RECENT DEVELOPMENTS AND TRENDS IN SECURITIES CLASS ACTIONS

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A. INTRODUCTION

To date, the Canadian experience with the *Class Proceedings Act*[1] [hereinafter, *CPA*] has not mirrored that of the United States, where class actions brought by disgruntled investors against issuers have become so common that federal legislation was introduced to deal with the growing problem of "strike suits". However, the high-profile debacles in recent years of Bre-X, Enron, and YBM Magnex International, Inc. [hereinafter, YBM] have raised the consciousness of the Canadian class action bar to such claims and caused Canadian investors in the capital markets to view participants in the securities industry with increased skepticism, which is likely to result in an increased number of securities class actions in the coming years. The response, by regulators such as the Ontario Securities Commission, has been promises of greater of scrutiny and enforcement and, by the legislatures, of legislative reform, designed to restore investor confidence.[2] The YBM case,

[1] S.O. 1992, ch. 6

[2] See, for example, Brown, David A. Q.C., "Measures Taken to Promote Investor Confidence, Submissions to the Standing Senate Committee on Banking, Trade and Commerce", October 29, 2002; and Bill 198, *Keeping the Promise for a Strong Economy Act (Budge Measures), 2002*, S.O. 2002, c. 22, which received Royal Assent on December 9, 2002 (but is

in particular, demonstrates the potential for successful results in securities class actions, even in the face of vigorous defences by the target defendants.

In recent years, there have been a number of interesting developments in the area of securities class actions, which show that this area of the law is evolving quickly.

B. RECENT SECURITIES CLASS ACTION CASES

1. Actions against the issuer's advisors

Class proceedings are ideally suited to resolving claims of shareholders who allege damages as a result of their purchase of shares in reliance upon misrepresentations made by the issuer or its advisors in information disclosed to the public, either in press releases, annual reports, prospectuses, or the like. Historically, a company's lawyers and accountants/auditors have owed a duty of care only to their client, a duty that was extended to others only in exceptional situations. However, the door appears to be opening to allow for an extension of these duties to any persons who reasonably rely upon the skills of these professionals. Ultimately, whether such claims in negligent misrepresentation or negligence

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not yet proclaimed in force) and makes significant changes to the Ontario *Securities Act*, R.S.O. 1990, c. S-5.

will be successful is likely to be determined by how the courts interpret and apply the policy analysis articulated by the Supreme Court of Canada in *Hercules Managements Ltd. v. Ernst & Young* [hereinafter, *Hercules Managements*].[3]

In Ontario, the most likely causes of action to be advanced in securities class actions are negligent misrepresentation at common law, misrepresentation under s. 130 of the Ontario *Securities Act*,[4] and negligence. The elements of negligent misrepresentation articulated by the Supreme Court of Canada in *Queen v. Cognos*[5] apply in the securities litigation context. However, the greatest room for development in the law is in the area of whether a duty of care is owed by the issuer's advisors to the shareholders in either a common law negligent misrepresentation or a negligence claim.

The two-stage test to be followed in determining whether a duty of care is owed at common law is that set out by Lord Wilberforce in *Anns v. Merton London Borough Council* [hereinafter, *Anns*],[6] and adopted by the Supreme Court of Canada. The test requires an analysis of proximity in the first stage and policy considerations in the second stage:

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[3] [1997] 2 S.C.R. 165

[4] R.S.O. 1990, c. S-5, as amended

[5] [1993] 1 S.C.R. 87

[6] [1978] A.C. 728 (H.L.) at pp. 751-752

> At the first stage of the *Anns* test, two questions arise: (1) was the harm that occurred the reasonably foreseeable consequence of the defendant's act? and (2) are there reasons, notwithstanding the proximity between the parties established in the first part of this test, that tort liability should not be recognized here? The proximity analysis involved at the first stage of the *Anns* test focuses on factors arising from the relationship between the plaintiff and the defendant. These factors include questions of policy, in the broad sense of that word. If foreseeability and proximity are established at the first stage, a *prima facie* duty of care arises. At the second stage of the *Anns* test, the question still remains whether there are residual policy considerations outside the relationship of the parties that may negative the imposition of a duty of care.[7]

By applying this principled approach, Canadian courts can assess whether new relationships and situations should give rise to a duty of care at common law and, ultimately, liability. There is a considerable debate in the courts, currently not settled at the appellate level, as to how these principles ought to be applied in the securities area.

(a) Liability of the issuer's lawyers

A review of the Canadian jurisprudence shows that a lawyer can, in certain circumstances, place himself or herself in a relationship of sufficient proximity to a third party who is not the client to owe that third party a duty of care.[8]

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[7] *Cooper v. Hobart,* [2001] 3 S.C.R. 537 at p. 550-551, para. 30

[8] See, for example: *Elms* v. *Laurentian Bank of Canada,* [2001] B.C.J. No. 1284 at paras. 22-30 (C.A.); *Filipovic* v. *Upshall,* [1998] O.J. No. 2256 (Gen. Div.) at paras. 58-60 and 64, affirmed, [2000] O.J. No. 2291 (C.A.); and *Delgrosso* v. *Paul* (1999), 45 O.R. (3d)

In addition, academic commentary in Canada supports the proposition that lawyers for an issuer could be liable in the case of misrepresentations in a prospectus. Professor Gillen has written that, in certain circumstances, a lawyer may have a duty to be a "whistle blower" when a client is distributing a misleading prospectus:

> If the client is found liable for misrepresentation in the prospectus, the client could sue the lawyer for negligent advice or assistance in the preparation of the prospectus. *The lawyer may also have a duty to the public requiring the lawyer to discourage the client from distributing securities under a misleading prospectus and possibly also requiring the lawyer to disclose, or "blow the whistle", where a client persists with the use of a misleading prospectus.*[9]
>
> [Emphasis added]

However, the Law Society of Upper Canada ("LSUC") *Rules of Professional Conduct* state that the lawyer's duty is more limited. Commentary under Rule 2.03 Confidentiality, states as follows:

> A lawyer employed or retained to act for an organization, including a corporation, confronts a difficult problem about confidentiality when he or she becomes aware that the organization may commit a dishonest, fraudulent, criminal, or illegal act. This

605 (Gen. Div.) at pp. 609-610

[9] M.R. Gillen, *Securities Regulation in Canada*, 2nd ed. (Scarborough: Carswell, 1998) at pp. 164-165

