cause of action requirement

70 In summary, I conclude that the pleading, as it now stands, discloses the following causes of action:

(a) the statutory cause of action for misrepresentation in the Prospectus, under s. 130 of the *Securities Act,* as against all defendants;
(b) a cause of action in negligent misrepresentation under the Prospectus and in the secondary market;
(c) a cause of action against all defendants for conspiracy, but particulars of the special damages suffered by the representative plaintiff must be provided; and

(d) a claim against the Underwriters for unjust enrichment and waiver of tort in connection with the Prospectus.

Other Claims

71 For the sake of good order, I will comment briefly on two additional "claims" that were the subject of submissions.

72 First, the statement of claim pleads that the plaintiff "intends promptly to deliver a notice of motion seeking leave under s. 138.8(1) of the [*Securities Act*] to amend this statement of claim to plead the causes of action [for misrepresentation in the secondary market] set out in s. 138.3 of the [*Securities Act*]."

73 Section 138.3 of the *Securities Act*, contained in Part XXIII.1 entitled "Civil Liability for Secondary Market Disclosure," gives shareholders of a reporting issuer a statutory cause of action for misrepresentation in relation to the secondary market "without regard to whether the person or company relied on the misrepresentation." The remedy is available against the issuer, directors, certain officers and others. Certain defences and limits of liability are also available or applicable. Section 138.8 stipulates that no action may be commenced under s. 138.3 unless leave is granted by the court on being satisfied that the action is brought in good faith and that there is a "reasonable possibility" that the action will be resolved at trial in favour of the plaintiff. The origins of the section were considered by Lax J. in *Ainslie v. CV Technologies Inc.* (2008), 93 O.R. (3d) 200, [2008] O.J. No. 4891. The statutory remedy was recently discussed and leave granted to commence a s. 138.3 claim in a separate decision issued by Van Rensburg J. in the *Imax* case: *Silver v. Imax Corp.*, [2009] O.J. No. 5573 (*"Silver v. Imax - s. 138"*).

74 Unlike the plaintiff in *Silver v. Imax - s. 138*, and notwithstanding the statement in his pleading, Mr. McKenna has not sought leave under s. 138.8.

75 While s. 138.3 does not preclude a common law action for negligent misrepresentation, a right that is preserved by s. 138.13, the "deemed reliance" provision in s. 138.3 is unavailable to Mr. McKenna. Hence the debate in this case about the need to establish reliance in a claim for common law misrepresentation and about the suitability of reliance as a common issue, which I shall discuss shortly.

76 The second point is that the statement of claim contains allegations that the Gammon Defendants "manipulated" the dates of stock options granted to insiders and misstated Gammon's stock option expense in the Prospectus and other filings. The pleading states, at para. 198, that as a result of these manipulations, the financial statements of Gammon, which were incorporated by reference into the Prospectus, understated Gammon's stock option expense. Para. 204 states that the Gammon Defendants selected option exercise prices that were below market ("in the money" options), issued options while they were in possession of positive information and signed financial statements that they knew understated Gammon's stock option expense. There is no separate claim for damages in respect of the stock options.

77 The Gammon Defendants say that the true nature of the stock option pleading relates to wrongs committed by Gammon's officers and directors against the corporation itself and, as such, it is a derivative claim that the plaintiff has no standing to assert. They say it offends the rule in *Foss v. Harbottle* (1843), 2 Hare 460, 67 E.R. 189. The fact that the claim is made in a proposed class

action does not overcome the rule: *Everest Canadian Properties Ltd. v. Mallmann* (2008), 46 B.L.R. (4th) 198, [2008] B.C.J. No. 1258 (C.A.).

78 The defendants also say that the plaintiff has failed to plead any "corrective disclosure" in relation to the stock options that could possibly have had an effect on the value of Gammon's shares. Thus, the plaintiff has failed to plead that he suffered detriment as a result of the alleged manipulation of stock options, a necessary ingredient of the misrepresentation claim at common law and under s. 130.

79 Mr. McKenna admits that a derivative claim would be unsustainable. He says, however, that he is not seeking to recover the harm he indirectly suffered as a result of Gammon receiving less consideration for its shares than it would have received, but for the manipulation of the option dates. He says that his pleading simply means that Gammon's net income was understated as a result of the improper pricing of the stock options and Gammon falsely represented that the financial statements accurately represented its financial picture.

80 I accept the submission of the plaintiff that the pleading of the stock options is not asserted as a cause of action and it is simply a part of the misrepresentation claim, to the effect that the price of Gammon's shares was improperly inflated as a result of the mis-statement of its stock option expense.

(b) The Proposed Class

81 The description of the Class is broad:

> All persons, [other than certain excluded persons related to the parties] who acquired securities of [Gammon] during the period from the opening of trading on October 10, 2006 to the close of trading on August 10, 2007 (the "Class Period"), whether over a stock exchange, or pursuant to a prospectus, or otherwise ...

82 The purpose of the class definition is set out in the oft-cited case of *Bywater v. T.T.C.*, [1998] O.J. No. 4913, 27 C.P.C. (4th) 172 (Gen. Div.) at para. 10:

> (a) it identifies the persons who have a potential claim against the defendant;
> (b) it defines the parameters of the lawsuit so as to identify those persons bound by the result of the action; and
> (c) it describes who is entitled to notice.

83 The class definition must not contain merit-based elements: *Markson v. MBNA Canada Bank* (2007), 85 O.R. (3d) 321 (C.A.) at para. 19, rev'g (2005), 78 O.R. (3d) 39 (Div. Ct.), which aff'd (2004), 71 O.R. (3d) 741, (S.C.J.), leave to appeal to S.C.C. ref'd, [2007] S.C.C.A. No. 346; *Ragoonanan v. Imperial Tobacco Canada Ltd.* (2005), 78 O.R. (3d) 98 (S.C.J.), leave to appeal ref'd [2008] O.J. No. 1644 (Div. Ct.). There must be a rational relationship between the class, the causes of action, and the common issues, and the class must not be unnecessarily broad or over-inclusive: *Pearson v. Inco Ltd.* (2006), 78 O.R. (3d) 641 (C.A.) at para. 57, leave to appeal refused, [2006] S.C.C.A. No. 1, rev'g [2004] O.J. No. 317 (Div. Ct.), which had aff'd [2002] O.J. No. 2764 (S.C.J.).

84 The class description in this case, simple though it may appear to be, gives rise to a number of issues. First, as I noted earlier, the Class has no geographic boundaries and includes individuals and institutions, anywhere in the world, who purchased securities of Gammon during the Class Period.

This raises a jurisdictional issue. Second, the Class includes persons who sold their securities before the end of the Class Period (the so-called "early sellers"), and therefore before the alleged misrepresentations were corrected. Third, the Class includes persons who received all, some or none of the alleged misrepresentations and who relied upon some, all or none of them. The defendants say that the class description is flawed for all these reasons, which I shall discuss in turn.

(i) The Jurisdiction Issue

A. Introduction

85 The issue is whether the Class should include persons outside the jurisdiction. There are really two issues here. The first is whether the court has jurisdiction over all or some of the defendants in this action. This is the "jurisdiction simpliciter" issue that can arise in every action. The second issue, unique to class actions, is whether the court should extend its jurisdiction to adjudicate on the claims of class members outside the jurisdiction who do not opt out of the class action. The resolution of these issues involves different, but related, considerations.

86 I will begin by setting out the positions of the parties and will then review the authorities and explain my conclusions.

87 The plaintiff submits that "an international class is appropriate" and notes that Ontario courts have certified actions encompassing class members who were resident in other provinces and countries: *Ford v. F. Hoffman-La Roche Ltd.* (2005), 74 O.R. (3d) 758, 2005 CarswellOnt 1095 (S.C.J.), at para. 31; *Nantais v. Telectronics Proprietary (Canada) Ltd.* (1995), 25 O.R. (3d) 331, 1995 CarswellOnt 994 (Gen. Div.) at para. 4 and 83; *Robertson v. The Thomson Corp.* (1999), 43 O.R. (3d) 161, 1999 CarswellOnt 301 (Gen. Div.); *Mondor v. Fisherman* (2002), 22 C.P.C. (5th) 346, 2002 CarswellOnt 1601 (S.C.J.) at para. 12. In *Mandeville v. Manufacturers Life Insurance Co.*, [2002] O.J. No. 5387 (S.C.J.) Nordheimer J. certified a worldwide class.

88 The plaintiff also refers to the decision of Sharpe J.A. in *Currie v. McDonald's Restaurants Canada Ltd.* (2005), 74 O.R. (3d) 321 (C.A.) ("*Currie*") at para. 15, to the effect that "there are strong policy reasons favouring the fair and efficient resolution of interprovincial and international class action litigation." While this is of course true, there are equally strong policy reasons, discussed in that decision, why the court must not act beyond its jurisdictional competence. I will discuss this decision below.

89 The Gammon Defendants submit that the courts of a province can only exercise jurisdiction over a person and determine their legal rights on the basis of:

(a) presence within the territory,
(b) submission or attornment to the jurisdiction, or
(c) a "real and substantial connection" between the province and the matters at issue.

In the case of non-resident Class Members, they submit that the third factor is the only one in play.

B. "Real and Substantial Connection": *Muscutt* and *Van Breda*

90 In determining whether there is a real and substantial connection with the action, sufficient to base jurisdiction over a defendant, the courts in recent years have applied the "*Muscutt*" test: *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (C.A.); see also *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.* (2003), 66 O.R. (3d) 112 (S.C.J.) at para. 16. This the test was

recently simplified and reformulated by the Court of Appeal in *Van Breda v. Village Resorts Ltd.*, 2010 ONCA 84, [2010] O.J. No. 402 ("*Van Breda*"). The test remains "real and substantial connection," but the analytical process has been simplified.

91 In *Van Breda*, the Court of Appeal stated that the application of the test requires the court to consider whether the case falls within one of the connections or categories in sub-rule 17.02 of the *Rules of Civil Procedure* (other than sub-rule (h), "damage sustained in Ontario" and sub-rule (o), "necessary and proper party"). If so, jurisdiction over the defendant will be presumed to exist (para. 72 of *Van Breda*).

92 The core aspects of the real and substantial connection test will be the first two *Muscutt* factors - - the connection of the plaintiff's claim to the forum and the connection of the defendant to the forum. In assessing the latter, the primary focus will be on things done by the defendant within the jurisdiction (para. 89 of *Van Breda*). This will not always require that the defendant carry on physical activity within the jurisdiction; if the defendant can reasonably foresee that its actions will cause harm in the forum it may be appropriate for the court to take jurisdiction.

93 Under *Van Breda*, the principles of order and fairness will remain linked to the question of real and substantial connection (para. 98). This is not simply a matter of tallying the contacts between the jurisdiction and the plaintiff on the one hand and the defendant on the other. It requires, however, that the interests of both parties be considered and balanced. The Court of Appeal said that *Muscutt* factors 3 and 4 (unfairness to the defendant in assuming jurisdiction and unfairness to the plaintiff in not assuming jurisdiction) should be collapsed and considered together, and they should "serve as an analytic tool to assess the relevance, qualify and strength of those connections, whether they amount to a real and substantial connection, and whether assuming jurisdiction accords with the principles of order and fairness" (at para. 98).

94 The Court of Appeal in *Van Breda* instructs us that the other *Muscutt* factors (the involvement of other parties to the suit, the court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis, whether the case is interprovincial or international in nature, and comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere) will also serve as analytic tools to assist the court in assessing the significance of the connections between the forum, the claim and the defendant, and will remain relevant to the existence of a real and substantial connection.

95 Sharpe J.A. summarized the reformulated test, including the approach to be taken to *forum non conveniens*, at para. 109 of *Van Breda:*

> To summarize the preceding discussion, in my view, the *Muscutt* test should be clarified and reformulated as follows:
>
> * First, the court should determine whether the claim falls under rule 17.02 (excepting subrules (h) and (o)) to determine whether a real and substantial connection with Ontario is presumed to exist. The presence or absence of a presumption will frame the second stage of the analysis. If one of the connections identified in rule 17.02 (excepting subrules (h) and (o)) is made out, the defendant bears the burden of showing that a real and substantial connection does not exist. If one of those connections is not made out, the

burden falls on the plaintiff to demonstrate that, in the particular circumstances of the case, the real and substantial connection test is met

* At the second stage, the core of the analysis rests upon the connection between Ontario and the plaintiff's claim and the defendant, respectively.
* The remaining considerations should not be treated as independent factors having more or less equal weight when determining whether there is a real and substantial connection but as general legal principles that bear upon the analysis.
* Consideration of the fairness of assuming or refusing jurisdiction is a necessary tool in assessing the strengths of the connections between the forum and the plaintiff's claim and the defendant. However, fairness is not a free-standing factor capable of trumping weak connections, subject only to the forum of necessity exception.
* Consideration of jurisdiction *simpliciter* and the real and substantial connection test should not anticipate, incorporate or replicate consideration of the matters that pertain to *forum non conveniens* test.
* The involvement of other parties to the suit is only relevant in cases where that is asserted as a possible connecting factor and in relation to avoiding a multiplicity of proceedings under *forum non conveniens.*
* The willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis is as an overarching principle that disciplines the exercise of jurisdiction against extra-provincial defendants. This principle provides perspective and is intended to prevent a judicial tendency to overreach to assume jurisdiction when the plaintiff is an Ontario resident. If the court would not be prepared to recognize and enforce an extra-provincial judgment against an Ontario defendant rendered on the same jurisdictional basis, it should not assume jurisdiction against the extra-provincial defendant.
* Whether the case is interprovincial or international in nature, and comity and the standards of jurisdiction, recognition and enforcement prevailing elsewhere are relevant considerations, not as independent factors having more or less equal weight with the others, but as general principles of private international law that bear upon the interpretation and application of the real and substantial connection test.
* The factors to be considered for jurisdiction *simpliciter* are different and distinct from those to be considered for *forum non conveniens*. The *forum non conveniens* factors have no bearing on real and substantial connection and, therefore, should only be considered after it has been determined that there is a real and substantial connection and that jurisdiction *simpliciter* has been established.
* Where there is no other forum in which the plaintiff can reasonably seek relief, there is a residual discretion to assume jurisdiction.

C. Jurisdiction in Class Actions -- *Currie*

96 While the *Van Breda* test applies to the determination of the court's jurisdiction in both the usual form of action and a class action, the defendants say that the test for the exercise of the court's

jurisdiction is modified where the issue is the court's jurisdiction not over a non-resident defendant, but over a non-resident class member or what the defendants describe as a "passive, absentee plaintiff." The defendants say that in such cases, the further issue is the connection between the forum and the foreign class members and any unfairness to such persons if the court declines jurisdiction: *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.*, above, at paras. 24-25.

97 In this case, the defendants say, there is no connection between Ontario and the non-resident members of the Class. Gammon is incorporated in Quebec, based in Nova Scotia and has its mining operations in Mexico. They say that the only connections between the claims in this action and Ontario are the filing of the Prospectus with the Ontario Securities Commission and the distribution of various public statements of Gammon in accordance with Ontario securities law.

98 The defendants say that the court must also consider whether a judgment of this court will be recognized and enforced in courts outside Ontario and, most important from their perspective, whether a judgment will be considered to be binding against non-resident shareholders and given preclusive effect in their "home" jurisdictions. In the absence of a real and substantial connection between Ontario and the claims of purchasers of Gammon shares in New York or Manitoba, for example, would the courts of those jurisdictions treat an Ontario judgment as precluding an action in their jurisdictions? See: *Canada Post Corp. v. Lépine*, [2009] 1 S.C.R. 549; *Englund v. Pfizer Canada Inc.*, [2006] S.J. No. 9 (Q.B.); *Currie*, above. If not, then the defendants run the risk that Class Members who have not opted out may be free to take a second bite at the defendant in their "home" jurisdictions if they are dissatisfied with the result in this action.

99 The defendants also raise the question of what law governs the claims of non-residents. While the provincial securities statutes may be relatively uniform (and the plaintiff says they are, but has not pleaded the law of other provinces) and while the court has jurisdiction to apply foreign law, the diversity of applicable laws could make the action unmanageable. The defendants submit that persons who purchased Gammon shares outside Ontario, have no cause of action under s. 130 of the *Securities Act*: *Pearson v. Boliden Ltd.* (2002), 222 D.L.R. (4th) 453 (B.C.C.A.) at paras. 64-66. See also *McNaughton Automotive Ltd. v. Co-Operators General Insurance Co.*, above, at paras. 37-38.

100 Lastly, the defendants submit that there is no real and substantial connection in this case between Ontario and shareholders outside Canada. They rely on the observations of Rady J. in *McCann v. CP Ships Ltd.*, at para. 83:

> It is difficult to understand the basis on which an Ontario court could or should take jurisdiction over the class members as proposed. Where is the real and substantial connection between, for example, the Ontario Court and a French citizen residing in France who purchased securities over the TSE? It strikes me as judicial hubris to conclude that an Ontario court would have jurisdiction in those circumstances.

101 In reply, the plaintiff says that notwithstanding these comments, the class certified by Rady J. was not limited to prospectus purchasers. As well, in *Kerr v. Danier Leather*, [2004] O.J. No. 1916, 2004 CarswellOnt 6608 (S.C.J.), at para. 351, rev'd on other grounds (2005), 77 O.R. (3d) 321, 2005 CarswellOnt 7296 (C.A.), a prospectus misrepresentation case, Cumming J. certified a national class. In *Pearson v. Boliden* itself, the British Columbia Court of Appeal created sub-classes for non-residents.

102 The plaintiff says that, at a minimum, in view of the similarities of the provincial and territorial securities statutes, there should be a single pan-Canadian class.

103 This brings me to the decision of the Court of Appeal in *Currie*. In that case, the Court of Appeal addressed the issue of enforcement of a foreign class action judgment in Ontario. The Court of Appeal refused to give preclusive effect to a judgment in Illinois, implementing a settlement of a class action suit, which purported to bind Canadian and other international class members who had not opted out.

104 The Court of Appeal held that before enforcing a foreign class action judgment, it is necessary to consider whether the foreign court had an appropriate basis for assuming jurisdiction and whether the rights of Ontario residents were adequately protected.

105 Sharpe J.A., who gave the judgment of the Court, noted that class actions have unique features, one of which is the involvement of the "unnamed, non-resident class plaintiff" who, unlike the plaintiff in a typical lawsuit, does not come to Ontario asking for access to our courts and thereby attorning to the court's jurisdiction. He suggested that a court considering the enforcement of a foreign class action judgment must look to the real and substantial connection test and the principles of order and fairness from the perspective of the party against whom enforcement is sought. One aspect of this analysis would be to examine whether it would be reasonable for that party to expect that its rights would be determined by the foreign court. He gave the example of an Ontario resident who engages in a cross-border transaction, such as buying goods from a foreign mail order merchant or purchasing securities over a foreign stock exchange - that person might reasonably expect that claims in relation to those transactions could be litigated in the foreign jurisdiction. Where there is no such contact between the plaintiff and the foreign jurisdiction, the court must nonetheless look to whether there is a "real and substantial connection" between the subject matter of the class action litigation and the foreign jurisdiction. In the case before the Court of Appeal, McDonald's had its head office in Illinois and the allegedly wrongful act occurred in the United States. Sharpe J.A. referred to the observations of Cumming J. in *Wilson v. Servier Canada Inc.*, (2000), 50 O.R. (3d) 219, [2000] O.J. No. 3392 (S.C.J.) at para. 83, that Ontario courts have certified national class actions "if there is a real and substantial connection between the subject-matter of the action and Ontario" in the expectation that "other jurisdictions on the basis of comity should recognize the Ontario judgment" (at para. 22).

106 Another aspect of the analysis would be to examine whether the procedures adopted in the "foreign" jurisdiction were "sufficiently attentive to the rights and interests of the unnamed non-resident class members. Respect for procedural rights, including the adequacy of representation, the adequacy of notice and the right to opt out, could fortify the connection with [the foreign] jurisdiction and alleviate concerns regarding unfairness" (at para. 25). In the context of the case before him, Sharpe J.A. stated, at para. 25:

> Given the substantial connection between the alleged wrong and Illinois, and given the small stake of each individual class member, it seems to me that the principles of order and fairness could be satisfied if the interests of the non-resident class members were adequately represented and if it were clearly brought home to them that their rights could be affected in the foreign proceedings if they failed to take appropriate steps to be removed from those proceedings.

107 He concluded, at para. 30 that a three part test should apply to the recognition of a foreign class action judgment:

> In my view, provided (a) there is a real and substantial connection linking the cause of action to the foreign jurisdiction, (b) the rights of non-resident class members are adequately represented, and (c) non-resident class members are accorded procedural fairness including adequate notice, it may be appropriate to attach jurisdictional consequences to an unnamed plaintiff's failure to opt out. In those circumstances, failure to opt out may be regarded as a form of passive attornment sufficient to support the jurisdiction of the foreign court. I would add two qualifications: First, as stated by LaForest J. in *Hunt v. T & N plc.*, above at p. 325, "the exact limits of what constitutes a reasonable assumption of jurisdiction" cannot be rigidly defined and "no test can perhaps ever be rigidly applied" as "no court has ever been able to anticipate" all possibilities. Second, it may be easier to justify the assumption of jurisdiction in interprovincial cases than in international cases: see *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 at paras. 95-100 (C.A.).

108 Although *Currie* involved the enforcement in Ontario of a judgment in a foreign class action, the mirror image of the principles stated by the Court of Appeal are applicable to the exercise of jurisdiction by this court in a class action that seeks to include class members outside the jurisdiction. It must be asked whether the assumption of jurisdiction would satisfy the real and substantial connection test and the principles of order and fairness. This is an issue of whether it is appropriate to assume jurisdiction over the legal rights of an individual who has neither attorned nor agreed to this Court's jurisdiction. In considering this issue from the perspective of the non-resident class member, it is appropriate to ask, as did Sharpe J.A., whether the non-resident has done something that would give rise to a reasonable expectation that legal claims arising out of the activity could be litigated in the jurisdiction. The court should also ask whether it would be reasonable from the perspective of the defendant that class action litigation in the jurisdiction should finally dispose of claims of non-resident class members.

109 This will not be the end of the analysis, as Sharpe J.A. pointed out at paras. 23-25 of *Currie*. The principles of order and fairness require that, even if there is a substantial connection between the wrong and the jurisdiction and the plaintiff might have expected that his or her legal rights would be resolved in the jurisdiction, the procedures adopted must ensure that the rights of absent class members are adequately protected. This calls for consideration of appropriate representation for such class members, appropriate notice and an informed and meaningful opportunity to opt out.

110 The relevant authorities were reviewed by Van Rensburg J. in *Silver v. Imax - Certification*, who noted that presence of non-resident class members could raise issues of applicable law but concluded that those issues need not be resolved at the certification stage. She found that there was a real and substantial connection with Ontario. Imax had its head office in Ontario, it was a reporting issuer under the *Securities Act* and its shares were traded on the TSX. The alleged misrepresentation was made in Ontario and the conduct of some of the defendants was alleged to have taken place in Ontario.

D. Application of jurisdictional tests in this case

111 In this case, dealing first with the s. 130 *Securities Act* claim, which is against all defendants, it seems to me that there is clearly a presumption of a real and substantial connection under a number of heads within Rule 17.02 of the *Rules of Civil Procedure*: the plaintiff claims in respect of personal property in Ontario, his shares (17.02(a)); it is a claim in respect of a contract made in Ontario to acquire his shares (17.02(f)); and a tort -- misrepresentation, committed in Ontario (17.02(g)); and is against a person resident or carrying on business in Ontario, at least in connection with the Underwriters and likely in relation to Gammon by virtue of its listing its shares on the TSX and entering into the underwriting agreement in Ontario (17.02(p)).

112 At the second stage of the *Van Breda* test, there is clearly a connection between Ontario and the plaintiff's claim. Mr. McKenna is a resident of Toronto and acquired his shares in Gammon in Ontario. It is a reasonable assumption that a number of the purchasers under the Prospectus were also residents of Ontario and acquired their shares in a similar fashion. There are also a number of connections between Gammon, the Underwriters and Ontario:

(a) Gammon's shares were traded on the TSX and the evidence suggests that the volume of trading was substantially higher on the TSX than on the AMEX;
(b) Gammon was a reporting issuer in Ontario;
(c) the Underwriters have offices in Ontario, carry on business in Ontario, are registered as dealers under the *Securities Act* and are members of the TSX;
(d) the underwriting agreement was made in Ontario, was expressly subject to Ontario law and called for closing of the offering in Ontario;
(e) the prospectus was filed with the Ontario Securities Commission; and
(f) one of the directors of Gammon, Mr., Hendrick, was resident in Ontario;

113 The activities of Gammon and the individual defendants in concluding the underwriting agreement in Ontario, filing the Prospectus with the OSC and listing Gammon's share on the TSX are clearly substantial connections with Ontario. Gammon and its officers and directors could reasonably expect that in closing the underwriting in Ontario and issuing the Prospectus through underwriters based in Ontario, their rights, and the rights of purchasers under the Prospectus, would be determined by the courts of Ontario, subject to appropriate safeguards to ensure that the court's judgment would be given preclusive effect in the case of non-resident purchasers. There is no unfairness in subjecting the defendants to Ontario jurisdiction. It would be unfair to require Mr. McKenna to pursue his claim in another province, such as Nova Scotia or Quebec, which have technical connections to Gammon, but no real or substantial connection with Mr. McKenna or the issues in this case.

114 The real and substantial connection test does not require a finding that Ontario has *the most* real and substantial connection. As the cause of action is for prospectus misrepresentation, however, Ontario's connection with the claim as a whole is greater than any other jurisdiction and is both *real* and *substantial.* Having come to Ontario for the purposes of making and closing the public offering, and having listed the shares on the TSX, it seems to me that Gammon can reasonably be taken to have submitted itself to Ontario jurisdiction for the purposes of the determination of its rights and liabilities under the Prospectus.

115 The second issue is whether the principles of order and fairness support the extension of the court's jurisdiction to require class members out of the jurisdiction to either opt out or be bound by

the result. Following the example given by Sharpe J.A., in *Currie,* where non-resident class members have engaged in a cross-border transaction, acquiring securities of a Canadian company, in Canada, through a Canadian underwriter, they can reasonably expect that their legal rights in relation to that acquisition would be subject to Canadian jurisdiction and, in this case, a jurisdiction with a real and substantial connection to the defendants and the issues. The same could reasonably be said of Class Members in other provinces. For this reason, subject to appropriate safeguards with respect to representation and notice, it is appropriate to certify a class that would include non-residents who made purchases from the underwriters in Canada and under the Prospectus.

116 It is not appropriate to include within the Class those persons who purchased securities from the Underwriters or their agents outside Canada. The acquisition of those securities in a jurisdiction outside Canada would not give rise to a reasonable expectation that the acquiror's rights would be determined by a court in Canada.

117 Like Van Rensburg J. in *Silver v. Imax - Certification,* I do not find it necessary at this stage to make a determination of the law applicable to the claims of non-resident members of the class who purchased their securities from underwriters in other provinces. Given the similarity between s. 130 of the *Securities Act* and the securities laws of other provinces of Canada, this may not be an issue with respect to Class Members from other provinces. I will require the appointment of a separate representative for Class Members located outside Canada who purchased their shares in Canada. In the event either party wishes to plead foreign law with respect to the rights of Class Members outside Ontario, the issue can be addressed at a later date.

118 As will become apparent, I do not consider it appropriate to certify the secondary market claim. Had I done so, I would have limited the Class to those who acquired their shares on the TSX, who, for the reasons set out above, could reasonably contemplate that their rights would be determined by the courts of the jurisdiction where the shares were acquired.

(ii) The early sellers

119 Counsel for the Gammon Defendants submits that in a "true" securities misrepresentation action, the investors suffer losses because they have purchased shares which have an artificially inflated value as a result of misrepresentations *and* because they continue to hold the shares until the truth is revealed and the share price drops. Counsel submits that the Class must be limited to those investors who held the shares on the date of the "revelation" of the true state of affairs, because anyone who sold before that date benefited from the inflated share price. Any loss suffered by an "early seller" must have been due to circumstances other than the alleged misrepresentation. Counsel relies on *Pearson v. Boliden Ltd.* (2002), 222 D.L.R. (4th) 453 (B.C.C.A.) at paras. 92-93 and *Carom v. Bre-X Minerals Ltd.* (1999), 46 O.R. (3d) 315 (Div. Ct.) at paras. 21-23, var'd on other grounds (2000), 51 O.R. (3d) 236 (C.A.); see also *Kerr v. Danier Leather Ltd.* (2004), 46 B.L.R. (3d) 167 (Ont. S.C.J.) at para. 345, rev'd on other grounds (2007), 36 B.L.R. (4th) 95 (S.C.C.).

120 Subsection 130(7) of the *Securities Act* provides that in an action for damages pursuant to ss. (1), the defendant is not liable for all or any portion of such damages that the defendant proves do not represent the depreciation in value of the security as a result of the misrepresentation relied upon. This provision is similar to the corresponding provision in the take-over bid remedy contained in s. 131 and to which I referred in *Allen v. Aspen Group Resources,* [2009] O.J. No. 5213 at paras. 106-125. I stated in that case at para. 122:

> Given this onus, and the complex legal and factual issues that will probably be involved in the resolution of value, depreciation and date of measurement, I prefer to follow the approach taken by Cumming J. in *Danier Leather*, rather than to prejudge those issues by excluding particular members of the class at this time. As Cumming J. noted, and as the subsequent trial before Lederman J. demonstrated, the *C.P.A.* is sufficiently flexible to address these issues in an efficient manner.

121 I accept that, as a general rule and on the authority of the cases referred to by counsel for the Gammon Defendants, it may be appropriate to exclude "early sellers" because no damages are suffered until the misrepresentation is disclosed -- shareholders who dispose of their securities before this date cannot suffer a loss as a result of the misrepresentation. In *Allen v. Aspen,* where shares in the acquiring company were exchanged for shares in the aquiree, it was alleged that the transfer ratio was skewed because of misrepresentations affecting the value of the acquiror's shares. I concluded that it was preferable to leave this issue for trial.

122 This case, as well, is an exception to the general rule. As I noted earlier, in asserting that Mr. McKenna's claim was time barred, the Gammon Defendants said that there had been partially corrective disclosure as early as May 10, when Gammon's public filing disclosed a US$10 million first quarter loss. This was slightly over three weeks after the Prospectus was issued. Representations of various kinds continued to be made for the remainder of the Class Period. It would be arbitrary at this stage to conclude that "early sellers" could not have suffered a loss as a result of the alleged misrepresentations in the Prospectus and the onus of proving this should be on the defendants at trial.

(iii) Is the Class overly broad?

123 The defendants submitted on the certification motion that the proposed Class was unmanageably broad, because it covered a long time period during which different misrepresentations, in various formats, were made to a wide-ranging group of shareholders. For the reasons that I will discuss in the next section, the proposed common issues arising from the negligent misrepresentation claim are not appropriate for certification and I do not propose to certify a class for the secondary market misrepresentation claim.

(c) Common Issues

124 The resolution of common issues lies at the heart of a class proceeding by avoiding duplication of fact-finding or legal analysis and promoting access to justice, judicial efficiency and behavior modification: *Western Canadian Shopping Centres Inc. v. Dutton* (2001), 201 D.L.R. (4th) 385 (S.C.C.) at para. 39, *Hollick v. Toronto (City),* above, at para. 18, *Fresco v. Canadian Imperial Bank of Commerce,* [2009] O.J. No. 2531 at para. 51.

125 In *Singer v. Schering-Plough Canada Inc.,* [2010] O.J. No. 113 at para. 140, I set out a number of principles, identified in the authorities, that are applicable to the common issues analysis:

> A: The underlying foundation of a common issue is whether its resolution will avoid duplication of fact-finding or legal analysis: *Western Canadian Shopping Centres Inc. v. Dutton*, above, at para. 39.

B: The common issue criterion is not a high legal hurdle, and an issue can be a common issue even if it makes up a very limited aspect of the liability question and even though many individual issues remain to be decided after its resolution: *Cloud v. Canada (Attorney General)*, above, at para. 53.

C: There must be a basis in the evidence before the court to establish the existence of common issues: *Dumoulin v. Ontario*, [2005] O.J. No. 3961 (S.C.J.) at para. 25; *Fresco v. Canadian Imperial Bank of Commerce,* above, at para. 21. As Cullity J. stated in *Dumoulin v. Ontario*, at para. 27, the plaintiff is required to establish "a sufficient evidential basis for the existence of the common issues" in the sense that there is some factual basis for the claims made by the plaintiff and to which the common issues relate.

D: In considering whether there are common issues, the court must have in mind the proposed identifiable class. There must be a rational relationship between the class identified by the Plaintiff and the proposed common issues: *Cloud v. Canada (Attorney General)*, above at para. 48.

E: The proposed common issue must be a substantial ingredient of each class member's claim and its resolution must be necessary to the resolution of that claim: *Hollick v. Toronto (City),* above, at para. 18.

F: A common issue need not dispose of the litigation; it is sufficient if it is an issue of fact or law common to all claims and its resolution will advance the litigation for (or against) the class: *Harrington v. Dow Corning Corp.*, [1996] B.C.J. No. 734, 48 C.P.C. (3d) 28 (S.C.), aff'd 2000 BCCA 605, [2000] B.C.J. No. 2237, leave to appeal to S.C.C. ref'd [2001] S.C.C.A. No. 21.

G: With regard to the common issues, "success for one member must mean success for all. All members of the class must benefit from the successful prosecution of the action, although not necessarily to the same extent." That is, the answer to a question raised by a common issue for the plaintiff must be capable of extrapolation, in the same manner, to each member of the class: *Western Canadian Shopping Centres Inc. v. Dutton*, above, at para. 40, *Ernewein v. General Motors of Canada Ltd.*, [2005] B.C.J. No. 2370, above, at para. 32; *Merck Frosst Canada Ltd. v. Wuttunee*, 2009 SKCA 43, [2009] S.J. No. 179 (C.A.), at paras. 145-146 and 160.

H: A common issue cannot be dependent upon individual findings of fact that have to be made with respect to each individual claimant: *Williams v. Mutual Life Assurance Co. of Canada* (2000), 51 O.R. (3d) 54, [2000] O.J. No. 3821 (S.C.J.) at para. 39, aff'd [2001] O.J. No. 4952, 17 C.P.C. (5th) 103 (Div. Ct.), aff'd [2003] O.J. No. 1160 and 1161 (C.A.); *Fehringer v. Sun Media Corp.*, [2002] O.J. No. 4110, 27 C.P.C. (5th) 155, (S.C.J.), aff'd [2003] O.J. No. 3918, 39 C.P.C. (5th) 151 (Div. Ct.).

I: Where questions relating to causation or damages are proposed as common issues, the plaintiff must demonstrate (with supporting evidence) that there is a workable methodology for determining such issues on a class-wide basis: *Chadha v. Bayer Inc.*, [2003] O.J. No. 27, 2003 CanLII 35843 (C.A.) at para. 52, leave to appeal dismissed [2003] S.C.C.A. No. 106, and *Pro-Sys Consultants Ltd. v. Infineon Technologies AG*, 2008 BCSC 575, [2008] B.C.J. No. 831 (S.C.) at para. 139.

J: Common issues should not be framed in overly broad terms: "It would not serve the ends of either fairness or efficiency to certify an action on the basis of issues that are common only when stated in the most general terms. Inevitably such an action would ultimately break down into individual proceedings. That the suit had initially been certified as a class action could only make the proceeding less fair and less efficient": *Rumley v. British Columbia,* [2001] 3 S.C.R. 184, [2001] S.C.J. No. 39 at para. 29.

126 I might have added a further proposition:

K. An issue is not "common" simply because the same question arises in connection with the claim of each class member, if that issue can only be resolved by inquiry into the circumstances of each individual claim: *Nadolny v. Peel (Region),* [2009] O.J. No. 4006 (S.C.J.) at para. 50; *Fresco v. Canadian Imperial Bank of Commerce,* [2009] O.J. No. 2531 at para. 51.

127 The plaintiff raises eighteen common issues, but condenses them as follows:

(a) whether the Defendants owed a duty to the Class Members to ensure that Gammon's Class Period disclosure documents (including the Prospectus) and their public oral statements did not contain a misrepresentation;
(b) whether the Gammon disclosure documents issued, or the public oral statements made by the Defendants, during the Class Period contained one or more misrepresentations;
(c) whether the Defendants made those misrepresentations negligently;
(d) whether a Class Member must demonstrate, at common law, that she relied in whole or in part upon the misrepresentations in order to have a claim against the Defendants;
(e) whether the Gammon Defendants, or some of them, conspired one with the other, and/or with persons unknown, to deceive the Class Members for the purpose of maintaining and increasing the price of Gammon's securities;
(f) whether the Underwriters were unjustly enriched by their failure to perform their duties to the Class Members; and
(g) whether any of the Gammon Defendants ought to pay punitive damages.

128 The plaintiff says that these common issues are a substantial part of the claims of Class Members and that their resolution does not require an examination of individual circumstances and will advance the claim of each Class Member. I will begin by dealing with the first four groups of common issues, which deal with the misrepresentation claims.

(i) Misrepresentation as a common issue

129 The pleading of common law misrepresentation, in relation to both the Prospectus and the secondary market claim, asserts that the plaintiff and Class Members relied to their detriment on the misrepresentations "by purchasing Gammon securities pursuant to the Prospectus and/or in the secondary market at inflated prices." Mr. McKenna also pleads that he and other Class Members "directly or indirectly relied" on the defendants' misrepresentations.

130 The plaintiff has attempted to finesse the thorny issue of reliance in a misrepresentation class action by making reliance a common issue. He proposes the following common issue in relation to the misrepresentation claim:

> (9) ... must a Class Member demonstrate that she relied in whole or in part upon the misrepresentations in order to have a claim against the Underwriters?

131 Under the heading "Damages", the plaintiff asks:

> (13) To the extent that Class Members must demonstrate that they relied upon the Defendants' misrepresentations in order to have a claim against the Defendants, what is the procedure whereby the Class Members must demonstrate their individual reliance?

132 I have noted earlier the leading decision of the Supreme Court of Canada in *Cognos* in which it was stated at para. 33 that one of the requirements of the tort of negligent misrepresentation is that "the representee must have relied, in a reasonable manner, on said negligent misrepresentation." The important role of reliance in both the proximity and causation analyses is highlighted by Allen M. Linden and Bruce Feldthusen, *Canadian Tort Law* (8th ed.), (Toronto: LexisNexis, 2006) at p. 446:

> Finally, misrepresentations do not injure anyone directly. The plaintiff must take some action in reliance on the statement before any harm occurs. This gives the plaintiff opportunities for self-protection not available in most physical injury situations. The reasonableness of the plaintiff's reliance is central to the duty-of-care analysis; critical to the issue of causation in fact; and also relevant to the question of contributory negligence.

133 Words are at the root of the action for misrepresentation. Like the tree that falls in the forest and is heard by no one, unless the words reach someone's eyes or ears, they result in no action and they cause no damage. Reasonable reliance plays a role in the proximity analysis by defining the scope of what the defendant can reasonably foresee. It also plays a role in the damages analysis by establishing causation. The role of reliance as an essential ingredient of a claim for negligent misrepresentation has been repeatedly affirmed by the highest authority: *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1. In *Hercules Management Ltd. v. Ernst & Young,* [1997] 2 S.C.R. 165, [1997] S.C.J. No. 51, La Forest J., giving the judgment of the Supreme Court of Canada, stated at para. 24:

> In cases of negligent misrepresentation, the relationship between the plaintiff and the defendant arises through reliance by the plaintiff on the defendant's words. Thus, if "proximity" is meant to distinguish the cases where the defendant has a responsibility to take reasonable care of the plaintiff from those where he or she

> has no such responsibility, then in negligent misrepresentation cases, it must pertain to some aspect of the relationship of reliance. To my mind, proximity can be seen to inhere between a defendant-representor and a plaintiff-representee when two criteria relating to reliance may be said to exist on the facts: (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable. To use the term employed by my colleague, Iacobucci J., in Cognos, supra, at p. 110, the plaintiff and the defendant can be said to be in a "special relationship" whenever these two factors inhere.

134 The Ontario Court of Appeal has confirmed the reliance requirement in two recent cases: *Abarquez v. Ontario* (2009), 95 O.R. (3d) 414, [2009] O.J. No. 1814 (C.A.); *White v. Colliers Macaulay Nicholls Inc.* (2009), 95 O.R. (3d) 680, [2009] O.J. No. 2188 (C.A.). In the latter case, Blair J.A. adopted the *Cognos* test, but noted, at para. 25, that in addition the plaintiff must prove that the misrepresentation was *material* in the sense that it would be likely to influence the conduct of the plaintiff or likely to operate on the plaintiff's judgment. He also confirmed, at para. 36, that for a representation to be actionable, damages must result from relying on it, referring to the fifth requirement in the *Cognos* test.

135 It has been generally accepted that the cause of action in negligent misrepresentation requires proof that the plaintiff relied on the misrepresentation. It is for this reason that courts have usually concluded that negligent misrepresentation claims give rise to such individual inquiries as to reliance that they are unsuitable for certification: *Mouhteros v. DeVry Canada Inc.*, [1998] O.J. No. 2786 (Gen. Div) at para. 30; *Abdool v. Anaheim Management Ltd. et al* (1995), 21 O.R. (3d) 453 (Div. Ct.) at para. 129; *Sherman v. Drabinsky* (1990), 74 O.R. (2d) 596 (H.C.J.), aff'd [1994] O.J. No. 4419 (C.A.); Moyes *v. Fortune Financial Corp.* (2002), 61 O.R. (3d) 770 (S.C.J.), aff'd (2003), 67 O.R. (3d) 795 (Div. Ct.); *Controltech Engineering Inc. v. Ontario Hydro*, [1998] O.J. No. 5350 (Gen. Div.) at para. 16; *Rosedale Motors Inc. v. Petro-Canada Inc.* (1998), 31 C.P.C. (4th) 340, [1998] O.J. No. 5461 (Gen. Div.) at para. 27; *Williams v. Mutual Life Assurance Co. of Canada* (2003), 226 D.L.R. (4th) 112 (Ont. C.A.) at para. 48; *Nadolny v. Peel (Region),* [2009] O.J. No. 4006 (S.C.J.) at para. 93; *Matoni v. C.B.S. Interactive Multimedia Inc.,* [2008] O.J. No. 197 (S.C.J.); *McKay v. CDI Career Development Institutes Ltd.* (1999), 30 C.P.C. (4th) 101, [1999] B.C.J. No. 561 (S.C.) at paras. 39-42; *Olar v. Laurentian University* (2004), 6 C.P.C. (6th) 276, [2004] O.J. No. 3716 (Div. Ct.) at paras. 25-26; *Samos Investments Inc. v. Pattison,* 2001 BCSC 1790, 22 B.L.R. (3d) 46 (S.C.) aff'd 2003 BCCA 87, 30 B.L.R. (3d) 177 (C.A.); *Huras v. COM DEV Ltd.,* [1999] O.J. No. 2560, 36 C.P.C. (4th) 31 (S.C.J.) at para. 19.

136 Issues of reasonable reliance have usually been considered to be individual issues that are not capable of being resolved on a common basis: *Lacroix v. Canada Mortgage and Housing Corp.*, [2009] O.J. No. 316, 68 C.P.C. (6th) 111 (S.C.J.) at para. 97; *Lawrence v. Atlas Cold Storage Holding Inc.* (2006), 34 C.P.C. (6th) 41, [2006] O.J. No. 3748 (S.C.J.), at paras. 91-93; *Carom v. Bre-X Minerals Ltd.* (2000), 51 O.R. (3d) 236 (C.A.) at para. 57; *Serhan (Estate Trustee) v. Johnson & Johnson* (2004), 72 O.R. (3d) 296 (S.C.J.) at paras. 57-60.

137 Exceptions may be made where there is a single representation made to all members of the class or there are a limited number of representations that have a common import: see, for example, *Hickey-Button v. Loyalist College of Applies Arts & Technology*, (2006), 211 O.A.C. 301, [2006] O.J. No. 2393.

138 In *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780, [1998] O.J. No. 4496 (Gen. Div.), Winkler J., as he then was, referred to *Cognos* and *Hercules Management Ltd. v. Ernst & Young* as well as *Parna v. G. & S. Properties Ltd.*, above, in support of the need to prove reliance in negligent misrepresentation cases. He rejected the proposition that proof of reliance could be supplanted by a "fraud-on-the-market" theory, which has found favour in the United States, based on the proposition that in an efficient securities market the market price of the securities reflects the misrepresentations. He concluded, at para. 40:

> The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of *actual reliance* in either tort. In the context of the torts of fraudulent and negligent misrepresentation a presumption of the nature advocated for by the plaintiffs does not exist in Canadian common law. Indeed, to import such a presumption would amount to a redefinition of the torts themselves [emphasis added].

139 The plaintiff relies upon what his counsel described in argument as the "non-reliance theory of misrepresentation" in support of the proposition that, contrary to the authorities set out above, the plaintiff is not required to establish that he or she relied upon the representation.

140 The submission is based, at least in part, on the two recent class action decisions of this court in which similar arguments, made by the same plaintiff's counsel, have been adopted. In the first case, *McCann v. CP Ships*, above, Rady J, after considering a number of authorities to which I shall refer shortly, concluded, at para. 59, that "the case law is in a state of evolution and the court, in certain circumstances, is prepared to relax the otherwise strict requirement to establish individual reliance." She concluded that the plaintiff should be given an opportunity to demonstrate at trial why individual reliance is not necessary and, if it is necessary, class members should be given an opportunity to prove it as a common issue. In the second case, *Silver v. Imax - Certification*, similar arguments were made and the same authorities were considered. Van Rensburg J. concluded that it was not necessary to determine, at the certification stage, whether a plaintiff was required to prove direct reliance and that the issue could be left for argument at trial.

141 In this case, the plaintiff cites many of the authorities that were referred to by Rady J. in *McCann v. C.P. Ships* in support of the proposition that Canadian and common law courts have recognized that reliance *per se* is not an essential element of a common law misrepresentation claim and that the plaintiff need simply establish that the impugned statements *caused* the plaintiff to sustain damage. The plaintiff's counsel says "If causation can be established by some means other than reliance, then the plaintiff can state a valid cause of action."

142 In my respectful view, some of the authorities referred to by the plaintiff are not cases of negligent misrepresentation -- as Van Rensburg J. pointed out at para. 73 of *Silver v. Imax - Certification*, they are cases of negligence or negligent mis-statement where the mis-statement had been made to someone other than the plaintiff, but the plaintiff suffered damages as a result.

143 Thus, in *Haskett v. Equifax Canada Inc.* (2003), 63 O.R. (3d) 577 (C.A.), leave to appeal to S.C.C. dismissed, [2003] S.C.C.A. No. 208, the plaintiff in a proposed class action sued two credit

reporting agencies claiming that their negligence in the preparation of credit reports damaged his ability to obtain credit. The claim was based in negligence, not in negligent misrepresentation. Reliance by the plaintiff was not an issue because the reports were made to other parties, not to the plaintiff. The third party recipient relied, however, on the misrepresentation. In *Spring v. Guardian Assurance plc*, [1994] 3 All E.R. 129 (H.L.), the issue involved the liability of an employer to an employee for negligently prepared letters of reference. Again, the plaintiff was not the immediate recipient of the mis-statement. In Lowe *v. Guarantee Co. of North America* (2005), 80 O.R. (3d) 222 (C.A.), the plaintiff sued medical assessors, alleging that they were negligent in their preparation of evaluations for accident benefit insurers. In this case, again, the plaintiff's reliance was not an issue because the statements complained of were made to third parties, not to the plaintiff. The causes of action are properly described as negligence or negligent mis-statement, not negligent misrepresentation.

144 In *Collette v. Great Pacific Management Co.* (2004), 26 B.C.L.R. (4th) 252, [2004] B.C.J. No. 381 (C.A.), leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 174, the plaintiff's claim was against a financial advisor for failing to undertake appropriate due diligence before offering investments for sale. The claim was expressed as a breach of duty in providing professional services and was framed in both contract and tort. It was alleged that, in providing their services, the defendants had a duty to screen out poor investments before offering them to their clients and that, but for their negligence in failing to do so, the plaintiff and other class members would not have purchased the investment. If the investments had not passed the defendants' flawed due diligence inquiry, they would not have been made available to their clients: the class members.

145 It was argued by the defendants that the investors could not succeed without proof of their individual reliance on representations by the defendants that they had carried out due diligence. Mackenzie J.A., giving the judgment of the British Columbia Court of Appeal stated at paras. 33 and 34:

> The respondents submit that the investors cannot succeed without proof of reliance on the misrepresentation by each investor individually, particularly with respect to the claims, for negligent misrepresentation. The chambers judge concluded that proof of reliance was required for the claims in tort but not in contract.
>
> The reason for insistence on reliance is to establish causation. If causation can be established otherwise, then reliance is not required: see *Henderson*, [1995] 2 A.C. 145, supra, per Lord Goff at 776, and *Yorkshire Trust Co. v. Empire Acceptance Corp. Ltd.* (1986), 24 D.L.R. (4th) 140 at 145-47, 69 B.C.L.R. 357 at 354-55, 22 E.T.R. 96 (S.C.) per McLachlin J. Here if the mortgage units had not passed the due diligence test they would not have been offered for sale by the respondents to any clients. *Causation is therefore established between a breach of due diligence duty and the investors' loss, independently of proof of individual reliance. In my view, proof of reliance does not present an obstacle to the appellant's case as framed. The appellant's case adequately links a breach of duty causally to the investors' losses.* [emphasis added]

146 The words in italics indicate that the Court of Appeal was not deciding that reliance is not an essential ingredient of the tort of negligent misrepresentation. It was simply saying that the claim

could be established in negligence as breach of a duty to conduct due diligence; but for that breach, the units would not have been offered for sale and the plaintiffs would not have suffered damages. The claim was framed as a breach of duty in both negligence and contract, not as an action in negligent misrepresentation. In the case before me, the plaintiff puts this aspect of his case in negligent misrepresentation.

147 The plaintiff also relies on *Yorkshire Trust Co. v. Empire Acceptance Corp. Ltd.* (1986), 24 D.L.R. (4th) 140, [1986] B.C.J. No. 3254 (S.C.), which was referred to by both Rady J. and Van Rensburg J. In that case, a company, Empire, invested in mortgages for the benefit of its clients. Once a mortgage was arranged, it was assigned to the clients, but Empire continued to manage the mortgage investment. Empire obtained a mortgage for some of its clients on the strength of an appraisal that showed there was sufficient equity in the property. The appraisal proved to be wrong and the investors ended up with nothing. Empire sued the negligent appraiser on the ground that it had a duty to its clients and recovered a judgment. In the meantime, Empire went into receivership and its general creditors claimed an interest in the funds that had been recovered as a result of the judgment. The investors claimed that the funds were held on constructive trust for them.

148 McLachlin J., as she then was, found that the funds had been held by Empire, and hence were held by the receiver, on a constructive trust for the investors. It was argued by the receiver that the investors suffered no detriment because they had no cause of action against the appraiser as they themselves had not relied on the appraisal. It was in this context that McLachlin J. considered authorities that had found a representor liable to persons other than the representee whom he or she knew or ought to have known would have been affected by their mistake. After reviewing the role of reliance in negligent misrepresentation, and observing that it had a diminished role in restricting the class of plaintiffs and in establishing a causal link between the statement and the plaintiff's loss, she observed, at paras. 19-21:

> It is my view that in the appropriate case, where proximity and the necessary causal connection between the negligence and the loss can be established apart from reliance, recovery may be had for a negligent statement without reliance, whether on the basis of simple negligence or an extension of the doctrine propounded by *Hedley Byrne, [1964] A.C. 465, supra.* ...
>
> This case, like the *Ministry of Housing v. Sharp*, [1970] 2 Q.B. 223, and *Whittingham v. Crease & Co.*, [1978] B.C.J. No. 1229, cases, does not follow the usual pattern of actions for negligent misrepresentation: the investors did not rely on the appraisal in the sense of considering it and acting on the strength of it. However, their loss was caused by the negligent appraisal just as effectively as they had done so. The agreement between the investors and Empire stipulated that an appraisal of the property had been obtained. Their money was invested on the basis that there was sufficient equity in the property to secure the mortgage. Had the appraisal been done properly, it would have shown insufficient equity in the property to secure a second mortgage; Empire would never have granted a second mortgage; and Empire could not then have assigned any such mortgage to the investors. Because the appraisal was negligently performed, the investors placed their money in a property which did not provide sufficient security and lost it. It might be argued that this is a form of reliance. At very least, both fore-

> seeability of the loss and a causal connection between the negligent appraisal and the investors' loss are established.
>
> ... I conclude that the investors had a cause of action against the appraisers.

149 This decision can be regarded as consistent with the authorities referred to earlier, in which a negligent mis-statement caused damage to someone other than the representee and formed a basis for a claim for damages for negligence. It was referred to in *Collette v. Great Pacific Management Co.,* above, and like that case was fundamentally an action in negligence. In the case before me, as I have noted, the plaintiff puts his claim squarely in negligent misrepresentation. In the case of the secondary market claim, he says that Class Members relied on the misrepresentations to their detriment by purchasing Gammon securities at inflated prices. He pleads that he "directly or indirectly" relied on the misrepresentations in the Prospectus -- unlike the plaintiffs in the foregoing cases, Mr. McKenna and the Class Members are the representees and he claims that they have suffered damages as a result of misrepresentations made to them.

150 The plaintiff also relies on *Eaton v. HMS Financial Inc.,* 2008 ABQB 631, 64 C.P.C. (6th) 295, in which a class of investors alleged that they had been induced to invest in a fraudulent investment. They sued not only the principals of the scheme but lawyers, financial institutions and others who played incidental roles in their losses. Some of the financial institutions argued that the claims against them for negligent misrepresentation would require individual assessments of the reliance issue. The plaintiffs argued that a direct causal link between the fraudulent scheme and the investors' losses could be established by means other than reliance. Rooke J. declined to decide the issue, leaving it to the judge at the common issues trial to determine the extent to which individual reliance needed to be analyzed.

151 I accept the proposition that in a case of misrepresentation proof of reliance can be made by inference, as opposed to direct evidence. The point was made by Cumming J. in *Mondor v. Fisherman,* (2001), 15 C.P.R. (4th) 289, [2001] O.J. No. 4620 (S.C.J.), in which he noted, at para. 61 that the "fraud on the market" theory has been expressly rejected in Canada and he noted the observation of Winkler J. in *Carom v. Bre-Ex Minerals Ltd.*, referred to above, to the effect that the ingredients of negligent misrepresentation are well known. Cumming J. held, however, that whether or not someone actually relied on a misrepresentation can be inferred from all the circumstances: see *Kripps v. Touche Ross & Co.,* [1997] B.C.J. No. 968, 89 B.C.A.C. 288 at para 101; *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514 at 547 (C.A.).

152 Similar observations were made by Hoy J. in *Lawrence v. Atlas Cold Storage Holding Inc.,* above, at paras. 88-93 in which she considered a motion to strike negligent misrepresentation claims in a proposed class action in which claims were made under s. 130 of the *Securities Act*, as well as on the basis of negligent misrepresentation and fraudulent misrepresentation. Hoy J. concluded, referring to *NBD Bank, Canada* v. *Dofasco Inc.,* above, and *Mondor v. Fisherman*, above, that the claim should not be struck because the plaintiff might be able to satisfy the trial judge that in all the circumstances actual reliance on the alleged misrepresentation could be inferred. She observed, however, at para. 93, that the issue could impact the appropriateness of misrepresentation as a common issue:

> This need to determine reliance, as a matter of fact, with respect to each member of the class, as opposed to being able to rely on a class-wide presumption of reli-

> ance on publicly distributed information as a matter of law [i.e., under s. 130 of the *Securities Act*], will of course significantly impact on certain issues in certification.

153 The action was ultimately settled, and certified without opposition: [2009] O.J. No. 4271 and for that reason the common issues were not discussed in detail.

154 In some cases examination of the surrounding circumstances may be a preferable means of determining reliance rather than the self-serving statement of the plaintiff saying "I relied on it." This does not mean, however, that reliance can be inferred on a class-wide basis. The need to examine the individual circumstances of each shareholder would, as Hoy J. suggested, make certification of the claim problematic.

155 The need for proof of reliance in misrepresentation claims was once again confirmed by the Court of Appeal in *Boulanger v. Johnson & Johnson Corp.* (2003), 174 O.A.C. 44, [2003] O.J. No. 2218. In that case, the plaintiff brought a proposed class action in connection with the marketing and sale of a prescription drug called Prepulsid. The plaintiff claimed, among other things, that the manufacturer's filings with Health Canada were negligently prepared and failed to disclose important information. The Court of Appeal agreed, at para. 11, with the motion judge that the pleading of negligent misrepresentation could not be sustained because of the lack of reliance by consumers on the statements in the regulatory filings:

> The motions judge also concluded that these pleadings could not be sustained on the basis of negligent misrepresentation. Again I agree. It is clear that in Canada, *actual reliance is a necessary element of an action in negligent misrepresentation and its absence will mean that the action cannot succeed.* See *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. Here there is absolutely no assertion of reliance by the appellant (or by anyone on her behalf) on the representations of the respondents to Health Canada. Indeed there is no pleading of reliance on the fact of regulatory approval. *This complete absence of reliance is fatal to a negligent misrepresentation claim.* Thus these paragraphs of the statement of claim cannot be said to disclose a reasonable cause of action based on misrepresentation [emphasis added].

156 The Court concluded, however, at para. 14, that a claim could be made out in either negligence or negligent misstatement:

> The appellant's allegation is that the standard of care required of the respondents includes taking reasonable care in the filings they made to obtain regulatory approval and that without that approval, Prepulsid would not have been available to harm the appellant. These filings are pleaded as an aspect of the respondents' conduct which caused the appellant harm and which fell below the standard required of a reasonable drug manufacturer. They are one of the ways in which the appellant says the respondents were negligent. Framed this way, I cannot say that it is plain and obvious that such a claim will fail. Indeed the claim could appropriately be viewed as one of negligent misstatement. See *Haskett v. Equifax Canada Inc.*, [2003] O.J. No. 771 (C.A.), leave to appeal to S.C.C. requested.

157 In *McCann v. CP Ships*, Rady J. concluded, at paras. 59-60, that the law on the issue of reliance is in a state of evolution and that in some cases the courts have been prepared to relax the requirement. She adopted the language of Rooke, J. in *Eaton v. HMS Financial Inc.*, above, to the effect that it was too early to determine whether individual reliance is necessary and the plaintiff should be given an opportunity to demonstrate at trial why individual reliance is not necessary. In addition, she found that if reliance is a necessary prerequisite to recovery, class members should have an opportunity to prove it as an individual issue.

158 In *Silver v. Imax (Certification)*, Van Rensburg J. expressed doubt about the plaintiff's theory that reliance is not a necessary ingredient of misrepresentation in light of the decision of the Supreme Court of Canada in *Cognos.* She found it unnecessary to rule on this issue for the purposes of certification, stating that the pleading disclosed a cause of action in negligent misrepresentation, notwithstanding the absence of a pleading of direct individual reliance, and that if the plaintiffs were not able to prove reliance it would remain open for them to argue at trial that reliance is not required.

159 With deference to my colleagues who have come to a different conclusion, I accept the submission of counsel for the defendants that there is authority, binding on me, that makes proof of reliance a necessary requirement of a negligent misrepresentation claim. This is why the legislature has seen fit to relieve the investing public of this onerous requirement in the primary market through s. 130(1) and s. 131.1(1), which contain "deemed reliance provisions," and in the secondary market by a similar provision in s. 138.3(1) of the *Securities Act.* The right to pursue the latter claim is subject to the plaintiff passing the initial hurdle in obtaining leave under s. 138.8 by showing that the action is brought in good faith and has a reasonable prospect of success.

160 I conclude that the need to prove reliance as a necessary element of negligent misrepresentation, and the inability to establish reliance as a common issue, makes the common law misrepresentation claims, in both the secondary and primary markets, fundamentally unsuitable for certification. In this case, multiple misrepresentations are alleged throughout the ten month Class Period, in press releases, regulatory filings, conference calls, annual reports and a multitude of other written and oral forms. The alleged misrepresentations relate to a variety of complaints, not simply the level of gold production. The plaintiff complains of undisclosed equipment failures, contracts with insiders, stock option expenses, non-compliant financial statements and inadequate disclosure controls. Individual inquiries would have to be made into what alleged misrepresentations were made to each class member and whether he or she relied upon any of those representations. As was stated by Winkler J. in *Mouhteros v. DeVry Canada Inc.,* above, at para. 30:

> Assuming that the misrepresentation issues identified above were capable of a common resolution, such resolution would be but the beginning, and not the end of the litigation. With respect to the claim for misrepresentation in tort, the plaintiff must prove reasonable reliance on a misrepresentation negligently made. Reliance is an essential element of the tort. The question of reliance must be determined based on the experience of each individual student, and will involve such evidentiary issues as to how the student heard about DeVry, whether the student saw any of the advertisements and if so, which ones, what written representations were made to the student prior to enrolment, whether the student met with an admissions officer, and whether the student relied on some or all of these in deciding to enrol in DeVry. The inquiry will not end there, however. If the class

members are able to demonstrate reliance, they must show that they relied to their detriment. Damages will require individual assessment.

161 There is no basis on which reliance could be resolved as a common issue. The need to determine the issue individually would give rise to a multitude of questions in each case concerning the representations communicated to a particular investor, the experience and sophistication of the investor, other information or recommendations made to the investor and whether there was a causal connection between the misrepresentation(s) and the acquisition of the security. The inability to determine the defendants' liability without individual inquiries as to reliance makes the proceeding unsuitable for certification in relation to the negligent misrepresentation claim.

162 For these reasons, to the extent that the proposed common issues identified above as (a), (b), (c) and (d) relate to the claim for negligent misrepresentation at common law, as opposed to the s. 130 claim, they are unsuitable for certification. To the extent that they (or specifically enumerated common issues) relate to the claims for negligence or "reckless misrepresentation", they will not be certified for the reasons set out under the cause of action analysis.

163 This conclusion does not prevent the plaintiff from bringing a properly-structured claim for misrepresentation in the secondary market under s. 138.3(1) provided its requirements are met. The plaintiff is entitled to pursue the claim for misrepresentation under the Prospectus, under s. 130 of the *Securities Act* and common issues dealing with that claim will be certified.

(ii) Conspiracy common issues

164 I will defer certification of the common issues relating to conspiracy until the plaintiff delivers particulars of the special damages alleged to have been suffered by the representative plaintiff, and any further motions by the defendants in relation to that pleading.

(iii) Unjust enrichment

165 The underwriters do not dispute that the cause of action in unjust enrichment raises common issues that are appropriate for certification. Those common issues will be certified.

(iv) Damages

166 The plaintiff's summary of the common issues, set out above, does not list damages as a common issue, presumably because the quantum of damages would be an individual issue. The list of common issues in the notice of motion, however, includes the question: "If the Defendants are liable to the Class Members, what is the price at which Gammon's shares would have traded had the Defendants made no representations?" It seems to me, that in the context of the s. 130 claim, the appropriate common issue is, to use the statutory language, "What was the depreciation in value, if any, of the Gammon shares as a result of the misrepresentations in the Prospectus." In light of s. 130(7) of the *Securities Act*, the defendants would have the onus of proving that the depreciation in value of the shares was not due to the misrepresentation. It seems to me that this issue could be determined on a common basis. I leave it to counsel to consider whether there should be a common issue certified with respect to damages and, if so, to bring the appropriate motion.

(v) Punitive damages

167 The defendants assert that the claim for punitive damages is not appropriate for certification because punitive damages should be awarded where the compensatory damages fail to achieve the goals of retribution, deterrence and denunciation: *Whiten v. Pilot Insurance Co.* (2002), 209 D.L.R. (4th) 257, [2002] 1 S.C.R. 595 ("*Whiten*") at para. 94. They say that this determination can only be made after the determination of individual entitlement to damages.