> problem is sometimes described as the problem of whether the lawyer should "blow the whistle" on his or her employer or client. Although the *Rules of Professional Conduct* make it clear that the lawyer shall not knowingly assist or encourage any dishonesty, fraud, crime, or illegal conduct [Rule 2.02(5)], it does not follow that the lawyer should disclose to the appropriate authorities an employer's or client's proposed misconduct. Rather, the general rule, as set out above, is that a lawyer shall hold the client's information in strict confidence, and this general rule is subject to only a few exceptions. Assuming the exceptions do not apply, there are, however, several steps that a lawyer should take when confronted with a difficult problem of proposed misconduct by an organization. The lawyer should recognize that his or her duties are owed to the organization and not to the officers, employees, or agents of the organization. The lawyer should therefore ask that the matter be reconsidered, and the lawyer should, if necessary, bring the proposed misconduct to the attention of a higher (and ultimately the highest) authority in the organization despite any directions from anyone in the organization to the contrary. If these measures fail, it may be appropriate for the lawyer to resign...[10]

American courts have recognized that there is a duty owed by securities lawyers to make complete and accurate disclosure to potential investors with respect to a public offering and have imposed a duty on a lawyer to act competently and to avoid public harm when that lawyer becomes aware that his or her client is making untrue statements or

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[10] Law Society of Upper Canada *Rules of Professional Conduct* effective November 1, 2000, Rule 2.03 Confidentiality at p. 17

omitting material information in making public disclosure.[11] In *Felts v. National Accounts Association Inc.*[12], for example, the court held that a lawyer for the issuer may be liable to investors if it concludes that the sale of shares would not have been completed without the use and exploitation of the lawyer's name.

In November, 2002, the United States Securities and Exchange Commission ("S.E.C.") proposed new rules to govern lawyers under the *Sarbanes-Oxley Act of 2002*, passed on July 30, 2002, which were to affect the conduct of all lawyers, including Canadian lawyers appearing and practicing before the S.E.C. in the representation of issuers.[13] These new rules impose increased duties upon lawyers to go beyond the traditional reporting ladder in a corporation and to report to the senior officers where the lawyer has any evidence of a material breach of securities laws. Additionally, these proposed rules originally required lawyers who disagreed with a decision of the issuer's board of directors and which they believed constitutes a material breach to withdraw their services and announce that withdrawal to the S.E.C. based upon "professional considerations". Because this rule conflicts with the LSUC *Rules of Professional Conduct* relating to client confidentiality cited above, the LSUC and the Canadian Bar Association

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[11] *Federal Deposit Insurance Corporation* v. *O'Melveny & Myers* (1992), 969 F. Supp. 2d 744 (U.S. Court of Appeals for 9th Circuit); reversed on other grounds 512 U.S. 79 (1994); and *Felts* v. *National Accounts Association Inc.* (1978), 469 F. Supp. 54 (U.S. Dist. Ct. Mississippi)

[12] *Felts v. National Accounts Association Inc., supra*, note 11

[13] Pub. L. No. 107-204, 116 Stat. 745, s. 307

(and others) lobbied for changes and the S.E.C. has drafted a new "noisy withdrawal" rule. However, solicitor-client confidentiality is still not assured since lawyers who choose to withdraw their services must still report their withdrawal to the S.E.C. Further submissions regarding the proposed new rule are due by April 7, 2003. The S.E.C. is soliciting comments on proposed alternative provisions which prescribe a lawyer's withdrawal in a narrower set of circumstances and which require the issuer, rather than the lawyer, to report to the S.E.C. either the lawyer's withdrawal or written notice of failure to receive an appropriate response to a report of a material violation and is asking for views on whether foreign lawyers should be exempt from these duties.

While no court in Canada has yet decided the issue of whether a relationship of sufficient proximity exists between a shareholder and an issuer's lawyer, there is no reason, in principle, why a duty will not be held to exist in the right case. The next consideration is whether there are any policy issues which would serve to negative a duty of care.

The Ontario *Securities Act* itself does not define the duties of lawyers in this context or provide policy reasons that would negative the existence of a duty of care. Rather, the statute is silent on the issue. Therefore, broader public policy issues must be considered. The public policy interest in protecting professionals from indeterminate liability to an indeterminate number of people over an indeterminate time, articulated in the *Hercules Managements* case, will likely be a consideration in the analysis of whether a lawyer owes a duty to a particular person or class of persons in any case.

Most recently, these issues were considered in *CC&L Dedicated Enterprise Fund (Trustee of) v. Fisherman* [hereinafter, the YBM prospectus class action][14], a class action brought on behalf of shareholders who purchased shares in YBM pursuant to a prospectus. The plaintiffs alleged that the prospectus contained numerous material misrepresentations and they advanced a statutory claim, pursuant to s. 130 of the Ontario *Securities Act*, as well as claims at common law in negligence and negligent misrepresentation against YBM's directors, auditors, and the underwriters of the prospectus financing. The duties owed by YBM's securities lawyers to shareholders was dealt with on the plaintiffs' motion for leave to amend their statement of claim to add claims against the lawyers in negligent misrepresentation at common law and negligence. The lawyers opposed the motion on the basis that the pleading, as proposed, did not disclose a reasonable cause of action against them, was not tenable at law, and could not succeed. The lawyers asserted the position that they had no duty to protect the interests of individual investors and that their only duty was to their client, YBM. The lawyers relied upon what they asserted was the "accepted norm" as expressed by Victor P. Alboini:

> A securities lawyer is not, however, responsible for disclosing material information to the public; securities legislation imposes this responsibility on the public company ... if, on the negligent advice of its securities lawyer, a public company makes a misrepresentation in a disclosure document, the

[14] (2001), 18 B.L.R. (3d) 240 (Ont. S.C.J.)

> public company may have a cause of action against the securities lawyer.[15]

Cumming J., who heard the motion, found that, as a result of the lawyers permitting the name of their firm to be referred to in the prospectus, potential investors might have believed that the lawyers were implicitly representing that they had no reasonable grounds to believe that the prospectus contained material misrepresentations. He said that it was also arguable that investors would reasonably rely upon that implicit representation by the lawyers and, arguably, that the firm's silence, while lending its name to the offering, in itself constituted a misrepresentation. As such, Cumming J. determined that it was not plain and obvious that the common law misrepresentation claim could not succeed as against the lawyers.

Cumming J. also made a similar finding in respect of the negligence claim against the lawyers. He considered the application of the two-part *Anns* test for determining whether a defendant owes a duty of care to the plaintiffs. In so doing, he found that it was not plain and obvious that the lawyers did not owe the shareholders a duty of care since it was arguable

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[15] V. P. Alboini, "Due Diligence and the Role of the Securities Lawyer" (1981-1982), 6 C.B.L.J. 241 at p. 268

that the lawyers ought reasonably to have foreseen that the prospective investors would rely upon their representation and that any such reliance would be reasonable.

Cumming J. next considered the public policy considerations, which he ultimately found did not negative the *prima facie* duty of care for the following reasons. The specific purpose of the legal services provided by the lawyers was to enable YBM to raise financing from the investing public through the prospectus. The lawyers knew their services were for the purpose of achieving this public offering and that the offering could not be made to the public without the prospectus being receipted by the regulators, which would not occur if it were known to contain misrepresentations. Moreover, Cumming J. accepted that there are "exceptional situations" where a cause of action for negligence against a lawyer has been sustained on the basis that the solicitor placed himself or herself in a relationship of sufficient proximity to a third party so as to owe that third party a duty of care. He recognized that American courts have emphasized that there is a duty to potential investors of complete and accurate disclosure with respect to a public offering owed by securities lawyers. Securities lawyers have a duty to make a reasonable, independent investigation to detect and correct false or misleading materials and a statement in the offering that is made by securities counsel, either with actual knowledge or with reckless disregard of whether it is true or false, can give rise to liability. The lawyers for an issuer may be liable to the investors if the court concludes that the sale of shares would not have been accomplished without the use and exploitation of the lawyers' name. Finally, Cumming J. stated that there are several

safeguards and securities regulations grounded in public policy designed to protect the interests of the investing public and, thereby, to enhance the mobility and formation of capital in a free market for the ultimate economic and social well-being of society. Effective implementation of the safeguards depends to a considerable degree upon the legal counsel who serve in an advisory capacity to the issuers of securities.

Overall, the elements of proximity based upon a special relationship and foreseeability were both present and there were no policy reasons that would negative the duty. The concerns of indeterminate liability to an indeterminate class did not arise in this case because the specific purpose of the legal services provided by the lawyers to YBM was known to them. Cumming J. noted that the factual background to the *Hercules Managements* decision “has less force than that seen in the pleading at hand” since a statutory audit report (which was the document alleged to contain the misrepresentations in that case) is not generally prepared for the purpose of guiding personal investment decisions.

Whether the claim against the lawyers could ultimately succeed on these facts was never determined, as the action was settled in February 2002.

(b) Liability of the issuer’s auditors

The leading case regarding claims against auditors for negligent misrepresentation is *Hercules Managements*, in which the Supreme Court of

Canada found that a company's auditors did not owe a duty of care at common law to the company's shareholders because of the policy considerations that came into play in the second branch of the *Anns* test. The court held that the first branch of the *Anns* test will generally (if not always) be satisfied in cases alleging auditors' negligent misstatements. In this case, a *prima facie* duty of care existed as it was reasonably foreseeable that the shareholders would rely upon the statutory audited year-end financial statements in conducting their affairs and that they might suffer harm if the audit reports were negligently prepared. However, with respect to the second branch of the *Anns* test, the court was concerned that auditors not be exposed to "liability in an indeterminate amount for an indeterminate time to an indeterminate class." Where, however, it can be shown that indeterminate liability is not a concern on the facts of a specific case, a duty of care will be found to exist. Indeterminate liability will not be a concern where the defendants knew the identity of the plaintiff or class of plaintiffs who would rely upon the statement in issue and where the statement itself was used by the plaintiff for precisely the purpose or transaction for which it was prepared since the scope of liability can be readily circumscribed.

Recently, this issue was considered in *Mondor v. Fisherman* [hereinafter, the YBM secondary market class action][16], a class action brought on behalf of shareholders who purchased shares of YBM in the secondary market. The plaintiffs' claim alleged conspiracy, negligence, as

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[16] (2001), 8 C.C.L.T. (3d) 240 (Ont. S.C.J.)

well as negligent and reckless misrepresentation by YBM's officers, directors, auditors, lawyers, and financial advisors and misrepresentation under the *Competition Act*.[17] The "representation" was alleged to be contained in the audit opinions included in two prospectuses. It was alleged that members of the public relied upon the "representation" to make their investment decisions, because of its effect on the market price of the shares, whether or not they purchased their shares pursuant to the prospectuses. It was alleged that the auditors were negligent in the preparation of the audit opinions and failed to warn investors that the financial statements did not fairly represent YBM's financial position. The plaintiffs claimed that the auditors owed them a duty of care, as the auditors knew their opinion was to be used in the prospectuses and it was the intention that the shareholders and public would rely upon the audited financial statements when making investment decisions.

The auditor defendants brought a motion to strike the pleading, under Rule 21, on the ground that it failed to disclose a reasonable cause of action against them. The auditors relied upon the decision in *Hercules Managements* and the policy concerns articulated by the Supreme Court of Canada in that case. Cumming J., who heard the motion, held that the defendant auditors ought reasonably to have foreseen that the class members would rely upon the financial statements in making their investment decisions. It was also arguable that such reliance by the class members was reasonable. Cumming J. considered the principles in *Hercules Managements* in the context of the

[17] R.S.C. 1985 c. C-34, s. 52

pleading of both negligent misrepresentation and negligence. He found that *Hercules Managements* involved a summary judgment motion with a very extensive evidentiary record, while the auditors' motion in this case simply went to the adequacy of the pleading. In his view, it could not be said that it was plain and obvious that the pleading did not disclose a reasonable cause of action against the auditors. Because it was arguable that they ought reasonably to have foreseen that the plaintiff class members would rely upon their representations and that such reliance would be reasonable, *prima facie* duty of care was held to exist.

Thereafter, Cumming J. turned to the second part of the *Anns* test. He distinguished this case from *Hercules Managements* on the facts. The statutory audit report considered in *Hercules Managements* was not prepared for the purpose of guiding personal investment decisions on the facts of this case. The specific purpose of the services provided by the auditors in this case was to enable YBM to raise $100,000,000 from the investing public through the use of a prospectus and the offering and qualifying of common shares. As such, the policy considerations which negatived the duty of care in *Hercules Managements* arguably did not apply. Although these shareholders did not purchase their shares pursuant to the prospectus, it was not plain and obvious that the plaintiffs did not have a reasonable cause of action against the auditor defendants for negligence and negligent misrepresentation at common law.