168 The defendants refer to *Robinson v. Medtronic Inc.*, [2009] O.J. No. 4366 (S.C.J.) in which Perell J. undertook an extensive review of the case law concerning certification of claims for punitive damages in class proceedings. While noting that such claims have been certified in a number of cases, Perell J. held that punitive damages will not be categorically certifiable as a common issue (at para. 166). Instead, the determination of whether a punitive damages claim is appropriate will depend on whether it has "the commonality necessary for a common issue" (at para. 166). Referring to Justice Binnie's judgment in *Whiten*, above, Perell J. held (at para. 170) that the assessment of punitive damages at a common issues trial will require an appreciation of:

> (a) the degree of misconduct;
> (b) the amount of harm caused;
> (c) the availability of other remedies;
> (d) the quantification of compensatory damages; and
> (e) the adequacy of compensatory damages to achieve the objectives of retribution, deterrence, and denunciation.

169 The certification of punitive damages as a common issue will only be appropriate where the common issues judge will be in a position to assess these factors. Applying this test to the case before him, Perell J. held (at para. 172) that:

> ... the common issues associated with negligence and with conspiracy ... will <u>not</u> be dispositive of Medtronic's liability because proof of causation and proof of damages will depend on individual trials that will follow the common issues trial. Whether Medtronic caused any harm and the amount of it will not be known until the individual issues are determined. [emphasis in original]

In the case before him, punitive damages could not be assessed by the common issues judge before determination of the individual issues.

170 Applying Justice Perell's test to the case presently before me, I find that the requirements for the certification of punitive damages as a common issue have been met. The nature of the present securities class action, as opposed to the product liability action before Perell J., makes the degree of misconduct, causation, harm, and the quantification of compensatory damages determinable by the common issues judge. There is no need for individual proof of loss to enable a common issues judge to assess punitive damages.

(d) <u>Preferable Procedure</u>

171 For a class proceeding to be the preferable procedure for the resolution of the claims of the class, it must represent a fair, efficient, and manageable procedure that is preferable to any alternative method of resolving the claims: *Cloud v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401 (C.A.) at paras. 73-75, leave to appeal to S.C.C. ref'd, [2005] S.C.C.A. No. 50.

172 The preferability inquiry should be conducted through the lens of the three principal advantages of a class proceeding: judicial economy, access to justice and behaviour modification: "Preferable" is to be construed broadly and is meant to capture the concepts of whether the class proceeding would be a fair, efficient and manageable method of advancing the claim and whether a class proceeding would be preferable to any other means of resolving the dispute.

173 The preferability determination must be made by looking at the importance of the common issues in relation to the claims as a whole: *Markson v. MBNA Canada Bank,* 2007 ONCA 334, 85 O.R. (3d) 321 at para. 69, leave to appeal dismissed [2007] S.C.C.A. No. 346. In considering the preferable procedure criterion, the court should consider:

(a) the nature of the proposed common issue;
(b) the individual issues which would remain after determination of the common issue;
(c) the factors listed in the *C.P.A.*;
(d) the complexity and manageability of the proposed action as a whole;
(e) alternative procedures for dealing with the claims asserted;
(f) the extent to which certification furthers the objectives underlying the *C.P.A.*; and
(g) the rights of the plaintiff(s) and defendant(s): *Chadha v. Bayer Inc.* (2001), 54 O.R. (3d) 520 (Div. Ct.) at para. 16, aff'd (2003), 63 O.R. (3d) 22 (C.A.), leave to appeal to S.C.C. ref'd, [2003] S.C.C.A. No. 106.

174 A class action is unquestionably the preferable procedure for the claim under s. 130(1) of the *Securities Act.* The remedy is tailor-made for a class action: see *Allen v. Aspen Group Resources Corp.*, above, at paras. 138-144; John J. Chapman, "Class Proceedings for Prospectus Misrepresentations" (1994), 73 *Can. Bar Rev.* 492. *Allen v. Aspen* was a claim under s. 131(1) of the *Securities Act* in connection with an offering memorandum in a take-over bid, but the principles are the same.

175 I can think of no more preferable procedure for the claims against the underwriters for unjust enrichment or against the Gammon Defendants for conspiracy. In both cases, a class action would promote the goals of access to justice, judicial economy and behavior modification. No alternatives were suggested.

176 The Gammon defendants submit that a class action under section 138.1 of the *Securities Act* would be the preferable procedure for the claim for negligent misrepresentation in the secondary market.

177 As discussed earlier, that section provides a statutory cause of action for misrepresentation against a "responsible issuer," its directors and against officers who authorized, permitted or acquiesced in the release of a document containing a misrepresentation. The Gammon Defendants say that s. 138.1 is the preferable procedure because the "deemed reliance" provision overcomes the intractable problem of proving reliance in a class action alleging common law misrepresentation. The say that the procedure is fair to both parties since it contains a reasonable threshold for leave that simply requires the plaintiff to show that the action has been brought in good faith and that there is a reasonable possibility that the action will be resolved in the plaintiff's favour. Moreover, while there are certain liability caps available to the defendants in the s. 138.1 action, there are certain benefits to plaintiffs. The availability of a fair efficient and manageable remedy under that Part, which has definite advantages over a common law action (albeit subject to some limitations), give some reas-

surance that access to justice and behavior modification can be achieved, notwithstanding that the common law claims have not been certified.

178 As I have found that the secondary market claim is not appropriate for certification, I do not propose to consider the preferability issue in relation to that claim.

(e) Representative Plaintiff

179 In order to certify this action as a class proceeding, there must be a representative plaintiff who would fairly and adequately represent the interests of the class, who does not have a conflict on the common issues with other members of the class, and who has produced a workable litigation plan.

180 Mr. McKenna acquired Gammon securities during the Class Period. He sold 900 shares in March of 2008 but continues to hold 100 shares. He claims that he can fairly and adequately represent the class, that he has no conflict with the Class and that he is represented by experienced counsel who have produced a workable litigation plan on his behalf. The defendants say that Mr. McKenna is hopelessly inadequate as a representative plaintiff for a variety of reasons, many of which are not applicable as a result of my conclusion that the secondary market and negligent misrepresentation claims will not be certified.

181 I have addressed the complaint that Mr. McKenna's claim is time-barred, which was one of the reasons the defendants said he was an unsuitable plaintiff.

182 The defendants say that Mr. McKenna is an inappropriate representative for the institutional shareholder of Gammon, who have the most at stake, little interest in pursuing claims and "different perspectives or objectives." The causes of action asserted by Mr. McKenna and the institutional investors are identical and they have no conflict on the common issues. It is not uncommon for members of a class to have different perspectives on the claim and for some members to be unenthusiastic about the claim. If the institutional investors have no interest in the claim, or see it as detrimental to their interests, they can opt out of the action. If they do not wish to opt out, but consider that their interests are not adequately represented by Mr. McKenna, they may move for the appointment of a separate representative. To the extent they see the claim as unfounded and ill-conceived, they can support Gammon's defence.

183 The defendants say that there is also a conflict between Mr. McKenna and investors who no longer hold Gammon securities and those (including the institutional investors) who will continue to hold them until the time of trial. They suggests that the effect of this is that current shareholders would effectively be suing themselves and that any judgment Gammon is required to pay to former and current shareholders will dilute the value of the shares held by the continuing shareholders. It seems to me that this concern arises in any s. 130 claim where the class will include former as well as current shareholders. It is not a reason to refuse to certify the claim. While there may be different theories of damages applicable to shareholders who have retained their shares, as opposed to those who have sold them, this does not mean that there will be an inevitable conflict of interest. I respectfully agree with the approach taken by Cumming J. in *Kerr v. Danier Leather Inc.*, [2001] O.J. No. 4000, 14 C.P.C. 292 (S.C.J.) at para. 67, that the issue can be dealt with by the creation of a subclass, with a separate representative plaintiff, should that prove necessary.

184 For the reasons set out above with respect to non-residents, it is my view that there should be a representative on behalf of non-resident Class Members. The plaintiff may make an application to propose a representative of this group and to propose a sub-class or classes if necessary.

IV. Conclusion

185 In the result, this action will be certified as a class proceeding with respect to the cause of action against all defendants under s. 130 of the *Securities Act* and the additional claim for unjust enrichment against the Underwriters. The motion for certification of the conspiracy claim is adjourned pending the delivery of particulars of the special damages alleged to have been sustained by the representative plaintiff.

186 The Class definition in relation to the claim under s. 130 of the *Securities Act* and the claim for unjust enrichment will be limited to those who acquired their shares through the Underwriters in Canada.

187 Counsel shall prepare an order incorporating my conclusions and in compliance with s. 8 of the *C.P.A.* If additional issues arise, they can be addressed in a case conference. The parties may make written submissions as to costs, to be filed within 30 days, in accordance with a schedule to be agreed upon between counsel.

G.R. STRATHY J.

cp/e/qlrxg/qljxr/qlced/qlaxw/qljyw

TAB 9

Case Name:

Marcantonio v. TVI Pacific Inc.

Between
Joe Marcantonio, Plaintiff, and
TVI Pacific Inc., Clifford M. James, Robert C. Armstrong, C. Brian Cramm, Jan R. Horejsi, Peter C.G. Richards, and John W. Adkins, Defendants
PROCEEDING UNDER the Class Proceedings Act, 1992

[2009] O.J. No. 3409

82 C.P.C. (6th) 305

2009 CarswellOnt 4850

179 A.C.W.S (3d) 761

Court File No. CV-08-35806100CP

Ontario Superior Court of Justice
Toronto, Ontario

J.L. Lax J.

Heard: June 17, 2009.
Judgment: August 10, 2009.

(38 paras.)

Civil litigation -- Civil procedure -- Parties -- Class or representative actions -- Certification -- Settlements -- Approval -- Costs -- Particular items -- Counsel fees -- Particular circumstances -- After discontinuance of action -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Class Proceedings Act, 1992, s. 33.

Legal profession -- Barristers and solicitors -- Compensation -- Contingency agreements -- Fair and reasonable -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Professional responsibility -- Self-governing professions -- Remuneration -- Contingency fees -- Professions -- Legal -- Barristers and solicitors -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable.

Securities regulation -- Civil liability -- Public statements or release of documents by influential persons -- Motion by parties for certification of class proceeding for settlement purposes allowed -- Plaintiff class properly defined as those who purchased securities from defendant over limited period -- Pleadings adequately alleged negligence, misrepresentation and conspiracy on part of company and officers -- Representative plaintiff appropriate -- Settlement of $2.1 million reasonable given statutory limits on recovery at and risks of trial -- Contingency fees of 25 percent of settlement amount reasonable -- Securities Act, s. 138.

Motion by all parties to certify an action as a class proceeding for settlement purposes. The action was launched against TVI, a publicly-traded mining company, and its directors and officers by shareholders who alleged the defendants conspired to issue materially false or misleading financial statements and otherwise contravening securities law. The action proceeded in Ontario and Quebec. On the eve of the due date for the defendants to file materials in response to the certification record, settlement negotiations were initiated. They resulted in a settlement agreement under which TVI would pay $2.1 million, would try to re-price certain outstanding stock options, and would adopt corporate governance measures to prevent future options manipulation. The parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees for the Ontario class of plaintiffs, defined as those who acquired TVI securities during the defined class period and held those securities on August 9, 2007, as well as exempt Quebec class members. The experienced class counsel retained by the representative plaintiff recommended approval of the settlement as it was half of what the plaintiffs were limited to achieve at trial, and would avoid the time and expense of trial which would significantly erode the benefits to the class members of the ultimate award. Litigation would have been complex because of recent changes to securities law. Class counsel sought approval for fees totalling $525,000, or 25 percent of the settlement amount. The retainer agreement provided for this sum.

HELD: Motion allowed. The pleadings disclosed a cause of action in negligence, negligent and fraudulent misrepresentation and conspiracy. There was ain identifiable class of plaintiffs. The claims raised common issues. Individual litigation of each plaintiff's claim would be difficult, time-consuming and expensive. The representative plaintiff had no interests in conflict with those of the

other Ontario class members. The settlement was the product of arm's length bargaining by experienced counsel and presumed fair. In light of the risks faced by the plaintiffs, the range of damages they stood to recover, and the recommendations of class counsel, the court approved the settlement. Legal fees were awarded to class counsel as claimed, because they were fair and reasonable.

Statutes, Regulations and Rules Cited:

Class Proceedings Act, 1992, S.O. 1992, c. 6, s. 33

Securities Act, R.S.O. 1990, c. S.5, s. 138.3, s. 138.5, s. 138.8(1)

Counsel:

A. Dimitri Lascaris and *Monique L. Radlein*, for the Plaintiff.

Eric R. Hoaken, for the Defendants.

ENDORSEMENT

1 J.L. LAX J.:-- This is a securities class action brought pursuant to the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 ("CPA") arising from alleged misrepresentations and stock options manipulation. The parties settled the action on April 22, 2009, and brought a motion for, among other things, an order certifying the action as a class proceeding for settlement purposes, approving the settlement and approving class counsel fees. I granted the order with reasons to follow. These are my reasons.

Nature of the Claim

2 TVI Pacific Inc. ("TVI") is a publicly-traded mining company with its shares listed on the Toronto Stock Exchange ("TSX"). The individual defendants were directors of TVI. This action is brought on behalf of an Ontario class of persons and entities who acquired TVI securities on or after March 30, 2006, and held some or all of the securities on August 9, 2007. It is alleged that during the class period the defendants (1) conspired and breached their duty of care to TVI shareholders by issuing materially false and/or inaccurate audited financial statements for years ended 2005 and 2006 and interim unaudited financial statements for the quarter ended March 31, 2007; and (2) granted in-the-money stock options in contravention of TVI's Stock Option Plan, TSX rules and securities legislation in Ontario and Quebec. With respect to the financial statements, TVI subsequently issued two corrective disclosures on August 9, 2007 and December 18, 2007.

3 On March 3, 2008, Siskinds LLP filed a class proceeding against the defendants on behalf of Mr. Florent Audette, a Quebec resident. At that time, no Ontario resident had come forward to represent the interests of the class in Ontario. On April 10, 2008, this action was filed on behalf of Mr. Joe Marcantonio, an Ontario resident, alleging claims similar to those made in the Audette Ontario action. On July 25, 2008, the Quebec affiliate of Siskinds, filed the Petition styled *Audette c. TVI Pacific Inc. et al*, [2009] J.Q. no 4647, in Quebec Superior Court and Mr. Audette gave instructions to hold the Audette Ontario action in abeyance. After the settlement was reached, Mr. Audette instructed Siskinds to request the discontinuance of the Audette Ontario action.

4 Mr. Marcantonio served his certification record in October 2008. On the eve of the due date for the filing of the defendants' responding materials, the defendants initiated settlement discussions. Following several months of negotiations, the parties concluded a settlement agreement that provides for:

(a) a gross settlement fund of $2.1 million;
(b) TVI's agreement to make efforts to re-price certain outstanding stock options; and
(c) the adoption of corporate governance measures designed to prevent future options manipulation.

5 As a result of the settlement, the parties jointly sought certification for the purposes of settlement, settlement approval and approval of legal fees and disbursements on behalf of an Ontario class defined as:

> All persons and entities, who acquired securities of TVI during the Class Period, and who held some or all of those securities on August 9, 2007, other than Excluded Persons and Quebec Class Members, but specifically including the Exempt Quebec Members.

Certification

6 Numerous cases hold that where certification is sought for the purposes of settlement, the certification requirements must be met, but are not applied as stringently. Perell J. has helpfully gathered the authorities together and they can be found in *Corless v. KPMG LLP*, [2008] O.J. No. 3092 at para. 30 (S.C.J.) (QL).

7 For settlement purposes, I am satisfied that each of the criteria for certification is satisfied. The pleadings disclose a cause of action against the defendants for negligence, negligent and fraudulent misrepresentation, and conspiracy. The pleading asserts that the plaintiff intends to seek leave under s. 138.8(1) of the *Securities Act*, R.S.O. 1990, c. S.5 ("OSA") to amend the Statement of Claim to plead the cause of action in s. 138.3 of the *OSA*. There is an identifiable class defined by objective criteria that (a) identifies persons with a potential claim, (b) describes who is entitled to notice, and (c) defines those who will be bound by the result: *Bywater v. Toronto Transit Commission*, [1998] O.J. No. 4913 at para. 10 (Gen. Div.) (QL).

8 The claims of the class members raise the following common issue:

> Did the defendants, or any of them, breach duties of care owed to the Ontario class, by reason of the alleged acts, omissions, disclosures or non-disclosures relating to the issuance and/or restatement of TVI's audited consolidated financial statements for the years ended December 31, 2005 and 2006, and its interim unaudited consolidated financial statements for the quarter ended March 31, 2007, and or to TVI's stock option practices during or prior to the Class Period?

9 Individual litigation of securities cases can be difficult, time-consuming and expensive. Many claims would never be advanced because they are uneconomic for an individual investor to pursue. A class action is the optimal method of procuring a remedy for a group of investors who allege they have been harmed in similar ways as a single determination of the defendants' liability eliminates

duplication of fact-finding and legal analysis. Further, a class action has the potential to act as an essential and useful supplement to the deterrent effects of regulatory oversight. It enhances the incentive for directors and officers to ensure that their disclosures to the investing public are materially accurate, thereby enhancing investor protection. Consequently, a class proceeding is the preferable procedure because it provides a fair, efficient and manageable method of determining the common issue, and advances the proceeding in accordance with the goals of access to justice, judicial economy and behaviour modification.

10 Mr. Marcantonio is a member of the proposed Ontario class and would fairly and adequately represent its interests. He does not have, regarding the common issues or any issues arising out of the common issues, any interests in conflict with the interests of other Ontario class members. He has an understanding of the issues and allegations raised in the Ontario action and has actively participated in the litigation and the settlement process.

Settlement Approval

11 To approve a settlement, the court must find that the settlement is fair, reasonable and in the best interests of the class as a whole: *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 at para. 9 (Gen. Div.) (QL); *Parsons v. Canadian Red Cross Society*, [1999] O.J. No. 3572 at paras. 68-69 (S.C.J.) (QL). To be approved, the settlement must fall within a zone or range of reasonableness: *Ontario New Home Warranty Program v. Chevron Chemical Co.* (1999), 46 O.R. (3d) 130 at para. 89 (S.C.J.), Winkler J. (now C.J.O.).

12 In determining whether to approve a settlement, the court uses the following factors as a guide, although some will have more or less significance than others and some may not be present in a particular case: (a) the likelihood of recovery or likelihood of success; (b) the amount and nature of discovery, evidence or investigation; (c) the settlement terms and conditions; (d) the recommendation and experience of counsel; (e) the risk, future expense and likely duration of litigation; (f) the recommendation of neutral parties, if any; (g) the number of objectors and nature of objections; (h) the presence of good faith, arm's length bargaining and the absence of collusion; (i) the information conveying to the court the dynamics of, and the positions taken by the parties during the negotiations; and (j) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation. See *Parsons v. Canadian Red Cross Society, supra* at paras. 71-72.

13 Before the court is a comprehensive affidavit of Mr. Charles Wright who is a Siskinds' partner and an experienced class action lawyer. He was directly involved in the prosecution and resolution of this action. His evidence points to a number of factors that commend this settlement as fair and reasonable and in the best interests of the class. I review some of these below.

14 Securities class actions are not that common perhaps because there are substantial risks in prosecuting them. Unlike purchasers in the primary market, who are provided a right of action under the *OSA*, until recently, secondary market purchasers had to persuade the court that the defendants owed them a duty of care. In response, defendants have argued, and courts have often held, that secondary market purchasers have to demonstrate that they actually relied upon the defendants' misrepresentations. On December 31, 2005, Bill 198, now embodied in Part XXIII.1 of the *OSA*, came into force. It was a response to the perceived failure of the common law to provide an effective remedy for secondary market misrepresentation. Part XXIII.1 removes the reliance requirement

through the creation of a statutory right of action. However, the right of action is subject to obtaining leave of the court and there has never been a leave decision under the new legislation.

15 In addition to the uncertainty surrounding the ability to advance the statutory cause of action, the plaintiff in this action also faced the risk of not being able to establish (i) that the representations or omissions were materially misleading; (ii) that the class had incurred the damages claimed; and (iii) to the extent necessary for purposes of the common law claims, detrimental reliance.

16 Class counsel's estimate of class damages was $16 million. In the course of settlement discussions, class counsel retained Mr. Paul Mulholland, an expert in the measurement of securities class action damages, to assess actual damages suffered by the class during the class period. It is Mr. Mulholland's opinion that class damages as assessed by a court would not approach this number, but rather would likely fall between the lowest and highest estimates of the statutorily established limits on the defendants' liability, as explained below.

17 The statutory claim under Part XXIII.1 of the *OSA* is subject to liability limits. It caps the issuer's liability at the greater of 5% of the pre-misrepresentation market capitalization of the defendant issuer and $1 million. The statute directs how market capitalization is to be calculated. Class counsel performed this calculation and determined that TVI's liability limit fell within the range of about $2.8 million to $4.2 million.

18 Part XXIII.1 of the *OSA* also sets caps on the liability of directors and officers. Class counsel performed this calculation and determined that these liability limits were $189,500 (rounded to $200,000). The application of the liability limits (absent proof of fraud) would thus limit total recovery from the defendants to a range of approximately $3 million to $4.4 million. As a result, even if the plaintiff and class members were completely successful at trial, they would have had difficulty obtaining damages greater than $4.4 million, and could be limited to damages of as little as $3 million.

19 The caps discussed above do not apply to the common law claims for damages arising from negligence and negligent and fraudulent misrepresentation. However, as I have mentioned, the damages assessment of Mr. Mulholland is that these damages, if proved, would fall within the statutory limits. Moreover, as noted earlier, misrepresentation claims can be difficult to certify as reliance is a necessary element of proof: *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. As well, the defendants had due diligence and reasonable reliance defences available to them and there was a risk that these defences would succeed.

20 The court requires sufficient evidence in order to exercise an objective, impartial and independent assessment of the fairness of the settlement: *Dabbs, supra* at para. 15. However, it is not necessary for formal discovery to have occurred at the time of settlement, and settlements reached at an early stage of the proceedings can be appropriate. In this case, no discoveries or other examinations were completed, but I am satisfied that class counsel had significant information about the case as a result of their own investigations and the information that was obtained from the defendants in the course of settlement discussions. In particular, the defendants provided to class counsel an expert opinion which they had obtained. The defendants' expert concluded that the damages of the class were negligible as all or virtually all of the share price decreases resulted from news affecting the mining industry as a whole and were unrelated to the erroneous financial statements. Although class counsel disputed this, it was in light of this opinion that Mr. Mulholland was retained.

21 The settlement amount of $2.1 million represents a substantial portion of the potentially recoverable damages of between $3 million and $4.4 million assessed by Mr. Mulholland. As a percentage of gross recovery, it represents between 48% and 70% of his assessment of loss. On a net recovery basis, taking into account class counsel's requested fees and administration expenses, which together are in the amount of $809,287.17, the class would recover between 29% and 43% of the loss. This recovery is fair and reasonable and compares very favourably with the percentage net recovery in other securities class action settlements, such as *Mondor v. Fisherman*, [2002] O.J. No. 1855 (S.C.J.) (QL), and *Lawrence et al. v. Atlas Cold Storage et al.* (February 12, 2009), Toronto 04-CV-263289CP (S.C.J.) where net recovery was in the range of 20%.

22 With respect to the options-related allegations, the information provided by the defendants made it clear that many of the problems were a result of poor procedures, rather than intentional fault. It also became clear that any benefits to the defendants were negligible due to the decrease in TVI's share price. This resulted in certain options becoming substantially out-of-the-money.

23 Nonetheless, in order to address the allegations concerning the granting of in-the-money stock options, the settlement agreement provides that TVI will make all reasonable efforts to effect the repricing of these options. In addition, it provides that TVI will develop and implement corporate governance measures as specified in the agreement to address its stock option granting practices. For the purpose of obtaining advice concerning the recommended corporate governance measures, class counsel retained and relied on advice from Dr. Richard Leblanc, Assistant Professor of Law, Corporate Governance & Ethics at York University. In the opinion of class counsel, these reforms are productive enhancements of significant value to shareholders.

24 Although Ontario class counsel received a number of inquiries about the settlement following publication of the notices approved by the court, there are no objectors. The distribution protocol harmonizes the plaintiff's theory of damages with s. 138.5 of the *OSA*. The result is a formula that takes into account the two corrective disclosures and is designed to fairly and rationally allocate the proceeds of the net settlement amount among authorized claimants based on the relative strength of the class members' claims as the class period progressed and damages were incurred.

25 At the time of settlement, the action was still in the early stages of litigation. Without a settlement, the plaintiff would have faced the expense of a leave motion under the new secondary market liability provisions of the *OSA*, a contested certification motion, discovery, a trial of the common issues, and inevitable appeals at each stage. Absent a settlement, there would have been no payment to class members for a number of years. A settlement brings the significant benefit of finality and an immediate payment to class members.

26 This settlement is the product of arm's length bargaining by very experienced counsel. There is a strong initial presumption of fairness when a proposed class settlement, which was negotiated at arm's length by class counsel, is presented for court approval. As Justice Sharpe (as he then was) stated in *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 2811 (Gen. Div.) (QL) at para. 32:

> ... The recommendation of counsel of high repute is significant. While class counsel have a financial interest at stake, their reputation for integrity and diligent effort on behalf of their clients is also on the line. ...

27 In light of the risks the plaintiff faced, the possible range of damages recoverable, the substantial benefit available to class members, and the recommendation of class counsel who have extensive experience in litigating class actions and particular expertise in securities class actions and stock options manipulation, I am satisfied that the settlement is fair, reasonable and in the best interests of the class. For these reasons, it was approved.

Class Counsel Fees

28 The fees of class counsel are to be fixed and approved on the basis of whether they are fair and reasonable in all of the circumstances. This is determined in light of the risk undertaken and the degree of success or result achieved: *Maxwell v. MLG Ventures Ltd.* (1996), 30 O.R. (3d) 304 (Gen. Div.); *Windisman v. Toronto College Park Ltd.*, [1996] O.J. No. 2897 (Gen. Div.); *Serwaczek v. Medical Engineering Corp.*, [1996] O.J. No. 3038 (Gen. Div.); *Parsons v. Canadian Red Cross Society* (2000), 49 O.R. (3d) 281 (S.C.J.). This approach was approved in *Gagne v. Silcorp Ltd.* (1998), 41 O.R. (3d) 417 at 423 (C.A.).

29 In the context of the *CPA*, a premium on fees is the reward for taking on meritorious but difficult matters. The courts have recognized that the objectives of the *CPA* - judicial economy, access to justice and behaviour modification - are dependent, in part, upon counsel's willingness to take on class proceedings, which in turn depends on the incentives available to counsel to assume the risks and burden of class proceedings: *Gagne, supra*; *Parsons, supra*; *Vitapharm Canada Ltd. v. F. Hoffmann-La Roche Ltd.*, [2005] O.J. No. 1117 (S.C.J.) (QL).

30 The need for a meaningful premium on fees is particularly important in cases involving more modest damage amounts where the maximum potential upside to class counsel is limited. Otherwise, there is a risk that counsel would decline to pursue cases giving rise to modest damages and smaller issuers would effectively become immunized from class litigation. This need is heightened in the context of the evolving practice of securities class actions where notice and administration costs are fixed expenses whether the settlement amount is $20 million or $2 million. As a result, in smaller settlements, costs and legal fees represent a larger percentage of the settlement fund. For example, in this case, these administrative costs (roughly $210,000) together with the requested fees of 25% of the settlement amount represent 39% of gross recovery, whereas in a $20 million settlement, the same costs with the same fee request would represent 27% of gross recovery.

31 Class counsel request fees in accordance with a written fee agreement dated April 10, 2008. It provides that legal fees will be charged on a percentage basis in an amount representing 25% of "all benefits obtained for the class members, including costs, notice and administration," plus disbursements and GST. Ontario class counsel and Quebec class counsel agreed to request legal fees such that their cumulative requests for legal fees do not exceed 25% of the settlement amount plus disbursements and applicable taxes. They estimated that the Ontario class constitutes 90% of the class defined in the settlement agreement, and that the Quebec class constitutes 10% of the class. As a result, Ontario class counsel request legal fees in the amount of $472,500, which represents 25% of the portion of the settlement amount allocated to the Ontario class, plus GST and disbursements in the amount of $42,667.69. Quebec class counsel will request legal fees in the amount of $52,500. The combined legal fee requests total $525,000 or 25% of the monetary settlement benefit of $2.1 million. The amount requested is consistent with the retainer agreement and in line with percentage contingency fees that have been awarded in other class actions.

32 In *VitaPharm, supra* at para. 67, Justice Cumming summarized some of the factors to be considered by the court when fixing class counsel's fees: (a) the factual and legal complexities of the matters dealt with; (b) the risk undertaken, including the risk that the matter might not be certified; (c)the degree of responsibility assumed by class counsel; (d) the monetary value of the matters in issue; (e) the importance of the matter to the class; (f) the degree of skill and competence demonstrated by class counsel; (g) the results achieved; (h) the ability of the class to pay; (i) the expectations of the class as to the amount of fees; and (j) the opportunity cost to class counsel in the expenditure of time in pursuit of the litigation and settlement.

33 The risks in undertaking this litigation include the following:

(a) that the court would dismiss certain of the claims on a preliminary motion;
(b) that there has never been a leave decision under the new investor protection legislation under Part XXIII.1 of the *OSA*, and the court may not have granted leave to plead causes of action under s. 138.3;
(c) that the court would not certify the action, or would not certify a national class;
(d) that the plaintiff would not be able to establish actionable misrepresentations, or would fail to establish a causal connection between the misrepresentations and some or all of the losses alleged; and
(e) that any judgment in favour of the plaintiff and the class would be appealed, so that the benefits of any such judgment would be significantly delayed.

34 In determining a fee award, the court may consider the manner in which counsel has conducted the proceeding. Whether counsel have agreed to indemnify the representative plaintiff against an adverse costs award, thereby saving the class from having to pay the statutory 10% to the Class Proceedings Fund, is a relevant factor in fixing fees: *Bellaire v. Daya*, [2007] O.J. No. 4819 at para. 81 (S.C.J.) (QL). Counsel in this case have done this. The class also benefits from class counsel having requested and reviewed fixed-fee quotations from several Administrators to ensure the most cost-effective administration of the settlement agreement.

35 In assessing the success achieved, I have already noted that the settlement amount of $2.1 million represents recovery of a substantial portion of the damages sustained by the class. The implementation of the corporate governance measures and the re-pricing of stock options also provide a benefit to class members and future TVI shareholders. Counsel are not asking the court to attach value to this aspect of the settlement, even though the retainer agreement provides for legal fees to be calculated as a percentage of "all benefits obtained for the class" and these are benefits obtained for the class. Further, class members benefit from a settlement term that required the defendants to pay the settlement amount into an escrow account which is earning interest. This will increase the net settlement amount available to class members. It will also decrease the fee request as a percentage of the recovery because class counsel do not seek interest on their legal fees and disbursements.

36 The method of determining fees set out in s. 33 of the *CPA* - the 'lodestar' method - has been the subject of judicial and academic criticism. Justice Cullity recently commented on its deficiencies in *Martin v. Barrett*, [2008] O.J. No. 2105 at paras. 38-39 (S.C.J.) (QL); see also, *Endean v. Canadian Red Cross Society*, [2000] B.C.J. No. 1254 at paras. 15-16, 19 (S.C.) (QL); Benjamin

Alarie, "Rethinking the Approval of Class Counsel's Fees in Ontario Class Actions" (2007) 4(1) *Canadian Class Action Review* 15 at 37-38.

37 A multiplier can reward lawyers who accumulate unnecessary time and punish those who are able to do things effectively in less time. I do not have to grapple with these difficulties in this case as the retainer agreement does not provide that fees are to be calculated by applying a multiplier and none is requested. Nonetheless, based on time included in the evidence on the motion, and based on consideration of only the monetary benefits obtained for the class, by the time the litigation is concluded and interest accrues on the settlement amount, counsel estimate the multiplier will be approximately 2.5. This settlement was achieved at an early stage, but if a multiplier were to be applied, I consider a multiplier in this range to be acceptable having regard to the risks assumed and the results obtained for class members in the circumstances of this case.