Unfortunately, whether these claims against the auditors could have succeeded on these facts was not determined as the action was settled,

along with the YBM prospectus class action referred to above, in February, 2002.

Recently, the approach taken by Cumming J. in the YBM secondary market class action decision was considered and approved by the Ontario Court of Appeal in the case of *Menegon v. Philip*.[18] That case involved a proposed class action by an investor for damages for negligent misrepresentation arising out of the purchase of shares of Philip Services Corp. in the secondary market. The plaintiff alleged that the prospectus contained numerous material misrepresentations, upon which he relied even though he did not purchase the shares offered by the prospectus. The plaintiff brought a motion under the *CPA* for an order certifying the action as a class proceeding and appointing him as a representative plaintiff. The plaintiff argued that the s. 130 *Securities Act* claim plaintiffs were a sub-class of that class of shareholders having a common law claim for negligent misrepresentation and, therefore, that he was an appropriate representative plaintiff for the class action. The plaintiff also brought a concurrent motion to amend the statement of claim. The defendant underwriters and auditors brought cross-motions to dismiss the plaintiff's claim on the basis that it disclosed no reasonable cause of action.

The motions judge, Gans J., refused to certify the action on two grounds.[19] First, Gans J. determined that the creation of a cause of action

[18] [2003] O.J. No. 8 (C.A.)

[19] [2001] O.J. No. 5547 (S.C.J.); (2001), 23 B.L.R. (3d) 151 (Ont. S.C.J.); and [2001] O.T.C. 989 (S.C.J.)

for the benefit of purchasers of shares in the secondary market, *in the absence of a special relationship*, was a matter for the legislature and not the courts. Second, Gans J. was of the view that the plaintiff's argument was contrary to the analysis of the Supreme Court of Canada in *Hercules Managements* as it would expose the auditors to liability of an indeterminate amount for an indeterminate time and in respect of, theoretically, an indeterminate class. The plaintiff appealed Gans J.'s decision on the basis that he erred in finding that the statement of claim did not disclose a reasonable cause of action. Specifically, the plaintiff's argument focussed on the reasoning of Cumming J. in the YBM secondary market class action decision.

At the Court of Appeal, Charron J. A. held that Gans J. had followed the same analytical framework as Cumming J. in the YBM secondary market class action decision and she determined that approach to be the correct one. In addition, the Court of Appeal agreed with Gans J. that the pleadings were insufficient and did not set out material facts which could give rise to a duty of care to the plaintiffs. As such, the appeal was dismissed.

Overall, these recent cases indicate that auditors may owe a duty of care to shareholders where the specific purpose of the audit report prepared by the auditors to the company was known to them and they were aware that shareholders would rely upon the audited financial statements for the purpose of making investment decisions. Much care must be taken by the plaintiff in drafting the statement of claim to plead a case that will withstand attack on a Rule 21 motion. The issue is an open one and awaits further appellate review.

(c) Liability of underwriters

Section 130 of the Ontario *Securities Act* grants to purchasers of securities offered pursuant to a prospectus a statutory cause of action for rescission or damages in a situation where a prospectus contains a misrepresentation and the plaintiff has purchased a security offered pursuant to the prospectus and suffered a loss.[20] A misrepresentation means both a positive misstatement of a material fact or an omission of a material fact which is required or necessary to make a statement not misleading.[21] Because the shareholder will be deemed to have relied upon the misrepresentation (without being required to prove reliance), such actions may be more likely to be certified than common law misrepresentation claims, where each class member's reliance will have to be proven.[22]

An action under s. 130 may be brought against: (1) the issuer or selling security holder; (2) each underwriter of the securities; (3) directors of the issuer at the time of the prospectus; (4) experts who provide opinions in the prospectus; and (5) persons who sign the prospectus. A purchaser has 180 days from the date of his or her purchase to bring an action for rescission, or until the earlier of 180 days after the date he or she first had

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[20] *Securities Act*, *supra* note 4, s. 130(1)

[21] *Securities Act*, *supra* note 4, s. 1 definitions "misrepresentation"

[22] *Kerr v. Danier Leather* (2001), 14 C.P.C. (5th) 292 (Ont. S.C.J.)

knowledge of the facts giving rise to the cause of action, or three years after the date of the transaction that gave rise to the cause of action, to bring an action for damages.[23]

The defences available are listed in ss. 130(3) - (5) and focus on the defendant's due diligence (except where the defendant is the issuer itself). An underwriter, for example, will not be liable for any part of the prospectus purporting to be made on its own report, opinion, or statement as an expert unless it failed to conduct such reasonable investigation as to provide reasonable grounds for a belief that there was no misrepresentation or it believed there was a misrepresentation.[24] The other defences available involve unique situations where the defendant did not give its consent to file the prospectus, withdrew its consent, or relied upon an official public document which contained the misrepresentation.[25] The statutory right of action against an underwriter is also unique, as there is an express limit upon the underwriter's liability, set out in s. 130(6), which states that "no underwriter is liable for more than the total public offering price represented by the portion of the distribution underwritten by the underwriter." It is presumed that this limit is available to all underwriters, not just those who sign the full, true, and plain disclosure certificate in the prospectus.[26]

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[23] *Securities Act, supra* note 4, s. 138(b)

[24] *Securities Act*, *supra* note 4, ss. 130(1), (4), and (5)

[25] *Securities Act*, *supra* note 4, s. 130(3)

[26] V.P. Alboini, *Securities Law and Practice*, vol. 2, looseleaf edition (Scarborough: Carswell, 1984) at p. 23-8

The statutory rights of action available under s. 130 have been available for many years, but until the introduction of the *CPA*, there were no cases dealing with this cause of action. With the *CPA* in place and the problems with establishing duty of care that stem from *Hercules Managements*, the deemed reliance provisions and causation provisions in s. 130, as well as the list of potential defendants who may be found liable have made actions under s. 130 attractive to plaintiffs, each of whose damages may be relatively small but are, collectively, very significant. Recently, several class actions have been launched against underwriters (and others) under s. 130 for alleged misrepresentations contained in a prospectus. Unfortunately, any unique issues which may arise in these actions have not been considered as they have all settled, been dismissed on other bases, or have not yet gone to trial.[27]

2. "Strike" Suits

The term "strike suit" refers to the commencement and pursuit of a class proceeding, where the merits of the claim are not apparent but the nature of the claim and the targeted transaction are 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

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[27] See *Menegon, supra* note 18, and YBM prospectus and secondary market class actions, *supra* notes 14 and 16; *Kerr v. Danier Leather* (2001), 14 C.P.C. (5th) 292 (Ont. S.C.J.); (2001), 7 C.P.C. (5th) 74 (Ont. S.C.J.); and *Scotia McLeod v. Peoples Jewellers* (1995), 26 O.R. (3d) 481 (C.A.)

process. The term has been adopted from the American experience, where strike suits have become a significant problem.[28]

Securities class actions are fertile ground for strike suits since they often arise out of an issuer's announcement that the company's financial picture is not as favourable as had been expected, as a result of which the value of the issuer's stock takes an immediate decline. The plaintiff's allegation is usually that the company's officers, directors, and perhaps others knew or should have known and failed to disclose material facts, which affected the value of the company.

As a result of perceived abuses with securities class action strike suits, two U.S. federal statutes were enacted, the *Private Securities Litigation Reform Act of 1995*[29] and the *Securities Litigation Uniform Standards Act of 1998*[30]. The *Private Securities Litigation Reform Act* was passed in December 1995, with the goal of reducing the number of frivolous securities class actions brought in federal courts, especially those based upon allegations that stock prices were lower than expected. The *Act* banned lawsuits commenced by professional plaintiffs and gave judges the authority to select a lead plaintiff. The standard for filing complaints was also raised by requiring facts that support the allegation that the defendant

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[28] *Epstein v. First Marathon Inc.* (2000), 41 C.P.C. (4th) 159 (Ont. S.C.J.) at p. 169, para. 41

[29] Pub. L. No. 104-67, 109 Stat. 737 (1995)

[30] Pub L. No. 105-353, 112 Stat. 3227 (1998)

acted with a fraudulent intent. After the introduction of this *Act*, more plaintiffs filed securities class actions in state courts in an effort to avoid the stricter federal laws. As a result, congress passed the *Securities Litigation Uniform Standards Act*, which requires certain securities class action lawsuits to be filed exclusively in federal court.

Cumming J. considered the possibility of a "strike suit" in Canada, in the case of *Epstein v. First Marathon Inc.*, where he stated:

> As the American experience suggests, "strike suits", which are lawyer rather than client driven, are disconcerting for two reasons. First, they often severely and unexpectedly interfere with standard corporate governance practices, creating unnecessary inefficiencies and bypassing existing regulatory devices.
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> Second, "strike suits" may effectively transform the class-action mechanism from a shield into a sword. When fashioned into a sword by profit-motivated lawyers and shareholder-plaintiffs posing as class representatives, the class proceeding becomes a means of harassing corporate defendants. Such harassment constitutes an abuse of process and a violation of the very goals that the class-action mechanism is expected to further.[31]

In that case, the plaintiff sought an order approving the settlement of the class action and dismissing it without costs. The plaintiff was a shareholder of First Marathon Inc. and alleged that a proposed merger

[31] *Epstein v. First Marathon Inc., supra* note 28, at paras. 51 and 52

agreement, whereby National Bank of Canada would take over First Marathon, constituted oppression on the basis that the price offered by National Bank was insufficient. The plaintiff filed an amended statement of claim, which was put before the court for approval on the motion, nine days *after* entering into the settlement agreement. The amended statement of claim dropped all references to the claim being a class proceeding and purported to reconstitute it as an individual claim. The proposed settlement agreement did not provide for any benefit to be conferred upon any shareholder of First Marathon, including the plaintiff (except that he avoided exposure to the costs of the defendants), and did not bind any person except the parties to the agreement. The entire settlement value was to the plaintiff's lawyer, whose fees and disbursements were paid.

Cumming J. inferred that the sole purpose for filing the amended pleading was to avoid the court's scrutiny of the settlement agreement. He found that an action, once commenced under the *CPA*, may not be converted through a unilateral amendment of the pleading by the proposed representative plaintiff into an individual action on behalf of that plaintiff. Counsel for the plaintiff submitted that, because the proposed settlement did not and could not possibly adversely affect the rights of any class member, it should be approved. However, Cumming J. considered this submission in light of two possibilities. The first was that the plaintiff's allegations in his pleading were frivolous and had no merit and were designed solely for the purpose of creating a perceived risk to the successful conclusion of the takeover and, if so, there was no settlement value based upon merit and the proceeding was, in reality, a strike suit. Alternatively,

the class proceeding was commenced in good faith, with honestly-held concerns as to the merits of the terms of the proposed takeover, in which case a settlement would not be in the interests of any class member other than the representative plaintiff. Cumming J. concluded that the action was in the nature of a strike suit and that it was appropriate to deny the motion seeking court approval of the settlement.

As the *Epstein v. First Marathon Inc.* case indicates, the requirement in the *CPA* that all settlements, dismissals, and discontinuances of class proceedings are subject to court approval may prevent such abuses from occurring in Canada. Other features of Ontario law may also discourage to strike suits. One example is the fact that class actions are no different from regular actions insofar as the losing party will be required to pay a portion of the winning party's legal fees. Others are requirements contained in new Bill 198 (not yet proclaimed in force and discussed in greater detail in section C below), which makes amendments to the *Securities Act* to provide for civil liability for secondary market disclosure (essentially "fraud on the market"), such as the requirement for leave of the court, upon notice to each proposed defendant, to commence an action based upon a misrepresentation or failure to make timely disclosure. On such a motion, the plaintiff must satisfy the court that the action is being 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 fact that the Quebec Superior Court has recently certified a securities class action founded upon "fraud on the market" cause of action

(without mentioning any of the common law jurisprudence on such actions) and that Ontario Bill 198 contains "fraud on the market" causes of action, raises the likelihood that Quebec and Ontario may well become the jurisdictions of choice for commencement of securities class actions.[32] Bill 198 may make Ontario the more attractive jurisdiction for some types of claims because the new statutory framework avoids the public policy concerns raised in *Hercules Managements*.