38 For these reasons, I concluded that the fees requested were fair and reasonable and I awarded legal fees in the amount of $472,500, plus applicable taxes, and disbursements in the amount of $42,667.69 to Ontario class counsel. The settlement that I approved settles the claims asserted in this action and the Audette Ontario action. As the classes are identical, the interests of the class proposed in the Audette Ontario action are resolved by the settlement of the Ontario action. Accordingly, the discontinuance of the Audette Ontario action does not prejudice the putative class in that action and an order was granted discontinuing that action.

J.L. LAX J.

cp/e/qllxr/qljxr/qlaxw/qlced/qljyw/qlcal

TAB 10

1992 CarswellOnt 185, 14 C.B.R. (3d) 303, 14 C.P.C. (3d) 339

Campeau v. Olympia & York Developments Ltd.

ROBERT CAMPEAU, ROBERT CAMPEAU INC., 75090 ONTARIO INC., and ROBERT CAMPEAU INVESTMENTS INC. v. OLYMPIA & YORK DEVELOPMENTS LIMITED, 857408 ONTARIO INC., and NATIONAL BANK OF CANADA

Ontario Court of Justice (General Division)

R.A. Blair J.

Judgment: September 21, 1992
Docket: Docs. 92-CQ-19675, B-125/92

© Thomson Reuters Canada Limited or its Licensors (excluding individual court documents). All rights reserved.

Counsel: *Stephen T. Goudge, Q.C.* and *Peter C. Wardle* , for the plaintiffs.

Peter F. C. Howard , for National Bank of Canada.

Yoine Goldstein , for Olympia & York Development Limited and 857408 Ontario Inc.

Subject: Corporate and Commercial; Insolvency; Civil Practice and Procedure

Practice --- Disposition without trial — Stay or dismissal of action — Grounds — Another proceeding pending — General.

Application for lifting of CCAA stay refused where proposed action being part of "controlled stream" of litigation and best dealt with under CCAA.

The plaintiffs brought an action against the defendant, O & Y, alleging that it breached an obligation to assist in the restructuring of C Corp. The plaintiffs also alleged that O & Y actually frustrated the individual plaintiff's efforts to restructure C Corp.'s Canadian real estate operation. Damages in the amount of $1 billion for breach of contract or, alternatively, for breach of fiduciary duty, plus punitive damages of $250 million were claimed. The plaintiffs also claimed against the defendant bank alleging breach of fiduciary duty, negligence and breach of the provisions of s. 17(1) of the *Personal Property Security Act* (Ont.). Damages in the amount of $1 billion were claimed against the bank. This action was brought two weeks before an order was made extending the protection of the *Companies' Creditors Arrangement Act* ("CCAA") to O & Y.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

The plaintiffs brought a motion to lift the stay imposed by the order under the CCAA and to allow them to pursue their action against O & Y. They argued that the claim would be better dealt with in the context of the action than in the context of the CCAA proceedings as it was uniquely complex.

The bank brought a motion opposing the plaintiffs' motion and seeking an order staying the plaintiffs' action against it pending the disposition of the CCAA proceedings. The bank argued that the factual basis of the claim against it was entirely dependent on the success of the allegations against O & Y and that the claim against O & Y would be better addressed within the context of the CCAA proceedings.

Held:

The plaintiffs' motion was dismissed and the bank's motion was allowed.

In considering whether to grant a stay, a court must look at the balance of convenience. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts is something with which the court must not lightly interfere. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay. The onus of satisfying the court is on the party seeking the stay.

The CCAA proceedings in this case involved numerous applicants, claimants and complex issues and could be considered a "controlled stream" of litigation; maintaining the integrity of the flow was an important consideration.

The stay under the CCAA was not lifted, and a stay made under the court's general jurisdiction to order stays was imposed, preventing the continuation of the action against the bank. There was no prejudice to the plaintiffs arising from these decisions, as the processing of their action was not precluded, but merely postponed. Were the CCAA stay lifted, there might be great prejudice to O & Y resulting from the diversion of its attention from the corporate restructuring process in order to defend the complex action proposed. There might not, however, be much prejudice to the bank in allowing the plaintiffs' action to proceed against it; however, such a proceeding could not proceed very far or effectively without the participation of O & Y.

Cases considered:

Arab Monetary Fund v. Hashim (June 25, 1992), Doc.34127/88, O'Connell J. (Ont. Gen. Div.), [1992] O.J. No. 1330 — *referred to*

Attorney General v. Arthur Anderson & Co. (1988), [1989] E.C.C. 244 (C.A.) — *referred to*

Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) — *applied*

Empire-Universal Films Ltd. v. Rank , [1947] O.R. (H.C.) — *referred to*

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) — *referred to*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.) — *applied*

Weight Watchers International Inc. v. Weight Watchers of Ontario Ltd. (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 (Fed. T.D.) , appeal allowed by consent without costs (1972), 10 C.P.R. (2d) 96n, 42 D.L.R. (3d) 320n (Fed. C.A.) — *referred to*

Weight Watchers International Inc. v. Weight Watchers of Ontario Ltd. (1972), 10 C.P.R. (2d) 96n, 42 D.L.R. (3d) 320n (Fed. C.A.) — *referred to*

Statutes considered:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 —

s. 11

Courts of Justice Act, R.S.O. 1990, c. C.43 —

s. 106

Personal Property Security Act, R.S.O. 1990, c. P.10 —

s. 17(1)

Rules considered:

Ontario, Rules of Civil Procedure —

r. 6.01(1)

Motion to lift stay under Companies' Creditors Arrangement Act; Motion for stay under Courts of Justice Act.

R.A. Blair J **:**

1 These motions raise questions regarding the court's power to stay proceedings. Two competing interests are to be weighed in the balance, namely,

a) the interests of a debtor which has been granted the protection of the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36, and the "breathing space" offered by a s. 11 stay in such proceedings, on the one hand, and,

b) the interests of a unliquidated contingent claimant to pursue an action against that debtor *and* an arm's length third party, on the other hand.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

2 At issue is whether the court should resort to an interplay between its specific power to grant a stay, under s. 11 of the C.C.A.A., and its general power to do so under the *Courts of Justice Act* , R.S.O. 1990, c. C.43 in order to stay the action completely; or whether it should lift the s. 11 stay to allow the action to proceed; or whether it should exercise some combination of these powers.

Background and Overview

3 This action was commenced on April 28, 1992, and the statement of claim was served before May 14, 1992, the date on which an order was made extending the protection of the C.C.A.A. to Olympia & York Developments Limited and a group of related companies ("Olympia & York", or "O & Y" or the "Olympia & York Group").

4 The plaintiffs are Robert Campeau and three Campeau family corporations which, together with Mr. Campeau, held the control block of shares of Campeau Corporation. Mr. Campeau is the former chairman and CEO of Campeau Corporation, said to have been one of North America's largest real estate development companies, until its recent rather high profile demise. It is the fall of that empire which forms the subject matter of the lawsuit.

The Claim against the Olympia & York Defendants

5 The story begins, according to the statement of claim, in 1987, after Campeau Corporation had completed a successful leveraged buy-out of Allied Stores Corporation, a very large retailer based in the United States. Olympia & York had aided in funding the Allied takeover by purchasing half of Campeau Corporation's interest in the Scotia Plaza in Toronto and subsequently also purchasing 10 per cent of the shares of Campeau Corporation. By late 1987, it is alleged, the relationship between Mr. Campeau and Mr. Paul Reichmann (one of the principals of Olympia & York) had become very close, and an agreement had been made whereby Olympia & York was to provide significant financial support, together with the considerable expertise and the experience of its personnel, in connection with Campeau Corporation's subsequent bid for control of Federated Stores Inc. (a second major U.S. department store chain). The story ends, so it is said, in 1991 after Mr. Campeau had been removed as chairman and CEO of Campeau Corporation and that company, itself, had filed for protection under the C.C.A.A. (from which it has since emerged, bearing the new name of Camdev Corp.).

6 In the meantime, in September 1989, the Olympia & York defendants, through Mr. Paul Reichmann, had entered into a shareholders' agreement with the plaintiffs in which, it is further alleged, Olympia & York obliged itself to develop and implement expeditiously a viable restructuring plan for Campeau Corporation. The allegation that Olympia & York breached this obligation by failing to develop and implement such a plan, together with the further assertion that the O & Y defendants actually frustrated Mr. Campeau's efforts to restructure Campeau Corporation's Canadian real estate operation, lies at the heart of the Campeau action. The plaintiffs plead that as a result they have suffered very substantial damages, including the loss of the value of their shares in Campeau Corporation, the loss of the opportunity of completing a refinancing deal with the Edward DeBartolo Corporation, and the loss of the opportunity on Mr. Campeau's part to settle his personal obligations on terms which would have

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

preserved his position as chairman and CEO and majority shareholder of Campeau Corporation.

7 Damages are claimed in the amount of $1 billion, for breach of contract or, alternatively, for breach of fiduciary duty. Punitive damages in the amount of $250 million are also sought.

The Claim against National Bank of Canada

8 Similar damages, in the amount of $1 billion (but no punitive damages), are claimed against the defendant National Bank of Canada, as well. The causes of action against the bank are framed as breach of fiduciary duty, negligence, and breach of the provisions of s. 17(1) of the *Personal Property Security Act* [R.S.O. 1990, c. P.10]. They arise out of certain alleged acts of misconduct on the part of the bank's representatives on the board of directors of Campeau Corporation.

9 In 1988 the plaintiffs had pledged some of their shares in Campeau Corporation to the bank as security for a loan advanced in connection with the Federated Stores transaction. In early 1990, one of the plaintiffs defaulted on its obligations under the loan and the bank took control of the pledged shares. Thereafter, the statement of claim alleges, the bank became more active in the management of Campeau, through its nominees on the board.

10 The bank had two such nominees. Olympia & York had three. There were 12 directors in total. What is asserted against the bank is that its directors, in co-operation with the Olympia & York directors, acted in a way to frustrate Campeau's restructuring efforts and favoured the interests of the bank as a secured lender rather than the interests of Campeau Corporation, of which they were directors. In particular, it is alleged that the bank's representatives failed to ensure that the DeBartolo refinancing was implemented and, indeed, actively supported Olympia & York's efforts to frustrate it, and in addition, that they supported Olympia & York's efforts to refuse to approve or delay the sale of real estate assets.

The Motions

11 There are two motions before me.

12 The first motion is by the Campeau plaintiffs to lift the stay imposed by the order of May 14, 1992 under the C.C.A.A. and to allow them to pursue their action against the Olympia & York defendants. They argue that a plaintiff's right to proceed with an action ought not lightly to be precluded; that this action is uniquely complex and difficult; and that the claim is better and more easily dealt with in the context of the action rather than in the context of the present C.C.A.A. proceedings. Counsel acknowledge that the factual bases of the claims against Olympia & York and the bank are closely intertwined and that the claim for damages is the same, but argue that the causes of action asserted against the two are different. Moreover, they submit, this is not the usual kind of situation where a stay is imposed to control the process and avoid inconsistent findings when the same parties are litigating the same issues in parallel proceedings.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

13 The second motion is by National Bank, which of course opposes the first motion, and which seeks an order staying the Campeau action as against it as well, pending the disposition of the C.C.A.A. proceedings. Counsel submits that the factual substratum of the claim against the bank is dependent entirely on the success of the allegations against the Olympia & York defendants, and that the claim against those defendants is better addressed within the parameters of the C.C.A.A. proceedings. He points out also that if the action were to be taken against the bank alone, his client would be obliged to bring Olympia & York back into the action as third parties in any event.

The Power to Stay

14 The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) , and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* , R.S.O. 1990, c. C.43, which provides as follows:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

15 Recently, Mr. Justice O'Connell has observed that this discretionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 34127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

16 Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure* . The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act* , whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the com pany except with the leave of the court and subject to such terms as the court imposes.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

The Power to Stay in the Context of C.C.A.A. Proceedings

17 By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

18 In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness": see the case comment following the report of *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B) , and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

19 Gibbs J.A. continued with this comment:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period* .

(emphasis added)

20 I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement.

21 I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff. On all of these issues the onus of satisfying the court is on the party seeking the stay: see also *Weight Watchers International Inc. v. Weight Watchers of Ontario Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 (Fed. T.D.) , appeal allowed by consent without costs (1972), 10 C.P.R. (2d) 96n, 42 D.L.R. (3d) 320n (Fed. C.A.) , where Mr. Justice Heald recited the foregoing principles from *Empire-Universal Films Ltd. v. Rank*, [1947] O.R. 775 (H.C.) at p.779.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

22 *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra, is a particularly helpful authority, although the question in issue there was somewhat different than those in issue on these motions. The case was one of several hundred arising out of the Mississauga derailment in November 1979, all of which actions were being case-managed by Montgomery J. These actions were all part of what Montgomery J. called "a controlled stream" of litigation involving a large number of claims and innumerable parties. Similarly, while the Olympia & York proceedings under the C.C.A.A. do not involve a large number of separate actions, they do involve numerous applicants, an even larger number of very substantial claimants, and a diverse collection of intricate and broad-sweeping issues. In that sense the C.C.A.A. proceedings are a controlled stream of litigation. Maintaining the integrity of the flow is an important consideration.

Disposition

23 I have concluded that the proper way to approach this situation is to continue the stay imposed under the C.C.A.A. prohibiting the action against the Olympia & York defendants, and in addition, to impose a stay, utilizing the court's general jurisdiction in that regard, preventing the continuation of the action against National Bank as well. The stays will remain in effect for as long as the s. 11 stay remains operative, unless otherwise provided by order of this court.

24 In making these orders, I see no prejudice to the Campeau plaintiffs. The processing of their action is not being precluded, but merely postponed. Their claims may, indeed, be addressed more expeditiously than might have otherwise been the case, as they may be dealt with — at least for the purposes of that proceeding — in the C.C.A.A. proceeding itself. On the other hand, there might be great prejudice to Olympia & York if its attention is diverted from the corporate restructuring process and it is required to expend time and energy in defending an action of the complexity and dimension of this one. While there may not be a great deal of prejudice to National Bank in allowing the action to proceed against it, I am satisfied that there is little likelihood of the action proceeding very far or very effectively unless and until Olympia & York — whose alleged misdeeds are the real focal point of the attack on both sets of defendants — is able to participate.

25 In addition to the foregoing, I have considered the following factors in the exercise of my discretion:

1. Counsel for the plaintiffs argued that the Campeau claim must be dealt with, either in the action or in the C.C.A.A. proceedings and that it cannot simply be ignored. I agree. However, in my view, it is more appropriate, and in fact is essential, that the claim be addressed within the parameters of the C.C.A.A. proceedings rather than outside, in order to maintain the integrity of those proceedings. Were it otherwise, the numerous creditors in that mammoth proceeding would have no effective way of assessing the weight to be given to the Campeau claim in determining their approach to the acceptance or rejection of the Olympia & York plan filed under the Act.

2. In this sense, the Campeau claim — like other secured, undersecured, unsecured, and

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

contingent claims — must be dealt with as part of a "controlled stream" of claims that are being negotiated with a view to facilitating a compromise and arrangement between Olympia & York and its creditors. In weighing "the good management" of the two sets of proceedings — i.e., the action and the C.C.A.A. proceeding — the scales tip in favour of dealing with the Campeau claim in the context of the latter: see *Attorney General v. Arthur Andersen & Co.* (1988), [1989] E.C.C. 224 (C.A.) , cited in *Arab Monetary Fund v. Hashim* , supra.

I am aware, when saying this, that in the initial plan of compromise and arrangement filed by the applicants with the court on August 21, 1992, the applicants have chosen to include the Campeau plaintiffs amongst those described as "Persons not Affected by the Plan". This treatment does not change the issues, in my view, as it is up to the applicants to decide how they wish to deal with that group of "creditors" in presenting their plan, and up to the other creditors to decide whether they will accept such treatment. In either case, the matter is being dealt with, as it should be, within the context of the C.C.A.A. proceedings.

3. Pre-judgment interest will compensate the plaintiffs for any delay caused by the imposition of the stays, should the action subsequently proceed and the plaintiffs ultimately be successful.

4. While there may not be great prejudice to National Bank if the action were to continue against it alone and the causes of action asserted against the two groups of defendants are different, the complex factual situation is common to both claims and the damages are the same. The potential of two different inquiries at two different times into those same facts and damages is not something that should be encouraged. Such multiplicity of inquiries should in fact be discouraged, particularly where — as is the case here — the delay occasioned by the stay is relatively short (at least in terms of the speed with which an action like this Campeau action is likely to progress).

Conclusion

26 Accordingly, an order will go as indicated, dismissing the motion of the Campeau plaintiffs and allowing the motion of National Bank. Each stay will remain in effect until the expiration of the stay period under the C.C.A.A. unless extended or otherwise dealt with by the court prior to that time. Costs to the defendants in any event of the cause in the Campeau action. I will fix the amounts if counsel wish me to do so.

Order accordingly.

END OF DOCUMENT

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

TAB 11

2002 CarswellOnt 2136

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36

In the Matter of a Plan of Arrangement of the Canadian Red Cross Society/La Société Canadienne de la Croix-Rouge

Ontario Superior Court of Justice

Blair R.S.J.

Heard: May 28, 2002
Judgment: June 28, 2002
Docket: 98-CL-002970

© Thomson Reuters Canada Limited or its Licensors (excluding individual court documents). All rights reserved.

Counsel: *Risa Kirshblum*, for Trustee under Plan

Harvey T. Strosberg, Q.C., for Claimants J.A.M. and D.L.M.

Dawna J. Ring, Q.C., for Various HIV Claimants, previously Court Appointed Representative for Persons Secondarily Infected with HIV

Danielle Joel, for Yang and Kerekes Families

Kenneth Arenson, for Four Families of Claimants

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — General

Canadian Red Cross Society was able to make arrangement under Companies' Creditors Arrangement Act — Principal object of plan was to make available fund of money to meet claims of various groups of people who became ill from blood products supplied by society — Under plan, referee was responsible for determining eligibility to apply for compensation — Trustee of plan brought motion for directions as to governing law with respect to eligibility of claimants under plan — Proper law governing issues of entitlement was law of Ontario — Rights of claimants flowed from compromise as sanctioned by court — Language of compromise was clear and plan was to be governed by laws of Ontario and federal law applicable

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

in Ontario — Fund was limited, it was important to minimize costs of assessing claims, and applying one law to all claims accomplished goal more effectively — Applying one law to all claims avoided inequality of treatment between claimants and uncertainty as to amount that fund was required to compensate claimants — Any participant who objected to application of Ontario law in respect of all claims could have voiced objection during approval and sanctioning of plan — Effect was to apply Ontario law retroactively to all claims across Canada — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Cases considered by *Blair R.S.J.*:

Burt v. LeLacheur, 2000 NSCA 90, 2000 CarswellNS 208, 189 D.L.R. (4th) 193, 6 M.V.R. (4th) 1, 49 C.P.C. (4th) 53, 186 N.S.R. (2d) 109, 581 A.P.R. 109, 2 C.C.L.T. (3d) 206, 18 C.P.C. (5th) 1 (N.S. C.A.) — considered

Burt v. LeLacheur (2001), 271 N.R. 199 (note), 198 N.S.R. (2d) 200 (note), 621 A.P.R. 200 (note) (S.C.C.) — referred to

Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110, 5 C.C.P.B. 219, [1995] 2 W.W.R. 404, 99 B.C.L.R. (2d) 73, 1994 CarswellBC 620 (B.C. S.C.) — referred to

Lindsay v. Transtec Canada Ltd., 2 B.C.L.R. (3d) 304, [1995] 4 W.W.R. 364, 31 C.B.R. (3d) 157, 1995 CarswellBC 77 (B.C. C.A.) — referred to

Olympia & York Developments Ltd. v. Royal Trust Co., 17 C.B.R. (3d) 75, 8 B.L.R. (2d) 69, 1993 CarswellOnt 187 (Ont. Gen. Div. [Commercial List]) — considered

Ontario v. Canadian Airlines Corp., 2001 CarswellAlta 1488, 2001 ABQB 983, 29 C.B.R. (4th) 236, [2002] 3 W.W.R. 373, 98 Alta. L.R. (3d) 277 (Alta. Q.B.) — considered

Waschkowski v. Hopkinson Estate, 2000 CarswellOnt 470, 47 O.R. (3d) 370, 184 D.L.R. (4th) 281, 129 O.A.C. 287, 32 E.T.R. (2d) 308, 44 C.P.C. (4th) 42 (Ont. C.A.) — considered

Statutes considered:

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

Generally — considered

Family Law Act, R.S.O. 1990, c. F.3

Generally — referred to

MOTION by trustee for directions as to governing law with respect to eligibility of claimants under plan.

***Blair R.S.J.*:**

Background

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

1 The Amended Plan of Compromise and Arrangement of the Canadian Red Cross Society [the "Society"], dated July 31, 2000, was approved by its creditors and sanctioned by the Court. The principal thrust of the Plan is to make available from the assets of the Society a Fund of money to meet the claims of various groups of persons who contracted HIV from certain blood products supplied by the Society. By its terms, the Honourable Peter Cory is appointed the Trustee under the Plan.

2 On this motion, the Trustee moves for directions as to the governing law respecting issues relating to the eligibility of persons to claim under the HIV Fund. Earlier, I ruled that this was a question for the Court to determine, rather than the Referee who is named under the Plan to assess the claims.

3 The Honourable Robert Montgomery is the Referee now designated under the Plan. His responsibility is to determine whether and to what extent individuals infected with HIV from blood products at various times can apply to the HIV Fund for compensation. The process for doing so is set out in Section 5.10 of the Plan, which gives the Referee the power to decide whether limitation periods have expired, to determine whether claimants have already released the Red Cross, and to assess damages.

4 The Referee's award as to damages is final, and is to be satisfied solely out of the HIV Fund.

5 The underlying problem giving rise to this motion for directions is that in making those determinations, the Referee will have to know what governing law applies to such matters as:

a) the limitation period applicable to each claimant; and,

b) whether certain claimants fall into the category of family members who would otherwise be eligible to claim for their relative's infection pursuant to family law legislation in the various Provinces.

6 The results for individual claimants may differ, depending upon the applicable choice of law and the jurisdiction in which their claims may have been asserted in the first place against the Red Cross prior to the *Companies' Creditors Arrangement Act*,[FN1] ("CCAA") Order of July 20, 1998. While time limitations are not dissimilar across the country of those HIV Claimants still alive, they vary for the estates for those who have died. In a number of Provinces, the discoverability rule applies to estate claims (see *Burt v. LeLacheur* (2000), 189 D.L.R. (4th) 193 (N.S. C.A.), leave to appeal to SCC refused (2001), 271 N.R. 199 (note) (S.C.C.)), whereas in Ontario, the Court of Appeal had ruled that it does not (see *Waschkowski v. Hopkinson Estate* (2000), 47 O.R. (3d) 370 (Ont. C.A.)).[FN2] At the same time, Ontario law is more favourable than that of other Provinces in terms of the scope of categories of family law members who are entitled to make *Family Law Act* types of claims against the HIV Fund.

7 The opening provisions of Section 5.10 of the Plan and paragraph (a) thereof stipulate that:

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

> The fund established under paragraph 5.05(c) shall be available to satisfy HIV Claims in accordance with the terms hereof. As a condition of Plan Implementation the Plaintiffs in the Listed HIV Claims shall execute a release fully and finally releasing the Society and all Plan Participants from their respective HIV Claims, in exchange for their entitlement hereunder. The release shall include an undertaking not to pursue any other party unless on a several basis. HIV Claimants may apply to the Referee within 4 months following the Plan Implementation Date for a determination of damages with respect to their respective HIV Claim. Any references held hereunder shall be conducted on the following terms:
>
> > (a) The Referee shall decide whether limitation periods had expired prior to July 20, 1998 and no award or payment under this Plan shall be made to an HIV Claimant where the Referee decides that the limitation period in respect of such Claim had expired prior to July 20, 1998.

8 Section 8.09 of the Plan is the general provision dealing with the law governing the Plan. It provides that:

> This Plan shall be governed by and construed in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein. Any questions as to the interpretation or application of this Plan and all proceedings taken in connection with this Plan and its provisions shall be subject to the exclusive jurisdiction of the Court.

9 As the affidavit filed in support of the Trustee's motion for directions notes:

> Some may therefore argue that the law of Ontario should apply in all respects to all claims regardless of factors such as the place of residence of the claimant or the place where the claimant received the blood transfusion which resulted in the HIV infection with respect to which the claimant is seeking recovery from the Fund. Others may argue that the issues outlined above do not, for the purposes of "choice of law", fall within the purview of s. 8.09 of the Plan and that a determination of choice of law must be made.

10 Hence, the motion for directions.

Analysis

11 I have concluded that the proper law governing the issues of limitation periods, categories of family members entitled to claim, and the quantum of damages those deemed eligible will be entitled to receive, is the law of Ontario. My reasons for arriving at that conclusion follow.

12 When interpreting a Court approved CCAA Plan, the Court must keep in mind "the purposes of the CCAA and the principles which guide the court's role in proceedings under that statute [as well as] the overall purpose and intention of the plan in question": *Ontario v. Canadian Airlines Corp.* (2001), 29 C.B.R. (4th) 236 (Alta. Q.B.), at 243, per Romaine J. See also, *Lindsay v. Transtec Canada Ltd.* (1994), 28 C.B.R. (3d) 110 (B.C. S.C.), aff'd (1995), 31 C.B.R. (3d) 157 (B.C. C.A.). This gives rise to the "fairness and reasonableness" considerations, and the general aim of minimizing the prejudice to creditors, that underlie such proceed-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

ings: *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 75 (Ont. Gen. Div. [Commercial List]); *Ontario v. Canadian Airlines Corp., supra.*

13 In addition, however, since a Plan of Compromise and Arrangement is in substance a contract, sanctioned by the Court, principles of contractual interpretation must also be applied.

14 The purpose of the CCAA, in broad terms, is to enable companies that would otherwise be lost to the community through bankruptcy to continue to operate if they can work out a satisfactory arrangement with their creditors. This benefits the company, the creditors, and the community as a whole. In this case, the Canadian Red Cross was able to make such an arrangement - after two years of exceedingly complex negotiations and court proceedings - and to continue to operate its non-blood-supply-related community activities, while at the same time establishing a Fund towards satisfying the claims of various groups of blood infected claimants, including the HIV Claimants.

15 Article 5 of the Plan contains the provisions of the compromise dealing with the treatment of Transfusion Claimants and HIV Claimants. Article 5.01 - a statement of general considerations in this regard - opens with these words:

> For the purposes of this Plan, the Transfusion Claimants and the HIV Claimants shall receive the treatment provided in this Article on account of their Transfusion Claims and HIV Claims, respectively, and, on the Plan Implementation Date, all Transfusion Claims and HIV Claims shall be compromised, as against the Society and the Plan Participants, in accordance with the terms hereof. [Emphasis added.]

16 Thus, the rights of the Claimants *flow from the compromise*, as sanctioned by the Court on the basis of the CCAA principles outlined above.

17 In this case, the language of the compromise - as voted on and accepted by the HIV Claimants - is clear: the Plan "shall be governed by and construed in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein" (i.e. in Ontario): Article 8.09.

18 There are sound policy reasons why the law of one jurisdiction should apply in a situation such as this. The HIV Fund is limited, and it is important to minimize the costs of assessing Claims. One law, applicable to all Claims - although perhaps cutting adversely against some Claimants in some respects, in comparison to their pre-insolvency positions - accomplishes this goal more effectively. One law, applicable to all Claims, avoids inequality of treatment as between claimants and uncertainty as to the amount of the HIV Fund required to compensate Claimants. As Mr. Strosberg noted, any participant who objected to the application of the law of Ontario in respect of all claims under the Plan could have voiced that objection and proposed an amendment to the Plan, or voted to defeat the Plan, during the approval and sanctioning phase. None did so.

19 On behalf of her Claimants, Ms. Ring argued very skillfully that the purpose of the Plan as a whole is to make the HIV Fund available to all persons in Canada affected with HIV, who had an outstanding claim against the Canadian Red Cross on July 20, 1998 - the

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

date upon which the Red Cross was initially given CCAA protection. Accordingly, she submits, the proper law applying to those claims should be the law of the jurisdiction that would have governed had the claim been commenced before that date.

20 Ms. Ring stresses what she submits is the claim-specific wording of Article 5.10(a) of the Plan cited above. She notes that the Referee is to decide "whether limitation periods had expired prior to July 20, 1998" and that no award is to be made to "*an*" HIV Claimant where the limitation period "*in respect of such Claim*" had expired. The clause refers to limitation periods (plural), the argument goes, and does not specifically state that only Ontario's time limitation period applies. Therefore, the language of the general governing law provisions of Article 8.09 should not override the specific provisions of Article 5.10(a).

21 Having regard to the terms of the Plan as a whole, however, I do not think that Article 5.10(a) can be given such a specific interpretation. There are a large number of HIV Claims to be dealt with. Hence the reference to "limitation periods" in the plural. However, the determination is to be made in relation to Claims where a limitation period issue arises. Hence the reference to "in respect of such Claim". If Article 5.10(a) were viewed as an exception to the general governing law provision of the Plan, the parties could easily have said so, and those voting on the Plan could easily have ensured that it did or - as noted above - voted against the Plan.

22 The rights of the HIV Claimants now flow from the Amended Plan *of Compromise* and Arrangement, not from what their respective positions may have been in terms of suing the Canadian Red Cross before insolvency.

23 I agree that the effect of interpreting the Plan to apply Ontario law to the issues in question is to apply Ontario law retroactively to all claims across Canada. This has possibly adverse implications in the case of certain individual claims; but it has possibly beneficial implications for other individual claims. In any event, I am satisfied on reading the Plan as a whole and considering the underlying purposes and principles of the CCAA and principles of contractual interpretation, that that is precisely what was intended by the negotiators of the Plan and by those who approved it by their votes.

Conclusion

24 Accordingly, an Order is granted directing that the law of Ontario and the federal laws of Canada applicable therein govern issues relating to eligibility of persons to claim under the HIV Fund, including but not necessarily limited to applicable limitation periods and categories of family members entitled to claim, and the quantum those deemed eligible will receive.

Order accordingly.

FN1 R.S.C. 1985, c. C-36.

FN2 Mr. Arenson has indicated that he will be challenging the application of the *Waschkowski* ruling to the circumstances of these Claims, in a proceeding to be dealt with later.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

2002 CarswellOnt 2136,

END OF DOCUMENT

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

TAB 12

2011 CarswellOnt 1286, 2011 ONSC 1300, 82 C.C.L.T. (3d) 292, 7 C.P.C. (7th) 388

Trillium Motor World Ltd. v. General Motors of Canada Ltd.

Trillium Motor World Ltd. (Plaintiff / Moving Party) and General Motors of Canada Limited and Cassels Brock & Blackwell LLP (Defendants / Respondents)

Ontario Superior Court of Justice

G.R. Strathy J.

Heard: December 15-16, 2010
Judgment: March 1, 2011
Docket: CV-10-397096CP

© Thomson Reuters Canada Limited or its Licensors (excluding individual court documents). All rights reserved.

Counsel: Bryan Finlay Q.C., Michael Statham, Allan Dick, David Sterns, for Plaintiff / Moving Party

David Morritt, Jennifer Dolman, Evan Thomas, for Defendant / Respondent, General Motors of Canada Limited

Peter Griffin, Rebecca Jones, Stephanie Couzin, for Defendant / Respondent, Cassels Brock and Blackwell LLP

Subject: Civil Practice and Procedure; Contracts; Estates and Trusts; Torts; Corporate and Commercial

Civil practice and procedure --- Parties — Representative or class proceedings under class proceedings legislation — Certification — Plaintiff's class proceeding — General principles

During global economic crisis, defendant automobile corporation sought financial bailout from government of Canada in order to avoid bankruptcy — In order to receive bailout, defendant was required to streamline dealer network — Defendant cut approximately one third of franchises, offering wind-down agreement to those which were cut — Franchisees were given six days to consider agreement, and majority signed within required time frame — Plaintiff brought action against defendant for breach of duty of fair dealing, breach of right of association and breach of franchisor's obligation of disclosure — Plaintiff brought motion to certify action as class proceeding on behalf of all franchisees who entered into wind-down agreement with defendant — Motion granted — Plaintiff adequately pleaded cause of action against defendant — Proposed class was bound and readily capable of identification; any con-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

flict between claims of members subject to laws of other provinces could be addressed through creation of sub-classes — Claims of class members raised common issues best dealt with as class proceeding for sake of judicial economy — Plaintiff was informed, committed and competent to represent class — All issues other than damages were capable of being commonly resolved; was not unreasonable to leave assessment of damages for future determination.