In Ontario, irrespective of whether Bill 198 is proclaimed in force, there may still be room for such actions at common law. For example, in the YBM secondary market class action, the defendant auditors sought an order, under Rule 21, dismissing the action on the basis that, in essence, the plaintiffs had pleaded fraud on the market. The claim expressly alleged that the financial statements and audit opinion contained the "representation" which was made to the public, that the plaintiffs relied upon it, and as a result of which they suffered a loss. The plaintiffs asserted that the issue of reliance upon the "representation" was a matter of fact and that the market price of the shares of YBM reflected the "representation" made in the audit opinions. Therefore, the plaintiffs argued, a court could conclude that, by purchasing YBM shares, each class member actually relied upon the "representation". The defendants asserted that this position was, in reality, to advance the "fraud on the market" theory, which is not part of the common law of Ontario and, therefore, the cause of action should be struck. The plaintiffs asserted that they recognized that the "fraud of the market"

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[32] *Yves Beaudoin et al. v. Avantage Link Inc.,* [2002] J.Q. No. 4575; and Bill 198, *supra* note 2

theory is not available under common law, however, they took the position that they were pleading reliance upon the "representation" and that they did not assert the "fraud on the market" theory at all. Cumming J. agreed with the plaintiffs and concluded that it was not plain and obvious that the plaintiffs did not have a reasonable cause of action on this basis because actual, as opposed to inferred, reliance was pleaded.

C. LEGISLATIVE REFORM - BILL 198

Ontario Bill 198 was introduced to implement measures designed to increase investor confidence in the capital markets and will be in force once proclaimed. Part XXIII.1 has been added to the *Securities Act*, which provides for civil liability for secondary market exposure. As stated above, in effect, these sections create "fraud on the market" offences. If an issuer, 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 an issue or security during the period between the time when the document was released and the time when the misrepresentation contained the document was publicly corrected has, *without regard to whether the person or company relied upon the misrepresentation*, a right of action for damages against the responsible issuer, directors and officers, and each "influential person" who knowingly influenced the responsible issuer [s. 138.3]. An "influential person" is defined to mean a control person, a promoter, an insider who is not a director or senior officer, or an investment fund manager if the responsible issuer is an investment fund [s. 138.1,

definitions]. Experts such as accountants, actuaries, auditors, financial analysts, or lawyers who consent in writing to their report, statement, or opinion being included the document that is publicly released or a public oral statement that is made, will be liable if a misrepresentation is contained in their report, statement, or opinion [s. 138.3]. Liability can also attract to oral statements containing misrepresentations [s. 138.3(2)].

However, no liability will attract unless the plaintiff proves that the person or company knew that the document or public oral statement contained the misrepresentation, deliberately avoided acquiring knowledge that the document or public statement contained the misrepresentation, or through action or failure to act was guilty of misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation [s. 138.4(1)]. In relation to a failure to make timely disclosure, a person or company is not liable unless the plaintiff can prove that the person or company knew of the change and that it was a material change, deliberately avoided acquiring knowledge of the change or that the change was a material change, or through action or failure to act, was guilty of gross misconduct in connection with the failure to make timely disclosure [s. 138.4(3)]. Nor will a person or company be liable if that person or company proves that it made reasonable investigation [s. 138.4(6)].

There are also specific provisions relating to "forward-looking information", which require reasonable cautionary language [s. 138.9]. This will be relevant to cases where shareholder plaintiffs allege they relied upon

forecasts of the issuer's profits or sales.

A limitation period is also set out. No proceeding shall be commenced under s. 138.3 in the case of an oral or written misrepresentation later than the earlier of 38 days after the date the misrepresentation was made and six months after the issuance of a news release disclosing that leave has been granted to commence a proceeding under s. 138.3 or under comparable legislation in other provinces or territories in respect of the same misrepresentation [s. 138.14].

There are also important limitations contained in the new legislation. There are provisions for assessing damages and determining how those damages are to be allocated among the defendants. The legislation sets a limit on damages for the issuer, directors or officers, "influential persons", and experts, which may be quite low [ss. 138.5 - 138.7]. There are also potential cost penalties to representative plaintiffs and other members of the class; notwithstanding the *Courts of Justice Act* and the *CPA*, the prevailing party in a proceeding relating to liability for secondary market disclosure is entitled to costs determined by a court in accordance with the applicable *Rules of Civil Procedure* [s. 138.11]. As already discussed above, there is also the high threshold for leave to commence an action; the plaintiff must show that the action is being brought in good faith *and* that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff, which places upon the plaintiff a greater burden than showing that the pleading discloses a reasonable cause of action. Affidavit

evidence must be filed by all parties to the motion.[33] No doubt a substantial amount of jurisprudence will arise out of this requirement, which may put plaintiffs at a substantial disadvantage because they must meet a "merits" test before a statement of defence is filed or there has been oral or documentary discovery.

The Canadian Securities Administrators has recently released a "Blueprint for Uniform Securities Laws for Canada", dated January 30, 2003, which proposes uniform securities legislation across the country and includes provisions substantially the same as those found in Bill 198.[34] However, so far, there has not been any legislative reform with respect to liability for secondary market disclosure in the other provinces in Canada.

D. CROSS-BORDER ISSUES

It is becoming increasingly common that the securities of an issuer are traded in both Canada and the United States and that shareholders reside in various jurisdictions throughout North America. This gives rise to a variety of issues, including whether an Ontario court has jurisdiction to approve a national or international class of plaintiffs, many of whom would not otherwise be subject to the jurisdiction of the Ontario courts, and the possibility that more than one action for the same or similar relief will be brought in more than one jurisdiction or even in the same jurisdiction.

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[33] Bill 198, *supra* note 2, ss. 138.8 and 138.10

[34] (2003), 26 O.S.C.B. 975

1. National and international classes

Initially, national and international classes were vigorously opposed in class actions, however, in numerous cases, national and international classes have been permitted on the basis that they are consistent with the purposes of the *CPA*[35]

[35] See for example, *Nantais v. Telectronics (Canada) Ltd. et al.* (1995), 127 D.L.R. (4th) 552 (Gen. Div.) at p. 567, leave refused (1995), 129 D.L.R. (4th) 110 (Ont. Div. Ct.); *Webb v. K-Mart* (1999), 45 O.R. (3d) 389 (S.C.J.); and *Wilson v. Servier Canada* (2000), 50 O.R. (3d) 219 (S.C.J.), and [2002] O.J. No. 2032; *Carom v. Bre-X Minerals Ltd.* (2000), 51 O.R. (3d) 236 (C.A.); *Robertson v. Thomson* (1999), 171 D.L.R. (4th) 171 (Ont. Gen. Div.)

and are constitutionally permitted where the non-resident claims have a "real and substantial" connection to Ontario and order and fairness dictate such a result.[36] Recently, the Ontario Court of Appeal released a group of decisions clarifying and explaining the "real and substantial connection" test. Among the factors to be considered to determine whether there is a "real and substantial connection" between the forum and the action are:

- the connection between the forum and the plaintiff's claim;
- the connection between the forum and the defendant;
- unfairness to the defendant in assuming jurisdiction;
- unfairness to the plaintiff in not assuming jurisdiction;
- involvement of other parties to the action;
- the court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis;
- whether the case is inter-provincial or international in nature; and

[36] This is consistent with the principles articulated by the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye,* [1990] 3 S.C.R. 1077

- comity and the standards of jurisdiction, recognition, and enforcement prevailing elsewhere.[37]

No factors are determinative and all are to be considered.

One recent development in this area is the *Western Canada Shopping Centres* case, which held that class actions are permissible under court supervision in any province, whether or not there is class proceedings legislation.[38] This undermines the potential failure of justice argument that was made and accepted in the Ontario cases on the basis that those residing where there was no legislation would be denied justice if they were not entitled to the benefits of class membership in an Ontario class action.

The issue, however, is not dead since the Supreme Court of Canada has yet to rule on it and there remain potential problems which have not yet been resolved. For example, it is not clear that Ontario courts can bind non-residents who do not opt out. The *CPA* provides that a member of the class is bound by the result in a class action unless that class member opts *out*.[39] However, this is different from the legislation in the provinces of British Columbia, Saskatchewan, and Newfoundland, where non-residents are bound only if they opt *in*.[40] This latter approach is more consistent with traditional

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[37] *Muscutt v. Courcelles* (2002), 60 O.R. (3d) 20 (C.A.) at pp. 45-53

[38] *Western Canada Shopping Centres v. Dutton*, [2001] 2 S.C.R. 534

[39] *CPA*, *supra* note 1, s. 9

[40] *Class Proceedings Act*, R.S.B.C. 1996, C.50, s. 16(2); *The Class Actions Act*, S.S.

principles of assumption of jurisdiction, since class members must attorn to the jurisdiction.

There is also an argument that these cases are procedural and, where the substantive law where non-resident plaintiffs reside would be different, national class actions are not appropriate. This issue is potentially problematic in securities class actions since each province has its own legislation, although the legislation is quite similar. For example, in *Pearson v. Boliden Ltd.*[41], the court declined to certify a national class on the basis that separate sub-classes were required for residents and non-residents (who resided both inside and outside Canada) due to the potential differences in securities legislation across the country and on grounds of constitutional and conflicts law. The court allowed sub-classes based on residence and excluded classes whose members resided in provinces where the purchase was made did not support the claim. Because the securities legislation of each jurisdiction regulated the distribution of securities there, that legislation had to be looked at for each plaintiff's cause of action. All secondary market purchasers were also excluded - except those from Manitoba, where the legislation is broader.

These issues may be further complicated and national classes denied in future securities class actions in Canada, especially if other provinces enact secondary market legislation and the legislation varies from province to

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2001, c. C-12.01, s. 18(2); and *Class Actions Act*, S.N.L. 2001, C.-18.1, s. 17(2)

[41] [2002] B.C.J. No. 2593 (C.A.); reversing in part (2001), 94 B.C.L.R. (3d) 133

province.

2. Overlapping Actions

Several problems arise with multi-regional overlapping class proceedings. The leading case is *Vitapharm Canada Limited et al. v. VF Hoffman-LaRoche Limited et al.*[42], in which six class proceedings were brought by different counsel at about the same time in three Ontario judicial regions for the same or similar relief against several defendants. Archie Campbell J. determined that section 12 of the *CPA* empowers the Court to make any order it considers necessary to ensure a fair and expeditious determination of the proceedings. His Honour relied upon Rule 37.15, which provides the machinery for one judge to address the problems of inter-regional conflict on a province-wide basis. It was ordered that all motions and proceedings related to the proposed class actions be heard in Toronto (where the balance of convenience lay) by a judge to be assigned by the Regional Senior Judge for Toronto. A similar order was made in *Logan v. Harper*[43], in which twenty-seven individual actions which overlapped with several class actions on the same matter were brought in various judicial regions in Ontario. The individual actions were consolidated under the management of the judge who was overseeing the related class actions. A

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[42] (2000), 48 O.R. (3d) 21 (S.C.J.). See also *Segnitz v. Royal & Sun Alliance*, [2002] O.J. No. 2137 (S.C.J.), where a similar order was made in a case where there were 30 separate class actions in various judicial regions in Ontario dealing with the same subject matter.

[43] (2001), 15 C.P.C. (5th) 338 (S.C.J.)

similar order obtained when the YBM prospectus and secondary market class actions were ordered to be case managed by Cumming J., along with several other Ontario actions arising out of the failure of YBM. In those proceedings, a class action brought in the United States (based on a "fraud on the market" cause of action) was dismissed by the Pennsylvania Court on principles of comity. Newcomer J. held that the matters at issue in the action had a greater connection to Canada. An appeal of that decision, by the plaintiffs, was abandoned when the U.S. court approved the settlement of the YBM litigation in Ontario on the basis of certification of classes of shareholders resident in both the United States and Canada.

E. STEPS FOR EFFECTIVE SETTLEMENT

1. Motivations to settlement

The significant costs associated with prosecuting or defending a class action, regardless of the perceived merits of the claim or defence, impose substantial pressures upon parties to consider settlement. Typically, the quantum of damages sought in the statement of claim is large, making the stakes sufficiently high for all parties that numerous interlocutory motions and appeals on those motions are perceived to be worthwhile and therefore seem inevitable. For example, it is not uncommon in class actions for defendants to bring motions under Rule 21, challenging the statement of claim on the basis that it discloses no reasonable cause of action. These motions often involve complex and novel points of law and, consequently, are subject to appeals. As a result, a substantial period of time may pass

between the time the statement of claim is issued and pleadings are closed, during which time the parties' costs are increased significantly and there are numerous delays in having the action tried on its merits. The recent cases in which substantial costs awards were made against plaintiffs in class actions is likely also to provide a motivation to early settlement.[44] These costs and delays can wear out representative plaintiffs and exert pressure upon defendants to enter into settlement discussions regardless of the action's merits.