Civil practice and procedure --- Parties — Representative or class proceedings under class proceedings legislation — Certification — Nonbars to certification — Individual assessment of damages

During global economic crisis, defendant automobile corporation sought financial bailout from government of Canada in order to avoid bankruptcy — In order to receive bailout, defendant was required to streamline dealer network — Defendant cut approximately one third of franchises, offering wind-down agreement to those which were cut — Franchisees were given six days to consider agreement, and majority signed within required time frame — Plaintiff brought action against defendant for breach of duty of fair dealing, breach of right of association and breach of franchisor's obligation of disclosure — Plaintiff brought motion to certify action as class proceeding on behalf of all franchisees who entered into wind-down agreement with defendant — Motion granted — Plaintiff adequately pleaded cause of action against defendant — Proposed class was bound and readily capable of identification; any conflict between claims of members subject to laws of other provinces could be addressed through creation of sub-classes — Claims of class members raised common issues best dealt with as class proceeding for sake of judicial economy — Plaintiff was informed, committed and competent to represent class — All issues other than damages were capable of being commonly resolved; was not unreasonable to leave assessment of damages for future determination.

Civil practice and procedure --- Parties — Representative or class proceedings under class proceedings legislation — Certification — Motion for certification

During global economic crisis, defendant automobile corporation sought financial bailout from government of Canada in order to avoid bankruptcy — In order to receive bailout, defendant was required to streamline dealer network — Defendant cut approximately one third of franchises, offering wind-down agreement to those which were cut — Franchisees were given six days to consider agreement, and majority signed within required time frame — Plaintiff brought action against defendant for breach of duty of fair dealing, breach of right of association and breach of franchisor's obligation of disclosure — Plaintiff brought motion to certify action as class proceeding on behalf of all franchisees who entered into wind-down agreement with defendant — Motion granted — Plaintiff adequately pleaded cause of action against defendant — Proposed class was bound and readily capable of identification; any conflict between claims of members subject to laws of other provinces could be addressed through creation of sub-classes — Claims of class members raised common issues best dealt with as class proceeding for sake of judicial economy — Plaintiff was informed, committed and competent to represent class — All issues other than damages were capable of being commonly resolved; was not unreasonable to leave assessment of damages for future determina-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

tion.

Civil practice and procedure --- Disposition without trial — Stay or dismissal of action — Grounds — Another proceeding pending — Civil proceeding

During global economic crisis, defendant automobile corporation sought financial bailout from government of Canada in order to avoid bankruptcy — In order to receive bailout, defendant was required to streamline dealer network — Defendant cut approximately one third of franchises and offered wind-down agreement to those which were cut — Franchisees were given six days to consider agreement, and majority signed within required time frame — Plaintiff brought action against automobile corporation with respect to wind-down agreement; plaintiff brought action against law firm for breach of contract, breach of fiduciary duty and negligence — Law firm brought motion to stay action against it — Motion dismissed — While claims against each defendant were different in nature, they arose from same factual matrix — Plaintiff's case against law firm was not necessarily dependant on result of action against automobile corporation — Was not judiciously economical to put claim on back burner for years when it was unnecessary to await result in other case — Would have been oppressive and prejudicial to plaintiff to stay one action pending outcome of other when result of one did not determine outcome of other — Was more advantageous for law firm to participate in proceeding from outset and view how evidence unfolded in other action.

Cases considered by *G.R. Strathy J.*:

Anns v. Merton London Borough Council (1977), (sub nom. *Anns v. London Borough of Merton)* [1977] 2 All E.R. 492, [1978] A.C. 728, [1977] 2 W.L.R. 1024, 121 S.J. 377, [1977] UKHL 4 (U.K. H.L.) — followed

Balanyk v. University of Toronto (1999), 1 C.P.R. (4th) 300, 1999 CarswellOnt 1786 (Ont. S.C.J.) — considered

Barbour v. University of British Columbia (2007), 2007 CarswellBC 1282, 2007 BCSC 800 (B.C. S.C.) — referred to

Beer v. Personal Service Coffee Corp. (2005), 2005 CarswellOnt 3099, (sub nom. *Personal Services Coffee Corp. v. Beer)* 200 O.A.C. 282, 256 D.L.R. (4th) 466 (Ont. C.A.) — considered

Bondy v. Toshiba of Canada Ltd. (2007), 39 C.P.C. (6th) 339, 2007 CarswellOnt 1419 (Ont. S.C.J.) — referred to

Bunn v. Ribcor Holdings Inc. (1998), 1998 CarswellOnt 2031, 65 O.T.C. 100, 38 C.L.R. (2d) 291 (Ont. Gen. Div.) — referred to

Bywater v. Toronto Transit Commission (1998), 27 C.P.C. (4th) 172, 1998 CarswellOnt 4645, 83 O.T.C. 1 (Ont. Gen. Div.) — referred to

Campbell v. Flexwatt Corp. (1997), 15 C.P.C. (4th) 1, [1998] 6 W.W.R. 275, 44 B.C.L.R. (3d) 343, 1997 CarswellBC 2439, 98 B.C.A.C. 22, 161 W.A.C. 22 (B.C. C.A.) — referred

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

to

Campbell v. Flexwatt Corp. (1998), 228 N.R. 197 (note), 120 B.C.A.C. 80 (note), 196 W.A.C. 80 (note) (S.C.C.) — referred to

Canadian Pacific Railway v. "Sheena M" (The) (2000), [2000] 4 F.C. 159, 2000 CarswellNat 615, 2000 CarswellNat 3261, 188 F.T.R. 16 (Fed. T.D.) — referred to

CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman (2001), 18 B.L.R. (3d) 240, 2001 CarswellOnt 4204 (Ont. S.C.J.) — referred to

Central & Eastern Trust Co. v. Rafuse (1986), 37 C.C.L.T. 117, (sub nom. *Central Trust Co. v. Rafuse)* 186 A.P.R. 109, 1986 CarswellNS 40, 1986 CarswellNS 135, 42 R.P.R. 161, 34 B.L.R. 187, (sub nom. *Central Trust Co. c. Cordon)* [1986] R.R.A. 527 (headnote only), (sub nom. *Central Trust Co. v. Rafuse)* [1986] 2 S.C.R. 147, (sub nom. *Central Trust Co. v. Rafuse)* 31 D.L.R. (4th) 481, (sub nom. *Central Trust Co. v. Rafuse)* 69 N.R. 321, (sub nom. *Central Trust Co. v. Rafuse)* 75 N.S.R. (2d) 109 (S.C.C.) — referred to

Cooper v. Hobart (2001), [2002] 1 W.W.R. 221, 2001 CarswellBC 2502, 2001 CarswellBC 2503, 2001 SCC 79, 8 C.C.L.T. (3d) 26, 206 D.L.R. (4th) 193, 96 B.C.L.R. (3d) 36, (sub nom. *Cooper v. Registrar of Mortgage Brokers (B.C.))* 277 N.R. 113, [2001] 3 S.C.R. 537, (sub nom. *Cooper v. Registrar of Mortgage Brokers (B.C.))* 160 B.C.A.C. 268, (sub nom. *Cooper v. Registrar of Mortgage Brokers (B.C.))* 261 W.A.C. 268 (S.C.C.) — referred to

Delgrosso v. Paul (1999), 1999 CarswellOnt 4561, 45 O.R. (3d) 605, 48 C.C.L.T. (2d) 315, 41 C.P.C. (4th) 390 (Ont. Gen. Div.) — referred to

Delgrosso v. Paul (1999), 1999 CarswellOnt 4562, 46 C.P.C. (4th) 140 (Ont. Div. Ct.) — referred to

Dowell v. Spencer (March 28, 2001), Doc. 00-CV-187752 (Ont. Master) — referred to

Elms v. Laurentian Bank of Canada (2001), 90 B.C.L.R. (3d) 195, 5 C.P.C. (5th) 201, 155 B.C.A.C. 73, 254 W.A.C. 73, 2001 BCCA 429, 2001 CarswellBC 1326 (B.C. C.A.) — referred to

Etco Financial Corp. v. Royal Bank (1999), 1999 CarswellOnt 3071 (Ont. S.C.J.) — referred to

Fehringer v. Sun Media Corp. (2002), 27 C.P.C. (5th) 155, 2002 CarswellOnt 3569 (Ont. S.C.J.) — referred to

Fehringer v. Sun Media Corp. (2003), 2003 CarswellOnt 3841, 39 C.P.C. (5th) 151 (Ont. Div. Ct.) — referred to

Fischer v. IG Investment Management Ltd. (2010), 89 C.P.C. (6th) 205, 2010 CarswellOnt 135, 2010 ONSC 296 (Ont. S.C.J.) — referred to

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

Folland v. Reardon (2005), 249 D.L.R. (4th) 167, (sub nom. *G.F. v. Reardon)* 194 O.A.C. 201, 28 C.C.L.T. (3d) 1, 74 O.R. (3d) 688, 2005 CarswellOnt 232 (Ont. C.A.) — referred to

Gagne v. Silcorp Ltd. (1998), 113 O.A.C. 299, 1998 CarswellOnt 4045, 27 C.P.C. (4th) 114, 41 O.R. (3d) 417, 167 D.L.R. (4th) 325, 39 C.C.E.L. (2d) 253 (Ont. C.A.) — referred to

Glover v. Toronto (City) (2009), 2009 CarswellOnt 1985, 70 C.P.C. (6th) 303 (Ont. S.C.J.) — considered

Graham v. Imperial Parking Canada Corp. (2010), 2010 ONSC 4982, 2010 CarswellOnt 6941, 74 B.L.R. (4th) 172 (Ont. S.C.J.) — followed

Griffin v. Dell Canada Inc. (2009), 72 C.P.C. (6th) 158, 2009 CarswellOnt 560 (Ont. S.C.J.) — referred to

Hanke v. Resurfice Corp. (2007), 69 Alta. L.R. (4th) 1, 404 A.R. 333, 394 W.A.C. 333, 2007 CarswellAlta 130, 2007 CarswellAlta 131, 2007 SCC 7, [2007] 4 W.W.R. 1, 45 C.C.L.T. (3d) 1, 278 D.L.R. (4th) 643, [2007] R.R.A. 1, 357 N.R. 175, [2007] 1 S.C.R. 333 (S.C.C.) — referred to

Healey v. Lakeridge Health Corp. (2006), 38 C.P.C. (6th) 145, 2006 CarswellOnt 6574 (Ont. S.C.J.) — referred to

Hickey-Button v. Loyalist College of Applied Arts & Technology (2006), 2006 CarswellOnt 3618, 267 D.L.R. (4th) 601, 211 O.A.C. 301, 31 C.P.C. (6th) 390 (Ont. C.A.) — referred to

Hollick v. Metropolitan Toronto (Municipality) (2001), (sub nom. *Hollick v. Toronto (City))* 56 O.R. (3d) 214 (headnote only), (sub nom. *Hollick v. Toronto (City))* 205 D.L.R. (4th) 19, (sub nom. *Hollick v. Toronto (City))* [2001] 3 S.C.R. 158, (sub nom. *Hollick v. Toronto (City))* 2001 SCC 68, 2001 CarswellOnt 3577, 2001 CarswellOnt 3578, 24 M.P.L.R. (3d) 9, 13 C.P.C. (5th) 1, 277 N.R. 51, 42 C.E.L.R. (N.S.) 26, 153 O.A.C. 279 (S.C.C.) — referred to

Hunt v. T & N plc (1990), 1990 CarswellBC 216, 43 C.P.C. (2d) 105, 117 N.R. 321, 4 C.O.H.S.C. 173 (headnote only), (sub nom. *Hunt v. Carey Canada Inc.)* [1990] 6 W.W.R. 385, 49 B.C.L.R. (2d) 273, (sub nom. *Hunt v. Carey Canada Inc.)* 74 D.L.R. (4th) 321, [1990] 2 S.C.R. 959, 1990 CarswellBC 759, 4 C.C.L.T. (2d) 1 (S.C.C.) — followed

Kumar v. Mutual Life Assurance Co. of Canada (2001), 2001 CarswellOnt 4449, 17 C.P.C. (5th) 103, (sub nom. *Williams v. Mutual Life Assurance Co. of Canada)* 152 O.A.C. 344, 34 C.C.L.I. (3d) 316, [2002] I.L.R. I-4052 (Ont. Div. Ct.) — referred to

Kumar v. Mutual Life Assurance Co. of Canada (2003), 2003 CarswellOnt 1209, [2003] I.L.R. I-4181, 226 D.L.R. (4th) 112, 31 C.P.C. (5th) 205, 47 C.C.L.I. (3d) 43, 170 O.A.C. 165 (Ont. C.A.) — referred to

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

Landsbridge Auto Corp. v. Midas Canada Inc. (2009), 2009 CarswellOnt 1655, 73 C.P.C. (6th) 10 (Ont. S.C.J.) — considered

Landsbridge Auto Corp. v. Midas Canada Inc. (2010), 70 B.L.R. (4th) 1, (sub nom. *405341 Ontario Ltd.)* 322 D.L.R. (4th) 177, 2010 ONCA 478, 2010 CarswellOnt 4714, (sub nom. *405341 Ontario Ltd. v. Midas Canada Inc.)* 264 O.A.C. 111 (Ont. C.A.) — referred to

Markson v. MBNA Canada Bank (2007), 43 C.P.C. (6th) 10, 2007 ONCA 334, 2007 CarswellOnt 2716, 282 D.L.R. (4th) 385, 32 B.L.R. (4th) 273, 224 O.A.C. 71, 85 O.R. (3d) 321 (Ont. C.A.) — considered

Markson v. MBNA Canada Bank (2007), 383 N.R. 381, [2007] 3 S.C.R. xii (note), 2007 CarswellOnt 7420, 2007 CarswellOnt 7421, 248 O.A.C. 396 (note) (S.C.C.) — referred to

MBCO Summerhill Inc. v. MBCO Associates Ontario Inc. (2010), 2010 ONSC 5432, 2010 CarswellOnt 7476 (Ont. S.C.J.) — referred to

McCarthy Corp. PLC v. KPMG LLP (2007), 2007 CarswellOnt 35 (Ont. S.C.J. [Commercial List]) — referred to

MDG Kingston Inc. v. MDG Computers Canada Inc. (2008), 51 B.L.R. (4th) 188, 299 D.L.R. (4th) 497, 2008 ONCA 656, 2008 CarswellOnt 5752, 92 O.R. (3d) 4, 241 O.A.C. 84 (Ont. C.A.) — referred to

Mont-Bleu Ford Inc. v. Ford Motor Co. of Canada (2000), 2000 CarswellOnt 541 (Ont. S.C.J.) — referred to

Mont-Bleu Ford Inc. v. Ford Motor Co. of Canada (2000), 2000 CarswellOnt 1826, 134 O.A.C. 66, 48 C.P.C. (4th) 353, 48 O.R. (3d) 753 (Ont. Div. Ct.) — considered

Mont-Bleu Ford Inc. v. Ford Motor Co. of Canada (2004), [2004] O.T.C. 279, 2004 CarswellOnt 1207, 45 C.P.C. (5th) 292 (Ont. S.C.J.) — referred to

Perez v. Galambos (2009), 97 B.C.L.R. (4th) 1, [2009] 12 W.W.R. 193, (sub nom. *Galambos v. Perez)* [2009] 3 S.C.R. 247, 394 N.R. 209, 70 C.C.L.T. (3d) 167, 312 D.L.R. (4th) 220, 276 B.C.A.C. 272, 468 W.A.C. 272, 2009 CarswellBC 2787, 2009 CarswellBC 2788, 2009 SCC 48 (S.C.C.) — considered

Pryshlack v. Urbancic (1975), 10 O.R. (2d) 263, 63 D.L.R. (3d) 67, 1975 CarswellOnt 892 (Ont. H.C.) — considered

Ragoonanan Estate v. Imperial Tobacco Canada Ltd. (2000), 4 C.C.L.T. (3d) 132, 2000 CarswellOnt 4613, 51 O.R. (3d) 603 (Ont. S.C.J.) — referred to

Ramdath v. George Brown College of Applied Arts & Technology (2010), 93 C.P.C. (6th) 106, 2010 CarswellOnt 2038, 2010 ONSC 2019 (Ont. S.C.J.) — considered

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

Robinson v. Medtronic Inc. (2009), 80 C.P.C. (6th) 87, 2009 CarswellOnt 6337 (Ont. S.C.J.) — referred to

Robinson v. Rochester Financial Ltd. (2010), 89 C.P.C. (6th) 91, 2010 CarswellOnt 206, 2010 ONSC 463 (Ont. S.C.J.) — considered

Rosedale Motors Inc. v. Petro-Canada Inc. (1998), 86 C.P.R. (3d) 1, 42 O.R. (3d) 776, 87 O.T.C. 180, 1998 CarswellOnt 5009, 31 C.P.C. (4th) 340 (Ont. Gen. Div.) — considered

Rosedale Motors Inc. v. Petro-Canada Inc. (October 22, 2001), Doc. 25/99 (Ont. S.C.J.) — referred to

Rumley v. British Columbia (2001), 95 B.C.L.R. (3d) 1, 9 C.P.C. (5th) 1, [2001] 11 W.W.R. 207, 157 B.C.A.C. 1, 256 W.A.C. 1, 275 N.R. 342, 205 D.L.R. (4th) 39, [2001] 3 S.C.R. 184, 2001 SCC 69, 2001 CarswellBC 2166, 2001 CarswellBC 2167, 10 C.C.L.T. (3d) 1 (S.C.C.) — referred to

Salah v. Timothy's Coffees of the World Inc. (2010), 2010 CarswellOnt 7643, 2010 ONCA 673, 74 B.L.R. (4th) 161, 268 O.A.C. 279 (Ont. C.A.) — considered

Sauer v. Canada (Minister of Agriculture) (2008), 2008 CarswellOnt 5081 (Ont. S.C.J.) — referred to

Smith v. National Money Mart Co. (2007), 2007 CarswellOnt 29, 29 E.T.R. (3d) 199, 37 C.P.C. (6th) 171 (Ont. S.C.J.) — referred to

Smith Estate v. National Money Mart Co. (2008), 2008 CarswellOnt 3310, 57 C.P.C. (6th) 99 (Ont. S.C.J.) — referred to

Stoneleigh Motors Ltd. v. General Motors of Canada Ltd. (2010), 2010 CarswellOnt 2381, 2010 ONSC 1965, 71 B.L.R. (4th) 271 (Ont. S.C.J.) — considered

Thames Steel Construction Ltd. v. Portman (1980), 15 C.P.C. 308, 111 D.L.R. (3d) 460, 1980 CarswellOnt 353, 28 O.R. (2d) 445 (Ont. Div. Ct.) — followed

Western Canadian Shopping Centres Inc. v. Dutton (2001), (sub nom. *Western Canadian Shopping Centres Inc. v. Bennett Jones Verchere)* 201 D.L.R. (4th) 385, [2002] 1 W.W.R. 1, 286 A.R. 201, 253 W.A.C. 201, 8 C.P.C. (5th) 1, 94 Alta. L.R. (3d) 1, 272 N.R. 135, 2001 SCC 46, 2001 CarswellAlta 884, 2001 CarswellAlta 885, [2001] 2 S.C.R. 534 (S.C.C.) — referred to

Williams v. Mutual Life Assurance Co. of Canada (2000), 2000 CarswellOnt 3739, 24 C.C.L.I. (3d) 298, 51 O.R. (3d) 54, [2001] I.L.R. I-3896 (Ont. S.C.J.) — referred to

Zicherman v. Equitable Life Insurance Co. of Canada (2003), 2003 CarswellOnt 1206, [2003] I.L.R. I-4182, 226 D.L.R. (4th) 131, 47 C.C.L.I. (3d) 60 (Ont. C.A.) — referred to

578115 Ontario Inc. v. Sears Canada Inc. (2010), 2010 ONSC 4571, 2010 CarswellOnt

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

7016, 325 D.L.R. (4th) 343 (Ont. S.C.J.) — followed

779975 Ontario Ltd. v. Mmmuffins Canada Corp. (2009), 62 B.L.R. (4th) 137, 2009 CarswellOnt 3262 (Ont. S.C.J.) — referred to

909787 Ontario Ltd. v. Bulk Barn Foods Ltd. (1999), 1999 CarswellOnt 2384 (Ont. S.C.J.) — considered

909787 Ontario Ltd. v. Bulk Barn Foods Ltd. (2000), 2000 CarswellOnt 3539, 2 C.P.C. (5th) 61, 138 O.A.C. 180 (Ont. Div. Ct.) — referred to

1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd. (2002), 28 C.P.C. (5th) 135, 62 O.R. (3d) 535, 2002 CarswellOnt 4272 (Ont. S.C.J.) — considered

1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd. (2004), 50 C.P.C. (5th) 25, 184 O.A.C. 298, 70 O.R. (3d) 182, 2004 CarswellOnt 945 (Ont. Div. Ct.) — referred to

1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd. (2005), 201 O.A.C. 95, 7 B.L.R. (4th) 1, 2005 CarswellOnt 3097, 256 D.L.R. (4th) 451 (Ont. C.A.) — referred to

2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp. (2008), 2008 CarswellOnt 1156, 89 O.R. (3d) 252, 56 C.P.C. (6th) 88 (Ont. S.C.J.) — referred to

2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp. (2009), 70 C.P.C. (6th) 27, 2009 CarswellOnt 2533, 96 O.R. (3d) 252, 250 O.A.C. 87 (Ont. Div. Ct.) — referred to

2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp. (2010), 100 O.R. (3d) 721, 87 C.P.C. (6th) 375, 320 D.L.R. (4th) 612, 265 O.A.C. 134, 2010 ONCA 466, 2010 CarswellOnt 4305 (Ont. C.A.) — considered

2189205 Ontario Inc. v. Springdale Pizza Depot Ltd. (2010), 2010 ONSC 3695, 2010 CarswellOnt 5257 (Ont. S.C.J.) — referred to

3464920 Canada Inc. v. Strother (2007), (sub nom. *Strother v. 3464920 Canada Inc.)* 2007 D.T.C. 5273 (Eng.), (sub nom. *Strother v. 3464920 Canada Inc.)* 2007 D.T.C. 5301 (Fr.), 363 N.R. 123, [2007] 2 S.C.R. 177, [2007] 7 W.W.R. 381, [2007] 4 C.T.C. 172, 29 B.L.R. (4th) 175, 399 W.A.C. 108, 241 B.C.A.C. 108, 281 D.L.R. (4th) 640, 2007 SCC 24, 2007 CarswellBC 1201, 2007 CarswellBC 1202, 67 B.C.L.R. (4th) 1, 48 C.C.L.T. (3d) 1 (S.C.C.) — referred to

4287975 Canada Inc. v. Imvescor Restaurants Inc. (2008), 2008 CarswellOnt 4812, 296 D.L.R. (4th) 294, 91 O.R. (3d) 705, 48 B.L.R. (4th) 227, 68 C.P.R. (4th) 186 (Ont. S.C.J. [Commercial List]) — referred to

4287975 Canada Inc. v. Imvescor Restaurants Inc. (2009), 2009 ONCA 308, 2009 CarswellOnt 1965, 73 C.P.R. (4th) 297, 247 O.A.C. 391, 56 B.L.R. (4th) 161, 305 D.L.R. (4th) 193, 98 O.R. (3d) 187 (Ont. C.A.) — referred to

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

4287975 Canada Inc. v. Imvescor Restaurants Inc. (2009), 401 N.R. 392 (note), 266 O.A.C. 399 (note), 2009 CarswellOnt 5852, 2009 CarswellOnt 5853 (S.C.C.) — referred to

6792341 Canada Inc. v. Dollar It Ltd. (2009), 95 O.R. (3d) 291, 2009 CarswellOnt 2514, 2009 ONCA 385, 250 O.A.C. 280, 310 D.L.R. (4th) 683, 60 B.L.R. (4th) 1 (Ont. C.A.) — referred to

Statutes considered:

Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3

Generally — referred to

s. 1(1) "franchise agreement" — considered

s. 1(1) "franchisee" — considered

s. 1(1) "prospective franchisee" — considered

s. 2(1) — considered

s. 3 — considered

s. 3(2) — considered

s. 3(3) — considered

s. 4 — considered

s. 4(4) — considered

s. 4(5) — considered

s. 5 — considered

s. 5(1) — considered

s. 5(4) — considered

s. 5(5) — considered

s. 5(6) — considered

s. 5(7)(g)(ii) — considered

s. 6 — considered

s. 6(2) — considered

s. 6(6) — considered

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

s. 7 — considered

s. 7(1) — considered

s. 11 — considered

Bankruptcy Code, 11 U.S.C.

Chapter 11 — referred to

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

Generally — referred to

s. 5 — considered

s. 5(1)(a) — considered

s. 5(1)(c) — considered

s. 5(1)(d) — considered

s. 5(1)(e) — considered

s. 6 — considered

s. 8 — considered

s. 11(2) — considered

s. 12 — referred to

s. 13 — referred to

s. 24 — referred to

s. 25 — considered

s. 25(1) — considered

s. 25(2) — referred to

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

Generally — referred to

Competition Act, R.S.C. 1985, c. C-34

Generally — referred to

s. 36(1) — referred to

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

s. 61 — referred to

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

s. 106 — referred to

s. 131 — considered

Franchises Act, R.S.A. 2000, c. F-23

Generally — referred to

s. 14(2) — considered

s. 16 — referred to

s. 17 — considered

Franchises Act, R.S.P.E.I, 2005, c. 36

Generally — referred to

s. 5 — considered

s. 6(2) — considered

s. 7(1) — considered

s. 11 — considered

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 1.04(1) — considered

R. 5.02 — referred to

R. 5.05 — referred to

R. 14.05(3)(d) — considered

R. 21.01(1)(b) — referred to

Regulations considered:

Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3

General, O. Reg. 581/00

Generally — referred to

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

MOTION for certification of proposed class action brought on behalf of franchisees who entered into Wind-Down Agreements with defendant automobile company; MOTION by defendant law firm for stay of action against it.

***G.R. Strathy J.*:**

1 This certification motion arises from events that occurred during six days in May 2009. The global economy was sunk in an economic quagmire that some compared to the Great Depression of the 1930s. North American consumer confidence was reeling from rising unemployment, plunging housing prices, a tanking stock market, frozen credit sources and volatile oil prices. With per capita auto purchases falling to fifty-year lows, General Motors Corp. ("GM") in the United States, and General Motors of Canada Limited ("GMCL"), its Canadian subsidiary, experienced plummeting sales, draining them of liquidity to fund their operations. In the face of a serious credit crunch, they were on the verge of bankruptcy. A financial bailout from governments in the United States and Canada was their only hope of avoiding insolvency.

2 This government financial aid was conditional on the automaker dealing with some of its more pressing problems, including a bloated dealer network, which was in urgent need of rationalization. Faced with the insistence of the federal and Ontario governments that it had to become leaner, GMCL informed 240 of its 705 franchisees[FN1] that their dealer agreements would not be renewed on their expiry on October 21, 2010, and offered them a wind-down package. Some 202 dealers accepted the offer within the six day deadline imposed by GMCL. Five more accepted at later dates, one in August 2009 and the other four in November 2009.

3 This is a motion for certification of a proposed class action brought on behalf of the 207 GMCL franchisees who entered into Wind-Down Agreements ("W.D.A.s") with GMCL in and after May of 2009. The defendants are GMCL and Cassels Brock & Blackwell, LLP ("Cassels"), a law firm allegedly retained on behalf of the dealers. The plaintiff, Trillium Motor World Ltd. ("Trillium"), is one of the GMCL dealers that was offered, and accepted, a W.D.A. and agreed to voluntarily terminate its dealership agreement with GMCL. It seeks to represent a class composed of dealers who signed the W.D.A. and it claims that GMCL breached its obligations under the *Arthur Wishart Act (Franchise Disclosure) 2000*, S.O. 2000, c. 3 (the "*A.W.A.*") and comparable legislation in Alberta and P.E.I.[FN2] It also claims that Cassels was retained to act on behalf of GMCL dealers, that Cassels had a conflict of interest and that it breached duties that it owed to the terminated dealers.

4 In order to understand the issues that arise on this certification motion, it will be necessary to give some factual background, which is included in the next section. In that section, I will also describe the dealership agreements under which Trillium and other GMCL dealers operated and the terms of the W.D.A.s, which the proposed class members accepted. In the following section, I will outline some of the relevant provisions of the *A.W.A.* and will make some general observations with respect to the purpose of that statute and of the *Class Proceedings Act, 2002*, S.O. 2002, c. 6 (the "*C.P.A.*"). I will then turn to the application of the test for certification set out in s. 5 of the *C.P.A.* Finally, at the conclusion of these reasons, I will deal with a request by Cassels that the action be stayed against it, pending the resolution of the

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

claim against GMCL.

Background

GM's Restructuring and the Wind-Down Agreements

5 Each GMCL dealer operates under a standard form Dealer Sales and Service Agreement. This agreement contains certain provisions that are applicable to all dealers. The agreements had a common termination date of October 31, 2010, but each dealer was given a contractual assurance of the "opportunity to enter into a new Dealer Agreement with [GMCL] at the expiration date if [GMCL] determines dealer has fulfilled its obligations under this Agreement."

6 GMCL's standard dealer agreement includes the right of the dealer on termination to require GMCL to purchase the dealer's inventory, signs, tools, parts, and accessories as well as the right to obtain assistance from GMCL in the disposition of the dealership premises.

7 While each dealer's agreement may have included addenda particularizing the dealer's relationship with GMCL, there is no evidence that any of those provisions are material to the issues before me.

8 In the face of the economic crisis of 2008/2009, GM and GMCL sought financial assistance from governments in the United States and Canada and had submitted restructuring plans to those governments. GMCL's initial viability plan of February 20, 2009, proposed reductions in the size of its dealer network through consolidation and attrition between 2009 and 2014. The plan also envisaged the retention of Pontiac as a "niche brand". On March 30, 2009, the governments of Canada and Ontario announced that they were rejecting this plan because it did not go far enough to guarantee GMCL's long-term viability. The United States government gave a similar response to the plan submitted by GM. The companies were given a further 60 days to submit revised plans.

9 On April 27, 2009, GM and GMCL announced revised restructuring plans. The Pontiac brand would be phased out by the end of 2010. GM's dealerships in the United States would be reduced by 42% by the end of 2010. GMCL promised to make a comparable reduction of its dealerships, going from 705 dealers in 2009 to approximately 400 by the end of 2010. It had yet to publicly identify which dealers would be cut.

10 In a satellite broadcast to all its dealers on May 19, 2009, GMCL explained the details of its plan to downsize its dealer network and outlined the criteria that had been used to determine which dealers had been selected for termination. It also explained the key terms of the W.D.A. Dealers who were going to receive a termination notice the following day were encouraged to review the W.D.A. with their legal and financial advisors. On the next day, May 20, 2009, GMCL sent a letter to 240 dealers across Canada, informing them that their dealership agreements would not be renewed on their expiry on October 31, 2010.

11 Attached to the May 20, 2009 letter addressed to each terminated dealer was a W.D.A. The W.D.A. was open for acceptance until May 26, 2009, and GMCL's obligations under the

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

agreement were expressed to be conditional on the execution of a W.D.A. by 100% of the dealers who were being terminated. That condition could be waived at the option of GMCL. The key terms of the W.D.A. were as follows:

> (a) each dealer was to receive a wind-down payment, in three instalments, based on the number of vehicles that dealer had sold in the previous year, as well as a sign removal allowance;
>
> (b) by accepting the W.D.A., the dealer surrendered all rights under its existing dealer agreement with GMCL, including rights on termination;
>
> (c) the affected dealer had to sell all its inventory, remove all signs, cease all business operations and comply with all post-termination obligations in order to receive its final payment;
>
> (d) GMCL could terminate the W.D.A. or cease making payments if the dealer breached any of the terms of the W.D.A. or of the dealer agreement;
>
> (e) the dealer released GMCL and its affiliates from all claims;
>
> (f) to accept the W.D.A., the dealer was required to obtain a certificate of independent legal advice, signed by a lawyer, attesting that the dealer had entered into the agreement, including a full waiver and the release of the right to sue GMCL and its affiliates, voluntarily and with a full understanding of the implications; and
>
> (g) the W.D.A. was expressed to be governed by Ontario law and the parties consented to the exclusive jurisdiction of the courts of Ontario.

12 There was a slight variation in the W.D.A. offered to GMCL's Saturn and Saab dealers. Instead of accepting the wind-down payments, those dealers could elect to wait for GMCL to find a buyer for the Saturn and Saab brands and hope that the new owner would take on their dealerships. It was a take-it-or-leave-it proposition, however, and they could not do both. In the end, no buyer was found for those brands.

13 GMCL's reduction of its dealer network was founded on Article 4.1 of the standard dealer agreement, which permitted GMCL to make whatever decisions might be necessary in changing market circumstances to preserve the success of its dealer network and to protect the network's reasonable return on investment.

14 In the letter of May 20, 2009, and in the broadcast to dealers the preceding day, GMCL stated that if all affected dealers did not sign the W.D.A. by May 26, 2009, there was a "strong possibility" that GMCL would file for reorganization under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*").

15 A total of 207 Canadian dealers, or approximately 85% of those who received the W.D.A., including Trillium, signed the agreement and returned it to GMCL before the May 26, 2009 deadline. GMCL elected to waive the 100% acceptance threshold and the W.D.A.s

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

therefore became operative.

16 On June 1, 2009, GMCL announced that its restructuring plan had been approved by the Canadian and Ontario governments, financial assistance would be forthcoming, and there would be no *CCAA* filing. In the United States, GM was not able to stave off insolvency and it filed for protection from its creditors under Chapter 11 of the United States Bankruptcy Code [FN3] that same day.

The Involvement of Cassels

17 Many of the GMCL dealers were members of the Canadian Automotive Dealers' Association ("CADA"), a federation of provincial and regional automotive dealer associations. On May 4, 2009, CADA announced that it had formed a General Motors Steering Committee to ensure that the interests of all GMCL dealers were represented "should General Motors of Canada Ltd. file for bankruptcy protection in Canada in the near future." CADA announced that the steering committee would provide policy direction and instructions to legal counsel who would represent the dealers in any bankruptcy filing and that it had retained Cassels "to handle our interests". CADA asked the dealers to contribute either $2,500 or $5,000 (depending on the number of vehicles the dealer had sold in the previous year) to a war chest that was to be held by CADA in trust for the payment of professional services associated with representing the dealers in restructuring or insolvency proceedings. A number of the GMCL dealers, including Trillium, made payments into the fund.

18 On May 22, 2009, after the distribution of the W.D.A.s to the affected GMCL dealers, CADA sent an email to its members enclosing a memorandum concerning the W.D.A. and pointing out the necessity of each dealer reviewing the document with its advisors. It emphasized the importance and urgency of executing and returning the W.D.A. before the May 26th, 2009 deadline if the dealer wished to accept it. The email also informed the dealers that CADA proposed to organize a conference call of all dealers whose franchises had been terminated.

19 Trillium pleads that Cassels drafted or assisted in drafting the May 22, 2009 memorandum to the affected dealers. It pleads that the memorandum offered no advice or strategy to the dealers about a response to the W.D.A. and did not advise the dealers of their rights under the *A.W.A.*

20 A conference call with terminated dealers, organized by CADA, was held on May 24, 2009. The terminated dealers were entitled to call in and participate, and a number chose to do so. It is alleged that two lawyers from Cassels participated in the call. The call lasted several hours, but there is no evidence before me concerning what advice, if any, was provided to the dealers by Cassels.

Subsequent Events

21 This action was commenced on February 12, 2010, on behalf of what was then said to be approximately 215 dealers who signed the W.D.A. A separate action was commenced on behalf of 19 of the 33 dealers who did not sign the W.D.A. They claimed that by terminating

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

their dealer agreements, GMCL was in breach of contract, breached its duty of good faith and fair dealing under s. 3 of the *A.W.A.*, and interfered with their right of association under s. 4. In a decision in *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.*, 2010 ONSC 1965, [2010] O.J. No. 1621 (Ont. S.C.J.), Pepall J. dismissed a request by GMCL to refer the matter to arbitration and refused GMCL's request that the plaintiffs' claim be severed and that they be required to proceed individually.

The Plaintiff's Claim

22 Trillium claims that GMCL breached the legal obligations that it owed to its dealers under the *A.W.A.* and similar legislation in other provinces. Both the dealer agreements and the W.D.A. incorporated Ontario law. As will be discussed below, the franchise legislation in Alberta and P.E.I. is generally similar to the *A.W.A.*, but there are some nuances. The legislation in those provinces invalidates contractual terms that exclude the application of the law of that province or the jurisdiction of the courts of that province. For terminated dealers located in those provinces, there will be a need to consider the law of that particular province, to the extent it differs from the *A.W.A.*

23 Trillium asserts that the W.D.A. was a "franchise agreement" as the term is defined in the *A.W.A.* and that under s. 5(1) of that statute, GMCL had a duty to deliver a disclosure document at least 14 days before a franchisee was required to sign the W.D.A. It also alleges that GMCL breached its statutory duty of fair dealing and interfered with its franchisees' statutory right of association. Among other things, Trillium claims that GMCL adopted a strategy that was designed to divide the franchisees, give them no time to make a unified response to GMCL's offer, and keep them in the dark concerning GMCL's actual financial position. The plaintiff claims damages against GMCL for breach of its statutory duty of fair dealing and interference with the right of association, seeks a declaration that class members can rescind or cancel the W.D.A. due to GMCL's failure to provide a disclosure document, and claims damages for GMCL's failure to comply with the disclosure obligations under the *A.W.A.*

24 Trillium alleges that Cassels had an undisclosed conflict of interest. It pleads that Cassels had been retained by the government of Canada to provide legal advice on the GMCL bailout negotiations and that this retainer was not disclosed to the terminated dealers. Canada had made financial assistance conditional on GMCL taking a more aggressive approach to its restructuring, including the reduction of its dealership network. Trillium asserts that because it was in Canada's interest to have the GMCL dealers accept the W.D.A.s, Cassels was not in a position to provide independent and impartial advice to the terminated dealers.

25 Trillium also alleges that Cassels continued to take instructions from the "continuing dealers", who had not been terminated and who had an interest in seeing the terminated dealers accept the W.D.A., in order to ensure the survival of GMCL.

26 Trillium pleads that Cassels failed to properly advise and represent class members — in particular, by failing to inform them of their rights under the *A.W.A.* and by failing to properly represent them in developing a collective response to the W.D.A. Trillium alleges that by failing to disclose its alleged conflict, and by failing to refer class members to an independent

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

lawyer who could inform them of their rights and properly represent their interests in a collective response to GMCL's ultimatum, Cassels deprived all class members of the opportunity to use their group negotiating power to full advantage. Trillium's theory is that the dealers could have used their combined leverage to negotiate a better deal with GMCL by refusing to agree to the voluntary downsizing unless their compensation was increased. Instead, says the plaintiff, Cassels told them to obtain advice from their own lawyers, which — in view of GMCL's position that the W.D.A. was non-negotiable — meant that there was no possibility of an effective response on an individual basis.

27 The plaintiff pleads that each partner of Cassels knew or ought to have known of the firm's alleged conflict of interest and has insisted that the statement of claim be served personally on each partner of Cassels. The plaintiff asserts a personal claim against each partner.

28 The terms of Cassels' retainer are in dispute, but it appears that it will be Cassels' position that its retainer by CADA, as described in the May 22, 2009 memorandum from the CADA, which is incorporated into the statement of claim, was limited to providing legal advice in the event of a bankruptcy of insolvency of GMCL, an event that never transpired. Every one of the proposed class members obtained legal advice from their own lawyer and a certificate was signed by that lawyer as part of the acceptance of the W.D.A.

Discussion

29 This motion involves the intersection of two important statutes, the *C.P.A.*, enacted in 1992, and the *A.W.A.*, enacted in 2000. It will assist the analysis that follows to give a brief overview of each and to discuss some of the cases in which claims by franchisees against franchisors have been certified as class proceedings.

The A.W.A.

30 The full title of the statute is *Arthur Wishart Act (Franchise Disclosure), 2000*. The words in brackets highlight the primary legislative purpose, which is to protect franchisees by ensuring that franchisors make full and fair disclosure before the franchise agreement is consummated. Disclosure levels the playing field between franchisor and franchisee by protecting the franchisee when it enters into the agreement: *MDG Kingston Inc. v. MDG Computers Canada Inc.* (2008), 92 O.R. (3d) 4, [2008] O.J. No. 3770 (Ont. C.A.) at para. 1. The legislation must be interpreted in light of this purpose: *6792341 Canada Inc. v. Dollar It Ltd.*, 2009 ONCA 385, [2009] O.J. No. 1881 (Ont. C.A.) at para. 72; *Landsbridge Auto Corp. v. Midas Canada Inc.*, 2010 ONCA 478, [2010] O.J. No. 2845 (Ont. C.A.) at para. 30. In *Beer v. Personal Service Coffee Corp.* (2005), 256 D.L.R. (4th) 466, [2005] O.J. No. 3043 (Ont. C.A.), MacFarland J.A. observed, at para. 28:

> [T]he focus of the Act is on protecting the interests of franchisees. The mechanism for doing so is the imposition of rigorous disclosure requirements and strict penalties for non-compliance. For that reason, any suggestion that these disclosure requirements or the penalties imposed for non-disclosure should be narrowly construed, must be met with skepticism.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

31 In the recent case of *Salah v. Timothy's Coffees of the World Inc.*, 2010 ONCA 673, [2010] O.J. No. 4336 (Ont. C.A.), Winkler C.J.O. observed at para. 26:

> The *Wishart Act* is *sui generis* remedial legislation. It deserves a broad and generous interpretation. The purpose of the statute is clear: it is intended to redress the imbalance of power as between franchisor and franchisee; it is also intended to provide a remedy for abuses stemming from this imbalance. An interpretation of the statute which restricts damages to compensatory damages related solely to proven pecuniary losses would fly in the face of this policy initiative.

32 The *A.W.A.* applies to franchise agreements (and to extension or renewals of agreements) where the business of the franchisee is to be operated wholly or partly in Ontario (s. 2(1)). I will highlight the provisions of the *A.W.A.* that have the greatest application to the plaintiff's claim.

33 Section 3 of the *A.W.A.* imposes a duty of fair dealing on both parties in the performance and enforcement of the franchise agreement. This includes the duty to act in good faith and in accordance with reasonable commercial standards (s. 3(3)). There is a statutory cause of action for damages for the breach of that duty (s. 3(2)).

34 Section 4 provides a right of franchisees to associate and to form an association and prohibits the franchisor from interfering with that right. Any provision in a franchise agreement "or other agreement relating to a franchise" which purports to interfere with that right is void (s. 4(4)). A franchisee has a right of action against the franchisor for interference with the right of association (s. 4(5)).

35 Section 5 requires the franchisor to provide a "disclosure document" to a "prospective franchisee" not less than 14 days before the earlier of the signing of the franchise agreement and the payment of any consideration by the franchisee to the franchisor (s. 5(1)). The disclosure document must contain (a) all material facts, including any material facts prescribed by regulation; (b) financial statements; (c) copies of all proposed franchise agreements and other agreements to be signed by the franchisee; (d) statements, as prescribed by regulation, for the purpose of assisting the prospective franchisee in making informed investment decisions; and (e) other prescribed information (s. 5(4)). Ontario regulation 581/00 under the *A.W.A.* prescribes certain information to be contained in the disclosure document. The franchisor is also required to provide the franchisee with a written statement of any material change as soon as practicable after the change has occurred and before the earlier of the signing of the franchise agreement and payment of consideration by the franchisee (s. 5(5)). The information in a disclosure document and a statement of material change must be "accurately, clearly and concisely set out" (s. 5(6)).

36 The disclosure requirement does not apply, among other things, to the grant of a franchise that is not valid for more than one year and does not involve the payment of a non-refundable franchise fee (s. 5(7)(g)(ii)).

37 Section 6 gives the franchisee a right to rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the agreement, if the franchisor

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

never provided the disclosure document. Section 7 confers a cause of action for damages if the franchisor has failed to deliver a disclosure document.

38 Section 11 provides that any purported waiver or release by a franchisee of a right given by the statute is void.

39 GMCL has historically maintained that its dealership agreements are not "franchise agreements" subject to the *A.W.A.* The W.D.A. contained the following acknowledgment of this position:

> ... Dealer and Dealer Operator acknowledge that it always has been and continues to be GM's position that the [*A.W.A.* and similar franchise legislation in Alberta and P.E.I.] are not applicable to the Dealer Agreement or the relations between GM and Dealer and/or Dealer Operator.

40 Notwithstanding this provision, the W.D.A. provided that the dealer released all rights under the *A.W.A.* or similar legislation.

41 GMCL now admits that its relations with its dealers are subject to the *A.W.A.* It does not, however, agree that the W.D.A. was a "franchise agreement" so as to give rise to a duty to deliver a disclosure agreement.

The C.P.A.

42 Like the *A.W.A.*, the *C.P.A.* is remedial legislation. It was designed in part to facilitate access to justice for individuals whose claims would be uneconomic or inefficient if pursued on an individual basis: *Gagne v. Silcorp Ltd.* (1998), 41 O.R. (3d) 417, [1998] O.J. No. 4182 (Ont. C.A.), at para. 14. In simplest terms, a class action is an action with a representative plaintiff on behalf of a group of persons who have a cause of action in which there are common questions of fact or law: *Ragoonanan Estate v. Imperial Tobacco Canada Ltd.* (2000), 51 O.R. (3d) 603, [2000] O.J. No. 4597 (Ont. S.C.J.) at para. 50.

43 By avoiding multiple individual actions, a class action promotes judicial economy. The legislation is to be construed generously, to promote the legislative goals of judicial economy, access to justice and behaviour modification: *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534, [2000] S.C.J. No. 63 (S.C.C.); *Hollick v. Metropolitan Toronto (Municipality)*, [2001] 3 S.C.R. 158, [2001] S.C.J. No. 67 (S.C.C.).

44 A class action has many advantages to a multitude of individual actions. The ones most often referred to are:

- enhancing access to justice by making it possible for a large group of plaintiffs to share the cost of litigation that would otherwise be unaffordable on an individual basis;
- promoting efficient administration of justice, by aggregating individual actions and avoiding duplication of fact-finding and legal analysis; and
- changing the behaviour of wrongdoers by holding them accountable for their actions.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

45 In order to proceed as a class action, the action must be certified. Section 5 of the *C.P.A.* provides that the court *shall* certify the action if (a) the pleadings disclose a cause of action; (b) there is an identifiable class of two or more persons; (c) the claims of the class raise common issues; (d) a class proceeding is the preferable procedure for the resolution of those issues; and (e) the plaintiff would fairly represent the class, is free of conflicts on the common issues, and has produced a workable method of advancing the proceeding. I will be discussing the application of the certification criteria to the facts of this case later in these reasons. Prior to doing so, it will be useful to review some of the cases in which claims by franchisees have been certified as class actions.

Franchise Claims Under the *C.P.A.*

46 The suitability of claims by franchisees for class action treatment was foreseen by the authors of the Ontario Law Reform Commission, *Report on Class Actions*, vol. 1 (Toronto: Ministry of the Attorney General, 1982) who noted, at p. 128, that:

> Even small businesses may be reluctant to sue more powerful companies where, for example, in a franchisor-franchisee situation, they must deal continuously with such companies on a basis of dependence.

47 One of the earliest class actions in Ontario involving a franchise was *Rosedale Motors Inc. v. Petro-Canada Inc.* (1998), 42 O.R. (3d) 776, [1998] O.J. No. 5461 (Ont. Gen. Div.), rev'd. (Ont. S.C.J.) ("*Rosedale Motors*"). The plaintiff alleged that the franchisor had misrepresented the profitability of the proposed franchise. The motion judge had refused to certify the proceeding, finding that the claims of the class members did not turn on a single common representation but rather depended on what had been said by the franchisor in its communications with each franchisee. He also found that a class action was not the preferable procedure due to the variety and importance of the remaining individual issues. The Divisional Court reversed, noting that the law had evolved in light of the then recent decisions of the Supreme Court of Canada in *Hollick v. Metropolitan Toronto (Municipality)*, above, and *Rumley v. British Columbia*, [2001] 3 S.C.R. 184, [2001] S.C.J. No. 39 (S.C.C.), which had been released a few days earlier. The Divisional Court held that the issues of whether the franchisor had a duty of care in relation to its research into the profitability of a franchise, whether it had breached the standard of care, and whether its representations were false and misleading were common issues that would advance the action, prevent duplication of trials and avoid the risk of inconsistent decisions, notwithstanding that there would still be individual issues to be resolved. The fact that different representations may have been made to individual franchisees, and that the resolution of the common issues would not be determinative of the franchisor's liability, were not barriers to certification.

48 In *909787 Ontario Ltd. v. Bulk Barn Foods Ltd.*, [1999] O.J. No. 2973 (Ont. S.C.J.), rev'd (2000), 2 C.P.C. (5th) 61, [2000] O.J. No. 3649 (Ont. Div. Ct.), the Divisional Court reversed the decision of the motion judge who had certified a class action on behalf of franchisees of the "Bulk Barn" chain. The plaintiff claimed that the franchisor had charged excessive mark-ups on products sold to franchisees and had breached a contractual obligation to charge prices that were as low or lower than other wholesalers. The motion judge found that

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

there were common issues of fact and law, including issues in the interpretation of the franchise agreements and related documents that would move the litigation forward for all members of the class. The fact that different class members may have paid different prices for the same products was a matter which could be addressed as the litigation progressed. The Divisional Court reversed, holding, among other things, that the defendant's liability to any particular class member would depend on the products purchased from Bulk Barn at various times and the prices at which those same commodities would be available from other suppliers in the particular area. As a result, the Divisional Court found that the proceeding would be unmanageable.

49 In *Mont-Bleu Ford Inc. v. Ford Motor Co. of Canada* (2000), 48 O.R. (3d) 753, [2000] O.J. No. 1815 (Ont. Div. Ct.), rev'g (Ont. S.C.J.), the Divisional Court reversed a motion judge who had declined to certify a class action, notwithstanding that he had found that the plaintiffs had met all the requirements for certification but for the preferable procedure requirement in s. 5(1)(d) of the *C.P.A.* The plaintiffs, who were Ford dealers, claimed that Ford had breached their dealership agreements by restructuring its dealerships such that Mercury dealers were permitted to sell vehicles that were formerly sold exclusively by Ford dealers. The plaintiffs alleged that this was contrary to their dealership agreements, which only permitted Ford to appoint an additional dealer in a particular area where a market study established the necessity. On the certification motion, it was not disputed that there was a cause of action and an identifiable class and the motion judge found that there were common issues. He held, however, that an application to interpret the dealer agreement, under rule 14.05(3)(d) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, would be a preferable procedure. The Divisional Court held that in the absence of an agreement by Ford that it would be bound by such a determination in the individual action, the determination of the issue on an application would not resolve the claims of the class. It remitted the matter to the motion judge for determination. The action was ultimately settled with the approval of the court: (2004), 45 C.P.C. (5th) 292, [2004] O.J. No. 1270 (Ont. S.C.J.)

50 In *1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada Ltd.* (2002), 62 O.R. (3d) 535, [2002] O.J. No, 4781 (Ont. S.C.J.), aff'd. (2004), 70 O.R. (3d) 182, [2004] O.J. No. 865 (Ont. Div. Ct.), ("*A & P*"), franchisees of a grocery store chain claimed that the franchisor had improperly withheld supplier rebates and allowances. The franchisor did not dispute that the claims of the class members raised common issues and the only real issue was whether a class proceeding would be preferable to joinder or consolidation of individual actions. Winkler J., as he then was, certified the action. He stated at para. 26:

> In my view, where a plaintiff has met the evidentiary burden of establishing that there is an identifiable class and common issues, can state a narrow issue that is common to the entire class, and is as significant to the resolution of each individual claim as is the case here, then he or she has established a basis for a determination that a class proceeding is the preferable procedure. This determination remains, consistent with the Supreme Court's holding in *Hollick*, subject to the court finding that the proceeding would achieve one or more of the goals of the *Act* or, conversely, a showing by the defendants that a class proceeding is not the preferable method of dealing with the claims.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

51 In *Landsbridge Auto Corp. v. Midas Canada Inc.* (2009), 73 C.P.C. (6th) 10, [2009] O.J. No. 1279 (Ont. S.C.J.), Cullity J. certified a class action on behalf of Midas franchisees who claimed that the franchisor had improperly terminated discounts that it had provided on products supplied to the franchisees. Cullity J. noted that the claims depended almost entirely on the interpretation of the standard form franchise agreement and whether the behaviour of the franchisor amounted to bad faith or unfair dealing. The plaintiffs claimed, among other things, that the franchisor had breached its duty of fair dealing under s. 3 of the *A.W.A.* Cullity J. concluded that the claims of the class raised common issues and, referring to the observations of Winkler J. in *A&P* found that a class proceeding would be the preferable procedure. He noted that a class proceeding would promote access to justice, noting that Winkler J. at para. 42 of *A&P* had commented on the "inherent vulnerability in the dependent ongoing nature of the relationship between franchisor and franchisee."

52 Recently, in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, 2010 ONCA 466, 100 O.R. (3d) 721 (Ont. C.A.), aff'g (2009), 96 O.R. (3d) 252, [2009] O.J. No. 1874 (Ont. Div. Ct.), rev'g (2008), 89 O.R. (3d) 252, [2008] O.J. No. 833 (Ont. S.C.J.), the Court of Appeal affirmed the certification of a class action by the Divisional Court, which had reversed the motion judge's decision denying certification. The plaintiff alleged that the franchisor charged its franchisees excessive prices for the purchase of food and other supplies. Claims were made for breach of the price maintenance provisions of the *Competition Act*, R.S.C. 1985, c. C-34, for conspiracy to fix prices and for breach of contract. The troublesome issue before the motion judge was commonality in relation to the proof of damages, which he found impacted all the other important common issues. The majority in the Divisional Court found that the motion judge did not fully analyze the other common issues and concluded that there were sufficient common issues to certify the proceeding. The Court of Appeal agreed. The claim under s. 61 of the *Competition Act* could be determined as a common issue because it would focus on the conduct of the franchisor, even though proof of loss or damage would be required to complete the claim, under s. 36(1). The claim of each class member would be advanced by a resolution of the issue, which would avoid duplication of legal analysis. For the same reason, the analysis of the conspiracy common issue would focus on the conduct of the franchisor, even in the absence of proof of loss and would avoid duplication of fact-finding and legal analysis. Finally, on the breach of contract claim, where it was argued that the claims were highly individualistic, the Court of Appeal agreed with the Divisional Court's conclusion that the meaning of the contract terms, the existence of a duty of fairness, and the breach of a particular contract term were all common issues that would advance the litigation. Both courts concluded that the resolution of the common issues would significantly advance the litigation even if the damages could not be dealt with on a class-wide basis.

53 In *578115 Ontario Inc. v. Sears Canada Inc.*, 2010 ONSC 4571, [2010] O.J. No. 3921 (Ont. S.C.J.), I certified a class action brought on behalf of 73 Sears franchisees alleging a failure to pass on rebates provided by suppliers. The plaintiff claimed breach of contract and breach of s. 3 of the *A.W.A.* The defendant admitted that there were proper causes of action and that some common issues were appropriate for certification, if fairly and neutrally worded. It argued, however, that many of the common issues were dependent on findings of fact that would have to be made with respect to each class member: see *Williams v. Mutual*

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

Life Assurance Co. of Canada (2000), 51 O.R. (3d) 54, [2000] O.J. No. 3821 (Ont. S.C.J.), at para. 39, aff'd (2001), 17 C.P.C. (5th) 103, [2001] O.J. No. 4952 (Ont. Div. Ct.), aff'd *Kumar v. Mutual Life Assurance Co. of Canada* (Ont. C.A.) and *Zicherman v. Equitable Life Insurance Co. of Canada* (Ont. C.A.); *Fehringer v. Sun Media Corp.* (2002), 27 C.P.C. (5th) 155, [2002] O.J. No. 4110 (Ont. S.C.J.), aff'd (2003), 39 C.P.C. (5th) 151, [2003] O.J. No. 3918 (Ont. Div. Ct.). I concluded, referring to *Rosedale Motors*, above, that the existence of the individual issues did not detract from the capacity of the common issues to materially advance the action.

54 In the more recent case of *1250264 Ontario Inc. v. Pet Valu Canada Inc.*, 2011 ONSC 287, released on January 14, 2011, I certified an action in which it was claimed that the franchisor failed to share volume rebates with its franchisees. It was acknowledged that the plaintiff had properly pleaded causes of action for breach of contract, breach of s. 3 of the *A.W.A.* and unjust enrichment. I found that the pleadings and the common facts gave rise to common legal issues pertaining to the interpretation of the franchise agreement and the duties of the franchisor under contract, statute and common law.

55 As these cases indicate, claims by franchisees under the *A.W.A.* have indeed proven to be a fruitful basis for class action litigation, particularly in this province. In the recent decision of the Court of Appeal in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, above, Armstrong J.A., giving the judgment of the Court, commented on the particular suitability of a class action to franchise disputes, at para. 62:

> I am also of the view that a class proceeding in this case will satisfy at least two of the objectives of the *Class Proceedings Act* of judicial economy and access to justice. It seems to me that this case involving a dispute between a franchisor and several hundred franchisees is exactly the kind of case for a class proceeding.

56 Armstrong J.A. made these comments in the context of the preferable procedure analysis, having agreed with the majority in the Divisional Court that there were common issues capable of moving that action forward.

57 A typical franchise relationship involves a common contract, a common "system" and common treatment of franchisees by the franchisor. These attributes may give rise to common issues that can be decided without reference to the individual circumstances of the franchisee, thereby making the proceeding particularly suitable as a class action. The court must nevertheless ask whether there are indeed issues common to the claims of all class members and whether the resolution of those issues will sufficiently advance the action and avoid duplication of fact-finding and legal analysis, even though individual issues remain to be determined.

58 As the foregoing cases illustrate, the resolution of the common issues need not be determinative of the franchisor's liability to every class member or of whether a particular franchisee has actually sustained damages. While the court on a certification motion has a duty to ensure that the resulting class proceeding will not collapse under its own weight, the *C.P.A.* contemplates that individual issues may remain after the determination of the common issues and gives the court considerable flexibility in determining the expeditious and least expensive

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

means of resolving those issues.

59 In making the preceding observations, I do not intend to suggest that every franchise case will be suitable for certification. I simply note that there are aspects of franchise claims that may promote the goals of both the *A.W.A.* and the *C.P.A.* In the section that follows, I shall consider whether this proceeding meets the test for certification under the *C.P.A.*

Application of the Test for Certification

60 As I noted earlier, there is a five-part test for the certification of an action as a class proceeding under the *C.P.A.* The requirements are linked: "[t]here must be a cause of action, shared by an identifiable class, from which common issues arise that can be resolved in a fair, efficient and manageable way that will advance the proceeding and achieve access to justice, judicial economy and the modification of behaviour of wrongdoers": see *Sauer v. Canada (Minister of Agriculture)*, [2008] O.J. No. 3419, 169 A.C.W.S. (3d) 27 (Ont. S.C.J.), at para. 14. I will now review the elements of this test as they apply to this action.

(a) The Pleadings Must Disclose a Cause of Action

61 The principles applicable to this aspect of the test are:

- no evidence is admissible for the purposes of determining the section 5(1)(a) criterion;
- all allegations of fact pleaded, unless patently ridiculous or incapable of proof, must be accepted as proved and thus assumed to be true;
- the pleading will be struck out only if it is plain, obvious and beyond doubt that the plaintiff cannot succeed and only if the action is certain to fail because it contains a radical defect;
- matters of law which are not fully settled by the jurisprudence must be permitted to proceed; and,
- the pleading must be read generously to allow for inadequacies due to drafting frailties and the plaintiff's lack of access to key documents and discovery information.

62 The test is the same as is applied in a motion to strike a pleading under rule 21.01(1)(b) on the ground that it discloses no reasonable cause of action: "assuming that the facts as stated in the Statement of Claim can be proved, is it 'plain and obvious' that the plaintiff's Statement of Claim discloses no reasonable case of action?": see *Hunt v. T & N plc*, [1990] 2 S.C.R. 959, [1990] S.C.J. No. 93 (S.C.C.) at para. 33. This test was summarized by Cameron J. in *Balanyk v. University of Toronto* (1999), 1 C.P.R. (4th) 300, [1999] O.J. No. 2162 (Ont. S.C.J.), at para. 25 as follows:

> The test to be applied is whether, assuming the facts pleaded are true, it is plain and obvious that the plaintiff's statement of claim discloses no reasonable cause of action. Only if the action is certain to fail because the pleading contains a radical defect should the relevant portions be struck out. If the pleading has some chance of success, it should remain.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

> An arguable point of law or a novel cause of action should be left to the trial judge or a motion for judgment based on the point after exchange of pleadings. The motion for judgment may be under Rule 21.01(a) on the basis of some question of law or under Rule 20 where a factual context is required for its resolution: see *Hunt v. Carey Canada*, [1990] 2 S.C.R. 959; *Prete v. Ontario* (1993), 16 O.R. (3d) 161 (C.A); *Nash v. Ontario* (1995), 27 O.R. (3d) 1 (C.A.); *Abramovic v. Canadian Pacific Ltd.* (1991), 6 O.R. (3d) 1 (C.A.).

(i) The Pleading Against GMCL

63 In this case, the claims made by Trillium against GMCL are entirely under the *A.W.A.* or comparable legislation in other provinces. There are three claims, as noted above. First, a claim for breach of the duty of fair dealing in s. 3; second, a claim for breach of the right of association in s. 4; and third, a claim for breach of the franchisor's obligation of disclosure in s. 5.

64 GMCL acknowledges that the plaintiff has properly pleaded a cause of action for breach of the duty of fair dealing in s. 3 of the *A.W.A.* A claim under s. 3 was certified in *Landsbridge Auto Corp. v. Midas Canada Inc.*, above. In *Salah v. Timothy's Coffees of the World Inc.*, above, Chief Justice Winkler observed that the focus of the cause of action under s. 3 is the conduct of the breaching party.

65 GMCL also acknowledges that there is a properly pleaded claim for breach of the s. 4 right of association.

66 The contentious issue is whether there is a properly pleaded cause of action under s. 5 of the *A.W.A.* based on GMCL's failure to deliver a disclosure document at least 14 days before the execution of the W.D.A. by each class member. The parties agree that there is no authority directly on point. The issue is largely a definitional battle, with each party supporting its position by reference to the purpose of the legislation. I shall summarize the opposing arguments.

67 Trillium notes that the obligation under s. 5 of the *A.W.A.* is to provide a disclosure document to a "prospective franchisee", defined in s. 1(1), in part, as a person who the franchisor "invites to enter into a franchise agreement." A "franchise agreement" is defined as "any agreement that relates to a franchise between a franchisor ... and a franchisee." A "franchisor" is a person who grants or offers a franchise and a franchisee is a "person to whom a franchise is granted." A "franchise" is a right to engage in a business that, among other things, requires the franchisee to make a payment or continuing payments to the franchisor in the course of operating the business or as a condition of acquiring the franchise or commencing operations. Trillium argues that the W.D.A. was an agreement that "relates" to the franchise between GMCL and its franchisees, like Trillium. It says that GMCL "invited" the 240 dealers to "enter into" the W.D.A. Trillium notes that the purpose of the *A.W.A.* is to protect franchisees and says that the term "franchise agreement" should be interpreted generously so as to protect franchisees by requiring full disclosure in the event of amendments of the underlying agreement.

68 GMCL focuses on the definition of "prospective franchisee". The full definition under

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

s. 1(1) of the *A.W.A.* is:

> "prospective franchisee" means a person who has indicated, directly or indirectly, to a franchisor or a franchisor's associate, agent or broker an interest in entering into a franchise agreement, and a person whom a franchisor or a franchisor's associate, agent or broker, directly or indirectly, invites to enter into a franchise agreement.

69 GMCL says that a "prospective franchisee" must mean someone who is not already a franchisee. GMCL says that by defining a "franchisee" as someone to whom a franchise is granted, and a "franchisor" as a person who "grants or offers to grant" a franchise, the statute is clearly focusing on persons who may become franchisees, not persons who already are franchisees. GMCL notes that this interpretation accords with the oft-stated purpose of the *A.WA.*, which is to allow prospective franchisees to make informed investment decisions *before* they enter into a franchise relationship: see Ontario Ministry of Consumer and Commercial Relations, *Ontario Franchise Disclosure Legislation* (Toronto: June 1998); *2189205 Ontario Inc. v. Springdale Pizza Depot Ltd.*, 2010 ONSC 3695, [2010] O.J. No. 3071 (Ont. S.C.J.) at para. 9; *MBCO Summerhill Inc. v. MBCO Associates Ontario Inc.*, 2010 ONSC 5432, [2010] O.J. No. 4201 (Ont. S.C.J.) at para. 16; *4287975 Canada Inc. v. Imvescor Restaurants Inc.* (2008), 91 O.R. (3d) 705, [2008] O.J. No. 3197 (Ont. S.C.J. [Commercial List]), at para. 14, aff'd, 2009 ONCA 308, 98 O.R. (3d) 187 (Ont. C.A.), leave to appeal to S.C.C. refused, (S.C.C.); *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* (2005), 256 D.L.R. (4th) 451, [2005] O.J. No. 3040 (Ont. C.A.), at para. 16; *MDG Kingston Inc. v. MDG Computers Canada Inc.*, above, at para. 1.

70 GMCL also says that the entire scheme of the *A.W.A.*, including its regulations, indicates that the disclosure obligation relates to persons who are not yet franchisees. For example, a material fact is defined in s. 1(1) of the *A.W.A.* as including information that would reasonably be expected to have a significant effect on "the price of the franchise *to be granted* or the decision *to acquire* the franchise" (emphasis added). This can only refer to someone who has not yet become a franchisee. Ontario Regulation 581/00, which prescribes the content of the disclosure document, makes reference to information that must be disclosed in relation to establishing the franchise or operating the franchise, which would have no application to a wind-down agreement. GMCL says that because the disclosure obligation is premised on the "grant" of a franchise, it cannot possibly apply to an agreement that does not grant a franchise.

71 GMCL notes that the *A.W.A.* must be interpreted in manner that is commercially reasonable and that balances the rights of both franchisor and franchisee: see *4287975 Canada Inc. v. Imvescor Restaurants Inc.* (C.A.), above, at para. 40; *779975 Ontario Ltd. v. Mmmuffins Canada Corp.*, [2009] O.J. No. 2357 (Ont. S.C.J.) at para. 32. It argues that it would not be commercially reasonable to adopt an interpretation that leaves the franchisor in doubt as to what kind of amendments trigger the disclosure obligation and what must be disclosed in the case of an amendment.

72 GMCL says that the plaintiff's interpretation of the statute is commercially unreasonable because it would force a franchisor to deliver a disclosure document every time it amended an existing franchise agreement. While the *A.W.A.* requires a disclosure document

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

where there is a renewal or extension of a franchise agreement, unless there has been no material change since the franchise agreement or the last renewal or extension, it makes no provision for amendment of the agreement, although it could easily have done so.

73 While an important purpose — arguably the dominant purpose — of the *A.W.A.* was to ensure full pre-contractual disclosure to would-be franchisees, it clearly was not the only purpose. The leveling of the playing field by imposing a reciprocal duty of fair dealing and a right of free association of franchisees was an important ancillary purpose. I cannot say that it is plain, obvious and beyond doubt that the plaintiff's interpretation of the franchise agreement is doomed to fail. Nor can I say that the policy of the statute runs contrary to imposing an obligation of disclosure when the franchisor proposes to make an important and unilateral amendment to the franchise agreement. One could certainly argue that an amendment that involves the franchisee divesting itself of its investment, and surrendering important rights under its franchise agreement is every bit as significant as its initial decision to invest in the first instance. To put this point in context, consider that Trillium and the other 239 franchisees who had been offered the WDA were essentially being told by GMCL, "if this offer is not accepted by every last one of you, there is a strong possibility that we will seek protection from our creditors and you may get nothing." It does not strike me as unreasonable, or inconsistent with the statutory purpose, to suggest that GMCL had an obligation to make full and fair disclosure of all material facts known to it that might reasonably affect the franchisees' decision.

74 The fact that there is no jurisprudence on the issue does not establish that the plaintiff's claim cannot be maintained — on the contrary, it is a good reason to exercise restraint in such circumstances. The issue is a novel one. It involves a relatively new and important piece of legislation that the Court of Appeal has said should be given a "broad and generous interpretation": see *Salah v. Timothy's Coffees of the World Inc.*, above, at para. 26. I cannot say that the plaintiff's interpretation is plainly wrong or that the claim under s. 5 of the *A.W.A.* has no chance of success.

75 There is another good reason for restraint. The parties do not agree on the nature of the W.D.A. itself. On the one hand, they both describe it as an amendment to the franchise agreement. On the other hand, GMCL has described it as a "settlement agreement" (i.e., a settlement of the franchisee's rights under its dealership agreement), but GMCL also describes it, in its fall-back argument, as a franchise agreement. Reading the W.D.A. itself, it could be described as a free-standing independent agreement, an amendment of the franchise agreement, a supplemental agreement, a settlement and release agreement, or some combination of all four. The application of the *A.W.A.* to this agreement should be considered on the basis of a full evidentiary foundation and not in the context of this procedural motion.

76 GMCL's fall-back position is that, if the W.D.A. is a "franchise agreement" within the meaning of the statute, it falls within the exemption contained in s. 5(7)(g)(ii) of the *A.W.A.*, that is, the W.D.A. was not valid for longer than one year and did not involve the payment of a non-refundable fee.

77 The plaintiff answers that the exemption applies only to "the grant of a franchise" and the W.D.A. was not the grant of a franchise. As I have noted, there is a dispute as to the nature

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

of the W.D.A. and one could certainly make the case that it was not the grant of a franchise and was instead either the termination of the franchise or an amendment of the grant of a franchise. The plaintiff also submits that this exemption does not apply because the W.D.A., by its own terms, could extend beyond the stated termination date of December 31, 2009 and up to October 31, 2010.

78 Again, I cannot say that it is plain, obvious and beyond doubt that the W.D.A. falls within s. 5(7)(g)(ii). The scope of that exemption is a novel issue and it is preferable that the issue be addressed in the context of full evidence and argument. I conclude, therefore, that the plaintiff has adequately pleaded a cause of action against GMCL under s. 5 of the *A.W.A.*

(ii) The Pleading Against Cassels

79 The plaintiff pleads causes of action against Cassels for breach of contract, breach of fiduciary duty, and negligence. In connection with the claims for breach of contract and breach of fiduciary duty, the plaintiff pleads that Cassels had a solicitor-client relationship with the class, that it had an undisclosed conflict of interest which caused it to breach its duty of fidelity and its duty to act in the client's best interests, and that it failed to properly advise the affected dealers in their response to the W.D.A. It is alleged that Cassels failed to advise the dealers of their rights under the *A.W.A.*, including their right to a disclosure document, their right to a reasonable time to review it, and their right and opportunity to associate for the purpose of negotiating a better deal. In the negligence claim, Trillium claims that independent of any retainer, Cassels owed a duty of care to the class. The pleading is that in the "unique circumstances" of Cassels' involvement, the actions or inaction of Cassels left the dealers with no alternative but to take advice from their own personal lawyers, without the benefit of any collective action or negotiation.

80 I will examine each of these causes of action.

A. Breach of Contract

81 Cassels says that Trillium has failed to plead particulars of the constituent elements of a cause of action for breach of contract. These are, specifically, the nature of the contract, the parties to the contract, the facts supporting privity of contract, the relevant terms of the contract, what terms were breached, how they were breached and the damages flowing from the breach: *McCarthy Corp. PLC v. KPMG LLP*, [2007] O.J. No. 32 (Ont. S.C.J. [Commercial List]) at para. 26. Cassels says that the pleading is inconsistent with documents that are incorporated by reference into it, which make it clear that Cassels was only being retained to provide advice in the event of GMCL's bankruptcy. It says that the pleading fails to properly identify which dealers were parties to the contract — were they all GMCL dealers, those who received a W.D.A., those who contributed to the CADA legal fund, or those who participated in the conference call? It says that the plaintiff has failed to identify whether the contract was written or oral, how the express or implied terms arise, and how privity of contract is established.

82 It seems to me that Cassels' objections are met by the principles set forth in para. 64, above. In particular, allegations of fact must be accepted as true and the pleading must be read

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

generously to account for the fact that the proceeding is at an early stage and the plaintiff may not have full access to information or documents, such as information or documents from CADA, concerning the precise nature and scope of Cassels' retainer.

83 Cassels argues that the CADA letter of May 4, 2009 indicates that Cassels' retainer was limited to representing the dealers in a bankruptcy. A generous reading of the pleading, however, would consider other allegations of fact, including the allegation that Cassels drafted the memorandum of May 22, 2009 and participated in the conference call of May 24, 2009. Read generously, these are capable of being interpreted as allegations that Cassels was performing services that are indicative of a broader retainer on behalf of all GMCL dealers, including all class members.

84 The plaintiff has pleaded the relevant terms of the contract, including implied terms that arise from a solicitor and client relationship. There are allegations that set out the manner in which the contract was breached. Damages are pleaded. The plaintiff pleads that as a result of Cassels' acts or omissions, the class members lost their chance to be represented as a collective and to negotiate a better settlement. I cannot say that this is a patently ridiculous allegation or that the damages claimed are incapable of proof: "[r]ecovery for lost chances based on lawyers' negligence either in advising clients, or in conducting litigation, is well established in the common law": see *Folland v. Reardon* (2005), 74 O.R. (3d) 688, [2005] O.J. No. 216 (Ont. C.A.) at para. 71.

85 For these reasons, I am satisfied that the plaintiff has pleaded a proper cause of action against Cassels for breach of contract based on a solicitor-client relationship.

B. Breach of Fiduciary Duty

86 My conclusion on the breach of contract claim also supports the plaintiff's pleading that Cassels breached fiduciary duties that it owed to the class. Both parties rely on the decision of the Supreme Court of Canada in *Perez v. Galambos*, [2009] 3 S.C.R. 247, [2009] S.C.J. No. 48 (S.C.C.). In that case, the Supreme Court noted that the lawyer-client relationship is a *per se* fiduciary relationship — that is, a relationship that because of its inherent purposes or presumed factual or legal incidents is considered to give rise to fiduciary obligations. The Supreme Court noted, however, that not all of the duties that a lawyer owes to a client are fiduciary in nature. The lawyer may breach some duties to the client without necessarily breaching a fiduciary duty. Cromwell J., giving the judgment of the Supreme Court, noted at para. 37:

> A claim for breach of fiduciary duty may only be founded on breaches of the specific obligations imposed because the relationship is one characterized as fiduciary: *Lac Minerals*, at p. 647. This point is important here because not all lawyers' duties towards their clients are fiduciary in nature. Sopinka and McLachlin JJ. (as the latter then was) underlined this in dissent (but not on this point) in *Hodgkinson*, at pp. 463-64, noting that while the solicitor-client relationship has fiduciary aspects, many of the tasks undertaken in the course of the solicitor-client relationship do not attract a fiduciary obligation. Binnie J. made the same point in *Strother v. 3464920 Canada Inc.*, 2007 SCC 24, [2007] 2 S.C.R. 177, at

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

para. 34: "Not every breach of the contract of retainer is a breach of a fiduciary duty." The point was also put nicely by R. M. Jackson and J. L. Powell, *Jackson & Powell on Professional Liability* (6th ed. 2007), at para. 2-130, when they said that any breach of any duty by a fiduciary is not necessarily a breach of fiduciary duty.

87 The statement of claim contains allegations that Cassels owed a duty of loyalty and faithful and undivided representation to class members. These are fiduciary duties: see *3464920 Canada Inc. v. Strother*, [2007] 2 S.C.R. 177, [2007] S.C.J. No. 24 (S.C.C.), at para. 35. There are allegations that Cassels had a conflict of interest that it did not disclose to class members and that it acted contrary to the interests of class members by simultaneously acting for Canada as well as for the ongoing GM dealers who were not being terminated. These are allegations of breaches of the fiduciary obligation of undivided loyalty that is at the heart of the lawyer-client relationship. There is a properly pleaded cause of action for breach of fiduciary duty.

C. Negligence

88 It is well established that a lawyer may have a liability to the client in both contract and negligence: *Folland v. Reardon*, above; *Central & Eastern Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147, [1986] S.C.J. No. 52 (S.C.C.).

89 Trillium pleads, however, that Cassels owed a duty of care to the class members apart from its contractual retainer due to the "unique circumstances" of the situation. This includes the exigent circumstances at the time of the May 24, 2009 conference call when the plaintiff says that dealers were between a rock and a hard place with only Cassels on hand to assist them.

90 Cassels attacks this pleading on a number of grounds. It notes that a pleading of negligence must contain material facts establishing: (a) that the defendant owed a duty of care to the plaintiff; (b) that the defendant breached that duty by engaging in conduct below the standard of care; and (c) that the plaintiff suffered damages as a result of the breach: *Balanyk v. University of Toronto*, above, at para. 19; *Hanke v. Resurfice Corp.*, [2007] 1 S.C.R. 333, [2007] S.C.J. No. 7 (S.C.C.), at para. 6. It also notes that where the claim is for pure economic loss, the plaintiff must satisfy the test set out in *Anns v. Merton London Borough Council* (1977), [1978] A.C. 728 (U.K. H.L.) and revisited in *Cooper v. Hobart*, [2001] 3 S.C.R. 537, [2001] S.C.J. No. 76 (S.C.C.). Finally, Cassels says that the plaintiff has failed to plead a causal link between the alleged negligence of Cassels and damages suffered by the class members. The plaintiff does not plead that it would not have signed the W.D.A. had Cassels not been negligent or that it relied on Cassels to its detriment. Since each class member retained its own lawyer for advice in connection with the W.D.A., and signed it after receiving such advice, Cassels argues that there can be no proximity to Cassels, no reliance on Cassels, no causal connection with anything that Cassels did or failed to do, and no damages.

91 Although the statement of claim does not organize the factual allegations in a fashion that precisely anticipates Cassels' arguments, there are allegations that:

- Cassels knew, by virtue of its representation of the government of Canada, that the offer

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

contained in the W.D.A. could have been substantially increased and that the sign-back deadline of May 26, 2009 could have been extended;

• Cassels also knew that both GMCL and Canada wanted to avoid formal insolvency proceedings and that GMCL would not have jeopardized a multi-billion dollar bailout package just because the affected dealers held out for more money;

• by participating in the May 24, 2009 conference call, Cassels knew or ought to have known that the dealers were looking to it for legal and strategic advice and that the dealers could reasonably expect that everything possible would be done by Cassels to ensure that their interests would be furthered;

• Cassels failed to take any steps on the dealers' behalf and failed to give them any advice concerning their collective rights, negotiating opportunities or strategies and simply advised them to obtain advice from their local lawyers;

• Cassels knew that the affected dealers would have no negotiating power on their own and that their local lawyers would be unable to give them the kind of advice they required in order to improve on GMCL's offer;

• Cassels had a duty, in the circumstances, to either inform the dealers of their rights, opportunities and strategies or to advise them that it had a conflict and that they should collectively obtain legal advice from another source;

• GMCL knew of Cassels' retainer by Canada and knew that its alleged conflict had not been disclosed to the dealers, that the dealers would not obtain representation from Cassels as a result of its conflict and that, as part of GMCL's "shock and awe" strategy, the dealers would be left without legal representation in their hour of greatest need;

• Cassels' actions or inactions left the dealers with no practical alternative except to sign the W.D.A.; and

• in so doing, the dealers lost the opportunity to be represented as a collective and to negotiate an improvement on GMCL's offer.

92 In *Robinson v. Rochester Financial Ltd.*, 2010 ONSC 463, 89 C.P.C. (6th) 91 (Ont. S.C.J.), Lax J. referred to a "developing line of authority" permitting a party to assert a claim in negligence against a lawyer where there is no retainer and no direct solicitor and client relationship between the plaintiff and the lawyer: see also *CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman* (2001), 18 B.L.R. (3d) 240, [2001] O.J. No. 4622 (Ont. S.C.J.); *Delgrosso v. Paul* (1999), 45 O.R. (3d) 605 (Ont. Gen. Div.); *Elms v. Laurentian Bank of Canada* , 2001 BCCA 429 (B.C. C.A.). In this case, it is at least arguable that in participating of the drafting of the May 22, 2009 memo (as it is alleged) and in participating in the May 24, 2009 conference call, Cassels brought itself into a relationship of sufficient proximity to the terminated dealers to owe them a duty of care — a duty, in light of its alleged conflict, to refer them to counsel who could protect and advance their collective interest. As in *Robinson v. Rochester Financial Ltd.* and *CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman*,

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

above, I need not decide whether there are policy considerations that might negative or circumscribe the scope of that duty. Those are matters best left for consideration at trial, on a full evidentiary record.

93 I do not agree that in order to advance such a claim against Cassels the plaintiff must plead that it would not have signed the W.D.A. "but for" Cassels' negligence. As I have noted earlier, the plaintiff's claim is based on loss of a chance, a recognized claim at common law.

94 I therefore conclude that the plaintiff has met the cause of action requirement in s. 5(1)(a) of the *C.P.A.* I now turn to the requirement that there be an identifiable class.

(b) There Must be an Identifiable Class

95 The plaintiff proposes a class that consists of all corporations in Canada that signed the W.D.A. The class is therefore composed of entities that have a direct contractual relationship with GMCL. There is a rational connection between the class and the common issues relating to both GMCL and Cassels. The class is bounded and readily capable of identification. Neither GMCL nor Cassels objects to the class definition.

96 I see no conflict between the claims of class members whose claims may be subject to the laws of other provinces. If that concern arises in the future, it can be addressed by creating a sub-class.

(c) Common Issues

97 Section 5(1)(c) of the *C.P.A.* requires that the claims or defences of the parties raise common issues. Both parties accept the following principles applicable to the common issues analysis, as stated in *578115 Ontario Inc. v. Sears Canada Inc.*, above, at para. 43:

> (a) the underlying foundation of a common issue is whether its resolution will avoid duplication of fact-finding or legal analysis;
>
> (b) an issue can be a common issue even if it makes up a very limited aspect of the liability question and even though many individual issues remain to be decided after its resolution;
>
> (c) there must be a basis in the evidence before the court to establish the existence of common issues;
>
> (d) there must be a rational relationship between the class identified by the plaintiff and the proposed common issues;
>
> (e) the proposed common issue must be a substantial ingredient of each class member's claim and its resolution must be necessary to the resolution of that claim;
>
> (f) a common issue need not dispose of the litigation; it is sufficient if it is an issue of fact or law common to all claims and its resolution will advance the litigation for (or against) the class;

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

(g) the answer to a question raised by a common issue for the plaintiff must be capable of extrapolation, in the same manner, to each member of the class;

(h) a common issue cannot be dependent upon individual findings of fact that have to be made with respect to each individual claimant;

(i) where questions relating to causation or damages are proposed as common issues, the plaintiff must demonstrate (with supporting evidence) that there is a workable methodology for determining such issues on a class-wide basis; and

(j) common issues should not be framed in overly broad terms [references omitted].

98 I might have added to this list as item (k) the following observation of Perell J. in *Graham v. Imperial Parking Canada Corp.*, 2010 ONSC 4982, [2010] O.J. No. 3898 (Ont. S.C.J.) at para. 176:

> The core of a class proceeding is the element of commonality; there must be commonality in the actual wrong that is alleged against the defendant and some evidence to support this: *Frohlinger v. Nortel Networks Group*, [2007] O.J. No. 148 at para. 25; *Fresco v. Canadian Imperial Bank of Commerce*, [2009] O.J. No. 2531 (S.C.J.) at para. 21.

99 A helpful initial approach to the common issues analysis is to examine what the claims of class members have in common, looking at the proceeding from a bird's eye view. At this altitude, I would observe that in this case, the claims of the class arise from a series of events that came to a head during the six days in May 2009. The issues arise from a franchise agreement that was common to all members of the proposed class, a W.D.A. that was common to all members of the class, and conduct of GMCL and Cassels that was substantially uniform in relation to all members of the class. I will elaborate.

100 First, the factual nexus includes the circumstances of GMCL, its financial condition, its negotiations with the governments, the facts and information that it possessed concerning its financial position and the likelihood of satisfying the governments' concerns and its communications with class members. While GMCL unquestionably had some individual dealings with particular franchisees, its overall approach was to deal collectively with its dealers. This was done by way of communications that were common to all class members. Indeed, it was part of GMCL's overall strategy to treat the terminated dealers in exactly the same way. These circumstances give rise to common issues of fact.

101 Second, the claims arise from an offer that was made by GMCL in exactly the same form to all class members on the express condition that it was not negotiable and that it had to be accepted by all, without individual variations. The package offered to the terminated dealers was developed according to a common set of principles. GMCL's dealings and communications with its franchisees concerning the W.D.A. were uniform and formulaic.

102 Third, the claims of all class members are based on an agreement, the W.D.A., which is a standard form, common to all class members, with irrelevant variations as to the amount of the wind-down and sign removal payments. The common agreement gives rise to common

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

questions of interpretation, which will be discussed below, under the analysis of the proposed common issues.

103 Fourth, the claims of all class members are based on a common legal regime: the *A.W.A.* and comparable legislation in other provinces. The application of this legislation to the common factual foundation raises significant legal issues that are common to the class. Again, I will discuss these issues below.

104 The claim against Cassels arises from actions of Cassels that were directed to the class as a collective and not to individual dealers. It gives rise to factual issues concerning the retainer of Cassels, the alleged conflict of interest of Cassels and the facts underpinning what Cassels is alleged to have done, or failed to have done in relation to the class. These factual issues in turn give rise to common legal issues concerning the nature of Cassels' relationship, if any, to the class and its obligations, if any, to the class.

105 At first impression, therefore, from the bird's perspective, it appears that there is much to be found in common in the claims of the class. It is necessary, however, to make a closer inspection of the proposed issues to see whether the commonality is illusory and really a collection of individual inquiries. I will therefore examine the common issues proposed by the plaintiff to see whether they can, in fact, be determined on a common basis. In the subsequent section of these reasons, dealing with the preferable procedure analysis, I will examine whether a class action would be a fair, efficient and manageable way of resolving the claims of the class.

106 I will consider the common issues first in relation to the claim against GMCL, then in relation to the claim against Cassels.

Common Issues Relating to GMCL

107 I will discuss each of the proposed common issues in relation to GMCL.

(a) Is GMCL a franchisor within the meaning of the Franchise Acts of [Ontario, Alberta and Prince Edward Island] or any of them?

108 This is an appropriate common issue. It is a question of mixed fact and law that focuses on the conduct of GMCL and the application of a statutory standard to that conduct. GMCL admits that it is a "franchisor" for the purposes of the *A.W.A.*, the Alberta *Franchises Act* and the Prince Edward Island *Franchises Act.* Without certification, this admission is not binding on GMCL in relation to anyone except the plaintiff: see *Bywater v. Toronto Transit Commission* (1998), 27 C.P.C. (4th) 172, [1998] O.J. No. 4913 (Ont. Gen. Div.), at paras. 13 and 14 (Gen. Div.). GMCL acknowledges that this is an appropriate common issue and would consent to certification of this action only for the purpose of the determination of that issue

(b) Are all class members entitled to the benefit of the statutory duty of fair dealing under s. 3 of the *Wishart Act* and the right of association under s. 4 of the *Wishart Act* (or similar provisions under such franchise legislation otherwise governing any such class member) by virtue of the choice of law provisions in the standard Dealer Agreement and

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

the WDA?[FN4]

109 GMCL acknowledges that this is an appropriate common issue, but notes that the answer may vary depending on the location of the dealership. The Alberta *Franchises Act* and the P.E.I. *Franchises Act* contain provisions that void terms of a franchise agreement that restrict the application of the law of those provinces or restrict jurisdiction or venue to forums outside of those provinces.[FN5] In *578115 Ontario Inc. v. Sears Canada Inc.*, above, I observed at para. 28 that such provisions would not prevent a class action being brought in Ontario on behalf of a class that includes franchisees in other provinces, but could require the court to apply the law of the province in which the franchise was located. The franchise legislation in Alberta and P.E.I. contain duties of fair dealing and a right to associate that are similar, but not identical, to those provided by ss. 3 and 4 of the *A.W.A.* It is possible, therefore, that the court could ultimately reach different conclusions on these issues depending on nuances in the wording of the applicable legislation. The question as worded addresses this possibility and is appropriate.

(c) Did GMCL breach the duty of fair dealing under s. 3 of the *Wishart Act* (or similar provisions under such franchise legislation otherwise governing any such class member)?

110 The breach of the duty of fair dealing can be an appropriate common issue. In *Landsbridge Auto Corp. v. Midas Canada Inc.*, to which reference was made above, a common issue was certified asking whether the franchisor had breached its duty of fair dealing under s. 3 of the *A.W.A.* and other provincial franchise statutes. A common issue was also certified in *578115 Ontario Inc. v. Sears Canada Inc.*, above, at paras. 46-49. As Winkler J. noted in *Salah v. Timothy's Coffees of the World Inc.*, above, s. 3 of the *A.W.A.* focuses on the conduct of the breaching party in the performance of the franchise agreement. I accept the submission of GMCL that there may be some breaches of the duty of fair dealing that require an examination of the conduct of the non-breaching party and that there may be cases where the issue cannot be resolved on a common basis. An open-ended question such as the one proposed by the plaintiff runs the risk of offending the principle that common issues should not be stated in overly broad terms. The issue can be addressed, in this case, by adopting GMCL's suggestion that the common issue should be made more precise by identifying the specific allegations of breach made by the plaintiff:

> If GMCL owed a duty of fair dealing to the Class Members, did GMCL breach this duty by:
>
> > i. delivering the Wind Down Agreements to the Class Members on or after May 20, 2009 and requiring acceptance of the Wind Down Agreements by 6 p.m. EST on May 26, 2009;
> >
> > ii. not disclosing to the Class Members the identities of dealers offered a Wind Down Agreement;
> >
> > iii. stating in the Notice of Non-Renewal and Wind Down Agreement that GMCL "will not be renewing the Dealer Sales and Service Agreement" between GMCL and each of the Class Members at the expiry of its current term on October 31, 2010;

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

iv. stating in the Wind Down Agreement that "it has always been and continues to be [GMCL's] position that the Acts are not applicable to the Dealer Agreement or the relations between GM and Dealer and/or Dealer Operator"; and

v. stating in the Notice of Non-Renewal, the Wind Down Agreement and the May 19, 2009 HIDL broadcasts that GMCL's offer of the Wind Down Agreement was conditional upon all of the Non-Retained Dealers accepting the offer on or before May 26, 2009; or

vi. breaching any terms of the Wind Down Agreement?

111 These common issues are directed to specific questions concerning the conduct of GMCL that can be answered without reference to the actions of any particular class member. They are similar to the common issues concerning price-fixing, conspiracy and breach of contract that were certified in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, above.

112 The plaintiff proposes the following additional common issue:

What information, if any, did GMCL withhold from its dealers relating to its restructuring at the time of soliciting the W.D.A.s and did such withholding, if any, constitute a breach by GMCL of its statutory duties to the dealers.

113 Another way of expressing this would be:

Did GMCL have a duty to disclose material facts concerning its restructuring to franchisees at the time of soliciting the W.D.A.? If so, did it fail to disclose material facts and did it breach such duties?

114 This question is based on the evidence that GMCL told the dealers who received the W.D.A. that, if they failed to sign the agreement, there was a "strong possibility" that GMCL would seek protection from its creditors. As I observed earlier in these reasons, in these circumstances, it is reasonable to ask whether the duty of fair dealing required GMCL to make full disclosure of its financial condition and restructuring plans, so that franchisees could make an informed decision concerning the risks associated with accepting or rejecting the W.D.A. This question, as amended, is an appropriate common issue.

(d) Did GMCL breach the right of association under s. 4 of the *Wishart Act* (or similar provisions under such franchise legislation otherwise governing any such class member)?

115 Like the previous question, this question focuses entirely on the conduct of GMCL. The right of association is a collective right and must be inherently capable of collective assertion and enforcement. I accept the submission of GMCL that the common issue should identify the conduct of GMCL that is alleged to be a breach of the franchisees' right of association.

116 I therefore approve GMCL's proposed amendment to this issue as follows:

If all Class Members had a statutory right to associate, did GMCL interfere with, prohibit,

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

restrict, penalize, attempt to penalize or threaten to penalize the Class Members' exercise of this right by:

i. delivering the Wind Down Agreements to the Class Members on or after May 20, 2009 and requiring acceptance of the Wind Down Agreements by 6 p.m. EST on May 26, 2009;

ii. not disclosing to the Class Members the identities of dealers offered a Wind Down Agreement;

iii. stating in the Notice of Non-Renewal and Wind Down Agreement that GMCL "will not be renewing the Dealer Sales and Service Agreement" between GMCL and each of the Class Members at the expiry of its current term on October 31, 2010;

iv. stating in the Wind Down Agreement that "it has always been and continues to be [GMCL's] position that the Acts are not applicable to the Dealer Agreement or the relations between GM and Dealer and/or Dealer Operator"; and

v. stating in the Notice of Non-Renewal, the Wind Down Agreement and the May 19, 2009 HIDL broadcasts that GMCL's offer of the Wind Down Agreement was conditional upon all of the Non-Retained Dealers accepting the offer on or before May 26, 2009; or

vi. any terms of the Wind Down Agreement?

(e) If the answer to (c) or (d) or both is yes, are the damages against GMCL to which the class members are entitled under ss. 3(2) and 4(5) of the *Wishart Act* (or similar provisions under such franchise legislation otherwise governing any such class member) to be assessed in the aggregate?

(i) If so, what is the aggregate amount of such damages?

(ii) If not, directions pursuant to s. 25(2) of the *C.P.A.* with respect to the calculation of damages under such provisions.

117 The damages referred to in this common issue are damages for breach of the duty of fair dealing (s. 3(2)) and for breach of the right of association (s. 4(5)).

118 It has been noted by the Court of Appeal in *Markson v. MBNA Canada Bank*, 2007 ONCA 334, 85 O.R. (3d) 321 (Ont. C.A.), at para. 59 (referring to the observations of Cullity J. in *Healey v. Lakeridge Health Corp.* (2006), 38 C.P.C. (6th) 145, [2006] O.J. No. 4277 (Ont. S.C.J.) at para. 102), that it is not necessary to certify a common issue as to aggregate assessment of damages as the trial judge has authority to do so under s. 24 of the *C.P.A.* if the statutory preconditions have been met. Alternatively, where the court determines that the participation of individual class members is required to determine individual damages issues, the

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

court has broad jurisdiction under s. 25 to fashion fair and efficient procedures to do so.

119 Lax J. expanded on this in *Glover v. Toronto (City)* (2009), 70 C.P.C. (6th) 303, [2009] O.J. No. 1523 (Ont. S.C.J.), at paras. 62-63:

> Strictly speaking, it is not necessary to state this as a common issue as this determination is made by the common issues trial judge. It has become the practice to do this if the court is satisfied that there is a reasonable likelihood that the preconditions in s. 24(1) of the *Act* can be satisfied: *Vezina v. Loblaw Companies Ltd.*, [2005] O.J. No. 1974, 17 C.P.C. (6th) 307 (S.C.J.) at para. 25; *Serhan v. Johnson & Johnson et al.* (2006), 85 O.R. (3d) 665 (Div. Ct.) at para. 139; *Cassano v. Toronto-Dominion Bank*, 2007 ONCA 781, 87 O.R. (3d) 401 at para. 45, leave to appeal to S.C.C. refused, [2008] S.C.C.A. No. 15.
>
> These conditions are (a) monetary relief is claimed on behalf of some or all class members; (b) no questions of fact or law other than those relating to the assessment of monetary relief remain to be determined in order to establish the amount of the defendant's monetary liability; and (c) the aggregate or a part of the defendant's liability to some or all class members can reasonably be determined without proof by individual class members.

120 In my view, this is not a case in which the certification of the action hinges on the availability of an aggregate assessment. If damages have to be dealt with individually, the task will not be insurmountable. On the other hand, depending on the findings of the common issues judge, there may be a basis for an aggregate assessment of damages against either GMCL or Cassels. I therefore leave the issue of aggregate assessment to the common issues judge.

(f) Are the waiver and release contained in the W.D.A. null, void and unenforceable in respect of the class members' rights under ss. 4 and 11 of the *Wishart Act* (or similar provisions under such franchise legislation otherwise governing any such class member)?

121 Section 5 of the W.D.A. contains a lengthy provision entitled "Release; Covenant not to Sue, Indemnity". It includes a release of all claims that franchisees may have under the *A.W.A.*, the Alberta and P.E.I. *Franchise Acts*, or similar franchise legislation.

122 Section 4 of the *A.W.A.* deals with the franchisee's right of association. Section 4(4) provides:

> Any provision in a franchise agreement or other agreement relating to a franchise which purports to interfere with, prohibit or restrict a franchisee from exercising any right under this section is void.

123 Section 11 of the *A.W.A.* provides:

> Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor's associate by or under this Act is void.

124 In light of these provisions, it is reasonable to ask whether the release contained in the W.D.A. violates the *A.W.A.* This question addresses the legal consequences of a term of

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

the W.D.A. that is common to all class members. The question can be determined without reference to the conduct of any class member. The plaintiff accepts GMCL's suggestion that the question should refer to the specific provision of the W.D.A. (s. 5) containing the release. I approve the common issue with this amendment.

(g) Was GMCL required to deliver to each class member carrying on business in Ontario, PEI and Alberta a disclosure document within the meaning of the *Wishart Act*, the Alberta Act and the PEI Act, respectively, at least fourteen days before the class member signed the WDA?

125 The issue of whether the W.D.A. was a "franchise agreement", triggering a duty to deliver a disclosure document under the relevant provincial legislation, is a question of mixed fact and law that can be determined on facts that are common to all class members and is based on statutory provisions that are also common. A negative answer to this question will bind all class members and will end the inquiry on this issue. An affirmative answer will give rise to the next issue.

(h) By virtue of GMCL's failure to deliver any disclosure document, is each class member carrying on business in Ontario and PEI entitled to rescind the WDA, and is each class member carrying on business in Alberta entitled to cancel the WDA, within two years of signing the WDA?

126 This is an important question that does not require an examination of the conduct of individual franchisees and an affirmative answer would substantially advance the claims of all class members. GMCL points out that there are differences in the franchise legislation in Ontario and P.E.I on the one hand and in Alberta on the other. Section 6(2) of the *A.W.A.* and of the P.E.I. *Franchises Act* provide that a franchisee may rescind the franchise agreement without penalty, no later than two years after entering into the franchise agreement if the franchisor never provided a disclosure document. By contrast, s. 13 of the Alberta *Franchises Act* provides a right of rescission, which must be exercised no later than 60 days after receiving the disclosure document, or no later than two years after the franchise is *granted.* This raises a question, in Alberta, as to whether the "grant of the franchise" refers to the date of the W.D.A. or the date of the underlying franchise agreement. This issue can be addressed simply by breaking it down into sub-issues applicable to the three provinces.

(i) Is each class member carrying on business in Ontario, PEI and Alberta which delivers to GMCL a notice of rescission or notice of cancellation, as the case may be, in respect of the WDA within two years of signing the WDA entitled to compensation under ss. 6(6) of the *Wishart Act* or the PEI *Act* or under s. 14(2) of the Alberta *Act*, as the case may be?

127 The issue of entitlement to compensation, as opposed to the quantum of compensation, can be decided on common facts and is an appropriate common issue.

(j) Directions pursuant to s. 25(2) of the *C.P.A.* with respect to the calculation of amounts under s. 6(6) of the *Wishart Act* and the PEI *Act* and under s. 14(2) of the Alberta *Act*, with such amounts to be assessed with respect to each such rescinding or cancelling class member, in accordance with such directions, in individual hearings held pursuant to s. 25 of the

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

C.P.A.;

(k) Are the damages against GMCL to which the class members are entitled under s. 7(1) of the *Wishart Act* or the PEI *Act* by reason of GM's failure to comply with s. 5 of the *Wishart Act* or the PEI *Act* to be assessed in the aggregate? If so, what is the aggregate amount of such damages?

(l) Alternatively, directions pursuant to s. 25(2) of the *C.P.A.* with respect to the calculation of damages under s. 7(1) of the *Wishart Act* and the PEI *Act*, with such amounts to be assessed with respect to each class member carrying on business in Ontario and PEI, in accordance with such directions, in individual hearings to be held pursuant to s. 25 of the *C.P.A.*

128 The common issues judge has jurisdiction to give directions under s. 25(2) of the *C.P.A.* for the determination of individual issues and it is not necessary to identify this as a common issue. For the reasons set out above, I do not propose to certify common issues relating to the aggregate assessment of damages, although I acknowledge that the common issues judge may find it appropriate to do so.

(m) What is the amount of pre-judgment and post-judgment interest applicable to any damages awarded?

129 A number of cases have approved a common issue as to pre-judgment interest: *Bondy v. Toshiba of Canada Ltd.* (2007), 39 C.P.C. (6th) 339, [2007] O.J. No. 784 (Ont. S.C.J.), at paras. 54-56; *Barbour v. University of British Columbia*, 2007 BCSC 800, [2007] B.C.J. No. 1216 (B.C. S.C.); *Griffin v. Dell Canada Inc.* (2009), 72 C.P.C. (6th) 158, [2009] O.J. No. 418 (Ont. S.C.J.); *Robinson v. Medtronic Inc.* (2009), 80 C.P.C. (6th) 87, [2009] O.J. No. 4366 (Ont. S.C.J.); *Smith v. National Money Mart Co.* (2007), 37 C.P.C. (6th) 171, [2007] O.J. No. 46 (Ont. S.C.J.). In *Ramdath v. George Brown College of Applied Arts & Technology* (2010), 93 C.P.C. (6th) 106 (Ont. S.C.J.), I declined to certify a pre-judgment interest common issue because I found that individual trials would likely be required to assess damages, referring to *Fischer v. IG Investment Management Ltd.*, 2010 ONSC 296, [2010] O.J. No. 112 (Ont. S.C.J.) at para. 193. In this case, it is a possibility that the common issues judge will decide that an aggregate assessment is appropriate and I will therefore certify this common issue.

(n) What scale and quantum of costs should be awarded?

130 In light of the court's discretionary jurisdiction over costs, conferred by s. 131 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, I see little point in making costs as a common issue. The court has jurisdiction under s. 11(2) of the *C.P.A.* to give a separate judgment in respect of the common issues, and this necessarily includes the jurisdiction to award costs with respect to the trial of the common issues.

Common Issues Relating to Cassels

131 The plaintiff proposes the following common issues relating to Cassels:

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

(a) Did Cassels owe contractual duties to some or all of the class members and, if so, did it breach those duties?

(b) Did Cassels owe fiduciary duties as lawyers to some or all of the class members and, if so, did they breach those duties?

(c) Did Cassels owe duties of care to some or all of the class members and, if so, did they breach those duties?

(d) Are the damages which were caused by or contributed to by Cassels' breach of contract, breach of fiduciary duties or negligence to be assessed in the aggregate?

(i) If so, what is the aggregate amount of such damages?

(ii) If not, directions pursuant to s. 25(2) of the *C.P.A.* with respect to the calculation of such damages.

132 In addition, the plaintiff raises common issues with respect to (q) interest and (r) the quantum and scale of costs.

133 The identification of a contractual relationship with the class, the terms of that contract, and whether the defendant breached that contract may be appropriate common issues: *Hickey-Button v. Loyalist College of Applied Arts & Technology* (2006), 267 D.L.R. (4th) 601, [2006] O.J. No. 2393 (Ont. C.A.). Similarly, whether the defendant owed a duty of care to the class, the standard of care, and whether the defendant breached the duty of care may constitute common issues: *Healey v. Lakeridge Health Corp.*, above; *Bunn v. Ribcor Holdings Inc.* (1998), 38 C.L.R. (2d) 291, [1998] O.J. No. 1790 (Ont. Gen. Div.); *Delgrosso v. Paul* (1999), 45 O.R. (3d) 605 (Ont. Gen. Div.), leave to appeal to Div. Ct. ref'd (1999), 46 C.P.C. (4th) 140, [1999] O.J. No. 2922 (Ont. Div. Ct.).

134 There are some obvious factual commonalities with respect to the claim against Cassels which give rise to common issues of fact:

- Cassels was centrally retained and centrally instructed by CADA — individual class members neither retained nor instructed Cassels — the scope and content of Cassels' retainer was therefore uniform across the class and can therefore be determined as a common issue;

- Cassels dealt with and communicated with the dealers as a group, rather than individually;

- there is no evidence that Cassels had separate dealings with any class member or that it disclosed its alleged retainer by Canada to any member of the class.

135 The determination of whether Cassels owed a contractual duty, a fiduciary duty or a duty of care to the class can be made without considering the particular circumstances of individual class members. The same is true of the question whether Cassels breached those duties.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

There is no evidence that Cassels had dealings with individual class members that would make the answers to these questions dependent on individual communications or circumstances.

136 Cassels says that the diversity of circumstances of the class members means that these issues are not common because they will be answered differently for different class members. It seeks to break down the class into sub-groups:

- those who would have signed the W.D.A. in spite of being advised of their *A.W.A.* rights;
- those who would not have had the "stomach" for a fight with GMCL;
- those who made a contribution to the retainer and those who did not;
- those who participated in the conference call with Cassels and those who did not;
- the eleven dealers who delivered signed W.D.A.s to GMCL before the May 26, 2009 deadline and who presumably felt that they had sufficient time to make up their minds;
- the five dealers who accepted the W.D.A. well after the deadline and who presumably had sufficient time to consider the W.D.A.

137 Cassels says that the plaintiff has implicitly recognized the diversity of interest of the class members by using the words "some or all [class members]" in framing this common issue.

138 In my view, Cassels' submissions on this issue mis-characterizes the plaintiff's case. That case is that Cassels' actions or inactions deprived class members of the opportunity to collectively exercise their rights to get a better deal from GMCL. Resolution of the issues depends on legal and factual inquiries that are independent of individual class members, including the following inquiries:

- the circumstances of Cassels' retainer and the nature and scope of that retainer;
- whether Cassels disclosed its alleged conflict of interest to CADA or the class;
- whether Cassels owed duties to the class and whether it breached those duties;
- whether class members have *A.W.A.* rights in relation to the W.D.A.;
- whether the exercise of class members' *A.W.A.* rights would have resulted in any increase in the compensation they were paid.

139 The plaintiff will say that it is irrelevant that all dealers obtained independent legal advice before signing the W.D.A. and that some would have signed the W.D.A. in any event or returned it early. The plaintiff's case is that all dealers had a chance, through Cassels, to obtain a better deal and that due to Cassels' breaches of duty they lost that chance.

140 In my view, the answers to these questions will substantially determine whether or

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

not Cassels has a liability to the class and they are appropriate. Even if it is determined that individual issues remain with respect to the sub-groups identified by Cassels, as discussed in the next section, the common issues judge will be able to devise means to address these issues in a fair and efficient way.

141 In summary, for the above reasons I find that this proceeding meets the requirement of s. 5(1)(c) of the *C.P.A.* in that the claims of the class members against GMCL and Cassels raise common issues, as approved or modified above.

(d) Preferable Procedure

142 Section 5(1)(d) of the *C.P.A.* requires the court to determine whether a class proceeding would be the preferable procedure for the resolution of the common issues. In *Markson v. MBNA Canada Bank*, 2007 ONCA 334, 85 O.R. (3d) 321 (Ont. C.A.), above at paras. 69-70, leave to appeal to S.C.C. refused, (S.C.C.), Rosenberg J.A., giving the judgment of the Court of Appeal, summarized the approach to the preferable procedure analysis, as set out in *Hollick v. Metropolitan Toronto (Municipality)*, above:

> (1) The preferability inquiry should be conducted through the lens of the three principal advantages of a class proceeding: judicial economy, access to justice and behaviour modification;
>
> (2) "Preferable" is to be construed broadly and is meant to capture the two ideas of whether the class proceeding would be a fair, efficient and manageable method of advancing the claim and whether a class proceeding would be preferable to other procedures such as joinder, test cases, consolidation and any other means of resolving the dispute; and
>
> (3) The preferability determination must be made by looking at the common issues in context, meaning, the importance of the common issues must be taken into account in relation to the claims as a whole.
>
> As I read the cases from the Supreme Court of Canada and appellate and trial courts, these principles do not result in separate inquiries. Rather, the inquiry into the questions of judicial economy, access to justice and behaviour modification can only be answered by considering the context, the other available procedures and, in short, whether a class proceeding is a fair, efficient and manageable method of advancing the claim.

143 Not surprisingly, the plaintiff also relies upon the observations of Armstrong J.A., referred to earlier in these reasons, giving the judgment of the Court of Appeal in *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, concerning the suitability of a franchise claim to class action treatment.

144 In *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.*, above, Pepall J. observed that the trial of 19 separate actions would be contrary to the convenient administration of justice and noted that economies would be achieved in a single proceeding. She held that there were common issues of fact, arising from the termination notices and W.D.A. as well as

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

common legal issues, including whether GMCL was a franchisor under the *A.W.A.* and whether it was subject to duties under ss. 3 and 4 of the *A.W.A.*

145 GMCL's position is that a class action is not the preferable procedure. First, it says that the common issues are relatively unimportant to the claims of the class, so that the efficiencies achieved by a common issues trial will be outweighed by the complexity associated with resolution of the individual issues. Second, it says that having collectively received over $123 million in wind-down payments from GMCL, the dealers have the means and the incentive to pursue individual claims if they wish to do so.

146 Cassels makes similar submissions. It says that the individual issues in this case "overwhelm" the common issues and that the common issues involve numerous individual issues of fact and law that will require individual discoveries and trials. Cassels says that inquiries would have to be made as to the extent to which, if at all, a particular dealer relied on Cassels' advice, in light of the advice that each dealer received from its own lawyer and the dealer's own particular circumstances. Cassels says that the common issues affecting it are of low importance in comparison to to the GMCL common issues and the other individual issues.

147 Defendants' submissions on the preferability analysis are invariably predicated on the assumption that they will lose the common issues trial. As Perell J. observed in *Smith Estate v. National Money Mart Co.* (2008), 57 C.P.C. (6th) 99, [2008] O.J. No. 2248 (Ont. S.C.J.), at para. 108, "it is sometimes lost sight of that class actions are not necessarily a bad thing for defendants." The determination of some of the *A.W.A.* common issues in favour of the defendants could well eliminate the need for a trial of any individual issues. At the very least, it would reduce the scope of the individual issues.

148 It also seems to me that the defendants' submissions on the preferable procedure analysis frequently assume that the court will be forced to adopt the *most expensive* and *least expeditious* method of determining the individual issues, rather than the opposite. Section 25 of the *C.P.A.* gives the court flexibility to craft a procedure for the resolution of the common issues in a way that is fair to the parties, expeditious and efficient.

149 In this case, GMCL says that the following individual issues will remain after the common issues:

> (a) whether GMCL breached a statutory duty of fair dealing to each Accepting Dealer;
>
> (b) whether GMCL breached or interfered with a statutory right to associate in respect of each Accepting Dealer;
>
> (c) the quantum of any damages to each Accepting Dealer caused by any such breach or interference;
>
> (d) the validity of each Accepting Dealer's release under its Wind Down Agreement;
>
> (e) by the plaintiff's own admission, the quantum of any compensation to be paid to any Accepting Dealer that rescinds or cancels its Wind Down Agreement under applic-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

able franchise legislation;

(f) whether any failure of GMCL to comply with any applicable disclosure obligations caused each Accepting Dealer a loss; and

(g) the amount of damages to each Accepting Dealer that allegedly suffered a loss from any failure to comply with any applicable disclosure obligations.

150 I do not agree that issues (a) and (b), as re-phrased in accordance with GMCL's suggestion, are individual issues, since the resolution of those issues will focus on the conduct of GMCL and a breach in relation to one dealer will be a breach for all. I have already concluded that these issues can be determined in common, since they focus on the conduct of the franchisor. Similarly, issue (d) has been identified as an appropriate common issue. Issues (c), (e), (f) and (g) really amount to the same thing — the calculation of any damages to class members arising from GMCL's alleged breach of its duties under the *A.W.A.*

151 If issues (a) and (b) are answered in favour of the class, the question will arise as to whether damages can be assessed in the aggregate. If not, individual assessments of damages may be required. Section 6 of the *C.P.A.* specifically provides that the court "shall not" refuse to certify a proceeding as a class proceeding "solely" on the ground that the relief claimed includes a claim for damages that would require individual assessment after determination of the common issues. As I have observed, s. 25(1) of the *C.P.A.* gives the court considerable flexibility in establishing inexpensive and efficient procedures, including a reference, for the resolution of individual issues such as damages. I am prepared to assume that if the need arises to make individual assessments, the court can give directions pursuant to s. 25(2) and will be able to devise efficient and economical procedures to do so.

152 If the trial of the common issues will genuinely advance the litigation, the presence of significant individual issues as to damages should not be a bar to certification: see *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.*, above, at para. 61; and *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.* above, at paras. 141-2.

153 Like GMCL, Cassels argues that individual issues will be necessary to resolve its liability, including:

(a) what legal advice was received by each class member from their individual lawyers in relation to the WDA;

(b) the timing of that legal advice in relation to the CADA memoranda and conference call;

(c) whether the dealer relied on Cassels or could reasonably rely on Cassels when signing the WDA;

(d) what they would have done differently, if anything, before May 26, 2009 if Cassels had not allegedly breached its duties;

(e) whether, in each of their unique personal and professional circumstances, the deal-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

er's decision to sign the WDA caused loss in relation to whatever alternative they can establish to the court that they would otherwise have pursued; and

(f) whether there was a loss or damage reasonably related to any action or omission of Cassels.

154 Counsel for Cassels submits that:

> The numerous individual factual and legal inquiries necessary to determine the major elements of each claim would overwhelm resolution of any potential common issue. Where resolution of common issues, in relation to the claim as a whole, will not significantly advance the action, a class action will not be the preferable procedure.

155 Cassels' submission ignores two important points. First, it ignores the significance of three important common issues, which can be summarized as follows:

(a) was Cassels in a solicitor and client relationship with all class members?

(b) did Cassels owe contractual, fiduciary or other duties to the class and if so what was the content of those duties?

(c) did Cassels breach those duties?

156 These are weighty questions. A negative answer to the first two questions will send the plaintiffs packing insofar as Cassels is concerned. A positive answer to all will significantly advance the claims of the class against Cassels.

157 Second, as I have observed earlier, in focusing on the decision of each individual class member to sign the W.D.A., Cassels fails to join issue with the claim as framed by the plaintiff. The plaintiff does not say to Cassels: "If you had properly represented me, I would not have signed the W.D.A." On the contrary, the plaintiff puts his case against Cassels on the following basis:

> If you had properly advised me and all your other clients, you would have told us that we had inalienable rights under the *A.W.A.* and you would have recommended that we use those rights and our bargaining power, as a potential spoiler of GMCL's bail-out, to negotiate a better deal with GMCL. By doing nothing because of your undisclosed conflict of interest, you deprived us of our only chance to negotiate a better deal and instead recommended that we speak to our individual lawyers, knowing that this would make it impossible for us to act collectively.

158 Framing the claim in this fashion, as the plaintiff has every right to do, the individual motivations of class members are irrelevant.

159 There is at least a possibility that the damages of the class could be assessed in the aggregate, based on the plaintiff's theory that Cassels could have negotiated a better deal for the class. Given that GMCL took a formulaic approach to compensation of all terminated dealers, it is possible that this could be a template for the distribution of aggregate damages or

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

that the court could develop an equitable plan of distribution. Failing that, my comments above concerning the individual assessment of damages apply equally to the plaintiff's claim against Cassels.

160 I do not see that the issue of the individual liability of all Cassels' partners will be a significant issue in the greater scheme of things. As a practical matter it may never arise unless (a) the plaintiff succeeds against Cassels; and (b) there is insufficient insurance available to cover the judgment against the limited liability partnership. If the need arises, I expect the court could give directions so that the inquiry could be focused and efficient.

161 Returning to the principles set out earlier in this section, a class proceeding is necessary to give class members *access to justice*. Individual proceedings are not a realistic alternative and as Pepall J. noted in *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.*, above, separate actions would not promote the administration of justice. I do not accept the proposition that class members are flush with cash. There is no specific evidence of this and the termination payments were designed in large measure to enable franchisees to discharge their liabilities (including employee claims) on the winding up of their dealerships and to provide some compensation for the loss of their investments. It is not realistic to think that an individual franchisee, who has experienced the loss of their business, is financially or psychologically equipped to engage in protracted, complicated and very expensive litigation with one of the largest corporations in North America and a major Canadian law firm.

162 *Judicial economy* will be promoted by the aggregation of the claims of the class, avoiding multiple trials and potential duplication of fact-finding. I have concluded that the tools of the *C.P.A.* can be used to address individual trials, if required, in an efficient, cost-effective manner.

163 The possibility that the action will promote *behaviour modification* has already been demonstrated by the fact that after several years of denial, GMCL has admitted (in this action and in *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.*) that it is subject to the *A.W.A.* The answers to the GMCL common issues in favour of the class will effect modification of GMCL's behaviour in relation to the class. The Cassels' common issues raise important issues concerning lawyers' duties to their clients, particularly in the context of group retainers.

164 I am satisfied that the common issues are capable of resolution in a fair, efficient and manageable way. In view of the size of the class, joinder would not be a practical alternative. Individual proceedings would not be realistic. Only a class proceeding will advance the goals of the *C.P.A.*

(e) Representative Plaintiff

165 Section 5(1)(e) of the *C.P.A.* requires the court to be satisfied that there is a representative plaintiff or defendant who:

(i) would fairly and adequately represent the interests of the class;

(ii) has produced a plan for the proceeding that sets out a workable method of advan-

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

cing the proceeding on behalf of the class and of notifying class members of the proceeding; and

(iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

166 The court must be satisfied that the proposed plaintiff will vigorously and capably prosecute the claim on behalf of the class: see *Campbell v. Flexwatt Corp.* (1997), 15 C.P.C. (4th) 1, [1997] B.C.J. No. 2477 (B.C. C.A.), leave to appeal to S.C.C. dismissed, *Campbell v. Flexwatt Corp.* (S.C.C.); *Western Canadian Shopping Centres Inc. v. Dutton*, above, at para. 41. The court must also be satisfied that counsel is qualified to advance the proceeding on behalf of the class.

167 There is no criticism of Trillium on this front, and GMCL does not challenge its suitability as a representative plaintiff. I am satisfied that Trillium is informed, committed and competent to represent the class, as is its counsel.

168 Cassels complains that Trillium's litigation plan is not workable or realistic, because it does not address the individual issues that will remain following the trial of the common issues. The litigation plan contemplates that the only individual issues will only concern damages. It says that if an aggregate assessment of damages is not possible, individual assessments may be required. Counsel for Cassels describes this as "a litigation plan that is afraid to look at itself in the mirror."

169 I have concluded that the issues other than damages are capable of being resolved on a common basis. The need for individual assessments of damages will depend on how the common issues are answered and whether aggregate assessments are possible. It is not unreasonable to leave this for future determination. This will permit the common issues judge, with a background in the underlying facts and in light of the resolution of the common issues, and with input from the parties, to craft a fair and efficient procedure for the resolution of the individual issues. I consider the litigation plan satisfactory in the present state of affairs and it will be approved.

Cassels' Stay Motion

170 Cassels brought a motion to stay the action, as against it, pursuant to s. 106 of the *Courts of Justice Act*, rules 5.02 and 5.05 of the *Rules*, and ss. 12 and 13 of the *C.P.A.* There is no dispute that I have jurisdiction to grant a stay where it would be just and convenient to do so. That jurisdiction should be exercised sparingly. The moving party must show that (a) continuation of the action would be unjust because it would be oppressive or vexatious to the moving party or would otherwise be an abuse of the process; and (b) the stay would not cause an injustice to the plaintiff: *Etco Financial Corp. v. Royal Bank*, [1999] O.J. No. 3658 (Ont. S.C.J.) at para. 3; *Dowell v. Spencer*, [2001] O.J. No. 5149 (Ont. Master) at para. 2; *Canadian Pacific Railway v. "Sheena M" (The)*, [2000] 4 F.C. 159, [2000] F.C.J. No. 467 (Fed. T.D.), at para. 32.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

171 Where the stay relates to the plaintiff's claim against one of several defendants, the principles applicable to joinder are instructive. In the leading case of *Thames Steel Construction Ltd. v. Portman* (1980), 28 O.R. (2d) 445, [1980] O.J. No. 3588 (Ont. Div. Ct.), Griffiths J., as he then was, stated at para. 26 that on a joinder motion the court should consider:

- whether the claims of the plaintiff arise out of the same transaction or series of transactions ...;

- whether or not there is a common issue of law or fact of sufficient importance to render it desirable that the claims against the proposed defendant be tried together;

- whether the expense and delay that would be caused by compelling the plaintiff to bring separate actions against the proposed defendant would be greatly out of proportion to the inconvenience, expense or embarrassment which that defendant would be put if the actions were tried together; and

- on the basis of *Samuel v. Klein* (1976), 14 O.R. (2d) 389. 3 C.P.C. 21 (Ont. H.C.), if the liability of the proposed defendant is contingent upon the plaintiff first establishing that he suffered a loss in respect of the transaction with the named defendant, then the application to join the proposed defendant may be considered premature.

172 A motion to stay is necessarily fact dependent. The court must balance fairness to the parties with the goal set out in rule 1.04(1) of securing the "just, most expeditious and least expensive determination of every civil proceeding on its merits." Section 12 of the *C.P.A.* engages similar considerations. The court must also consider the goals of access to justice and judicial economy.

173 Cassels submits that the action should be stayed as against it because:

- the claim against it is not intertwined with the claim against GMCL;

- there are no common issues of fact and law;

- Cassels will suffer disproportionate inconvenience and expense; and

- the trial of the action against GMCL will not assist in the determination of whether Cassels is liable to the class.

174 Cassels says that the two claims involve "distinct transactions" and that there is no factual or legal nexus between them, that trying them together will cause unnecessary expense, complication and delay and that the claim against Cassels is premature because "[I]f the court finds that GMC did not violate the *Wishart Act*, and that the proposed class members received independent legal advice, they cannot sustain a claim against Cassels." Cassels says that requiring it to participate in the action at this stage would be oppressive and onerous and staying the action would promote judicial economy. The conclusion of Cassels' submission is that the claim against it is tangential to the main issues in the dispute and that neither victory nor defeat against GMCL necessarily leads to a viable claim against Cassels.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

175 While the claims against GMCL and Cassels are different in nature, and are based on different causes of action, they arise out of the same factual matrix, namely the financial plight of GMCL, the termination of 240 dealerships, the W.D.A. and the events during the six days in May 2009. GMCL and Cassels were different actors in this mix, but from the perspective of the Trillium they were each the cause of related harm. Cassels would have the "transaction" involving it as narrowly confined to the memo of May 22, 2009, and the conference call on May 22, 2009. The plaintiff's pleading, however, is much broader than this, and alleges, particularly at paragraphs 90-97 inclusive, that "at no time" did Cassels properly advise the dealers of their rights under the *A.W.A.* or assist them in asserting their collective negotiating power. These allegations are factually linked to the conduct of GMCL and to the plaintiff's complaints against GMCL.

176 I do not accept the proposition that if the class members are unsuccessful against GMCL and if all received legal advice (as they were required to do as a condition of accepting the W.D.A.), they will necessarily be unsuccessful against Cassels. As I have said earlier, this is not how the plaintiff frames its claim against Cassels.

177 This is not a typical solicitor's negligence case, such as *Thames Steel Construction Ltd. v. Portman*, above or *Pryshlack v. Urbancic* (1975), 10 O.R. (2d) 263 (Ont. H.C.), involving a failed business deal or a real estate transaction, where the plaintiff says that if he/she is not successful against the vendor then his/her solicitor is liable for botching the deal. In such a case there may be some logic in staying the action against the solicitor since his/her liability only arises if the plaintiff loses against the other party to the transaction. On the plaintiff's theory of the case against Cassels, the result in the action against GMCL will not necessarily be determinative of the claim against Cassels. In my view, this is not a reason that favours the stay — it is a reason against granting a stay. If a trial against Cassels may well be necessary regardless of the outcome against GMCL, I see no logic in putting the Cassels' claim on the back burner for years, waiting for the claim against GMCL to work its way through the courts and then potentially reviving the claim against Cassels regardless of the outcome of the other claim. This would not promote judicial economy — on the contrary, it would require much of the same fact-finding with the potential for inconsistent results.

178 Nor would a stay facilitate access to justice. It would be oppressive and prejudicial to require the plaintiff to take the action against GMCL through the courts, including appeals which would likely ensue, for many years, only to be sent back at some far distant date, to reactivate the claim against Cassels.

179 I accept that this action may be oppressive and onerous to Cassels and an embarrassment to its partners. A lawsuit, particularly one involving a claim for $750 million, is necessarily so. It cannot be in the interests of the limited liability partnership, or its partners who are being individually sued, to have litigation of this magnitude hanging over their heads for many years awaiting the outcome of a proceeding that may not be determinative of their liability. It seems to me that it would be more advantageous to enable them to participate in the proceeding from the outset, as they are likely to have a real interest in how the evidence unfolds in the claim against GMCL.

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works

180 For these reasons, I decline to grant a stay.

Summary and Conclusion

181 For the foregoing reasons, this action will be certified as a class proceeding on the basis set out above. Counsel for the plaintiff should draft an order following the provisions of s. 8 of the *C.P.A.* for review with counsel for the defendants and the order can be settled, if necessary, at a case conference. The plaintiff is entitled to its costs. If the parties are unable to agree, submissions should be addressed to me, in writing. I leave it to counsel to agree on an appropriate timetable.

Order accordingly.

FN1 GMCL admits that the dealers are "franchisees" within the meaning of the *Arthur Wishart Act (Franchise Disclosure), 2002*, S.O. 2000, c. 3 and the franchise legislation in other provinces. I will refer to them from time to time as "dealers" or "franchisees". The evidence is not uniform as to the number of dealers who received a Wind-Down Agreement, but the number of 240 seems to be accepted by both parties.

FN2 *Franchises Act*, R.S.A. 2000, c. F-23; *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1.

FN3 *Bankruptcy*, 11 U.S.C. §§ 1101-1174.

FN4 I have modified this question very slightly to make it more grammatically correct by moving the words in bracketsfrom the end of the question to its position after "*Wishart Act*".

FN5 PEI *Franchises Act*, s. 11: "Any provision in a franchise agreement purporting to restrict the application of the law of Prince Edward Island or to restrict jurisdiction or venue to a forum outside Prince Edward Island is void with respect to a claim otherwise enforceable under this Act in Prince Edward Island." Alberta *Franchises Act*, s. 17: "Any provision in a franchise agreement restricting the application of the law of Alberta or restricting jurisdiction or venue to any forum outside Alberta is void with respect to a claim otherwise enforceable under this Act in Alberta." See also Alberta *Franchises Act*, s. 16.

END OF DOCUMENT

© 2012 Thomson Reuters. No Claim to Orig. Govt. Works