2. Obstacles to settlement

Common obstacles to settlement include a lack of information about the merits of the claim and defences, the numbers of parties involved representing different interests, and similar or overlapping actions in other jurisdictions.

Settlement discussions which take place before examinations for discovery have been completed can be hampered by a lack of information relating to the class size, estimated value of damages suffered by each class member, and extent of or proportionate liability of each defendant. Parties can, of course, overcome this problem by agreeing to exchange

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[44] See, for example, *Gariepy v. Shell Oil Co.,* [2002] O.J. No. 3495 (S.C.J.)

information as part of the settlement discussions.

In an action where there are numerous defendants having a variety of different interests and, perhaps crossclaims against one another, settlement discussions may prove to be complex and unwieldy. Ultimately, some defendants may not willingly participate in settlement discussions or agree to make any monetary contribution, while other defendants may be prepared to come to the bargaining table. This problem can be overcome by a court order, made pursuant to Rule 50, requiring counsel and/or their clients to attend before a judge for a pre-trial conference to consider the possibility of settlement of any or all of the issues in the action. This can be an effective tool to force parties to consider the possibility of a compromise where there is a risk that the litigation is taking on a life of its own. Where the pre-trial conference is mandated by the court, parties cannot simply choose to withdraw from settlement discussions at will (although, obviously, unless the parties are prepared to participate in the pre-trial conference in a meaningful way, a resolution is unlikely). A settlement agreement which results from a discussion taking place through the auspices of the court may also be viewed more favourably by the court which is asked to approve the settlement under s. 29 of the *CPA*.

A settlement need not fall apart even if some defendants fail to participate or to offer to contribute. The parties may seek court approval of a settlement with only some defendants through the use of a bar order, a mechanism borrowed from United States jurisprudence, which prevents further action for contribution and indemnity against defendants who have

settled with the plaintiff by future defendants or non-settling defendants.[45] Winkler J. has found that the *CPA* contains authority for the use of a bar order in s. 13 (which permits stays of proceedings on such terms as the court considers appropriate) and s. 12 (which permits the court to make such orders as are necessary to ensure the fair and expeditious determination of the class proceeding). Making use of a bar order can be effective in ensuring that a settlement reached by the representative plaintiffs and several of the defendants does not fall apart because other defendants are not prepared to participate or make any contribution.

A further problem which is common in securities class actions, arises out of fact that there may be threatened or existing litigation in other jurisdictions either inside or outside Canada. Defendants will undoubtedly want a settlement which achieves "global peace", that is, a resolution of all litigation throughout the world. Therefore, the parties may have to submit the proposed settlement for approval to courts in other jurisdictions, which may have different approval criteria.

3. Obtaining court approval

Pursuant to section 29(2) of the *CPA*, a settlement of a class proceeding is not binding unless approved by the court, in which case it will bind all class members who do not exercise their right to opt out. The court

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[45] See, for example, *Ontario New Home Warranty Program v. Chevron* (1999), 46 O.R. (3d) 130 (S.C.J.) and *Sawatzlay v. Société Chirurgicale Instrumentarium Inc.*, [1999] B.C.J. No. 1814 (S.C.)

will be asked to approve a proposed settlement at what has come to be known as a "fairness hearing", at which time the court will consider the following:

(a) whether the action may be certified (if it has not already been certified);
(b) whether the settlement is fair and in the best interests of the members of the class; and
(c) whether the process for the administration of the proposed settlement is workable.

(a) whether the action can be certified

If the action has not already been certified, a certification order must also be sought as part of the fairness hearing so that all members of the class will be bound. Section 5(1) of the *CPA* set outs the criteria which, if established, require the court to certify a class proceeding.

The general policy considerations in favour of settlements appear to have caused some courts to relax the stringent requirements for certification under section 5 of the *CPA*. For example, in *Gariepy v. Shell Oil Co.,*[46] Nordheimer J. approved a proposed settlement and made a certification order, notwithstanding that a previous motion for certification of the action had been denied. Nordheimer J. stated that the requirements

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[46] [2002] O.J. No. 4022 (S.C.J.)

for certification in a settlement context are the same as they are in a litigation context, however, their application need not "be as rigorously applied in the settlement context ..., principally because the underlying concerns over the manageability of the ongoing procedures are removed." This reasoning was accepted by Brenner C.J.S.C. in *Furlan v. Shell Oil Co.*,[47] who stated that settlement also provides a measure of certainty and early recovery not available in the litigation context. Similarly, in *Haney Iron Works Ltd. v. Manufacturers Life Insurance Co.*,[48] the court found that the parties had to establish only a *prima facie* case for certification where settlement approval was sought.

Therefore, a court may decide that a case which ought not to be certified if the litigation were to proceed may still be certified for the purposes of settlement. In the *Gariepy* case, it may be that the concerns which Nordheimer J. identified on the certification motion originally were

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[47] [2002] B.C.J. No. 2549. (S.C.)

[48] (1998), 169 D.L.R. (4th) 565 (B.C. S.C.)

resolved by the manner in which settlement was to be carried out and, therefore, certification was granted and the settlement approved.[49]

(b) the settlement must be fair, reasonable, and in the best interests of the class

[49] *Gariepy v. Shell Oil Co.,* [2002] O.J. No. 4022 at paras. 27 - 35

To approve a settlement, the court must find that it is “fair, reasonable, and in the best interests of the class”. A proposed settlement must not be measured against a standard of perfection. Rather, the court must balance the need to scrutinize the settlement against the recognition that there may be a number of possible resolutions that fall within the range of reasonableness. The court must recognize that settlements are, by their nature, the product of compromise and need not (and usually will not) satisfy every single concern of all interested parties. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs of litigation. The court must, therefore, recognize the uncertainties of law and fact in any particular case and the concomitant risks and costs necessarily inherent in taking any litigation to completion.[50]

The resolution of complex litigation through the compromise of claims is encouraged by the courts and favoured by public policy. The practical value of an expedited recovery is a significant factor for consideration since it saves litigants the costs and risks associated with going to trial and reduces the strain on an already overburdened court system.[51]

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[50] See *Dabbs v. Sun Life Assurance Co. of Canada* (1998), 40 O.R. (3d) 429 (Gen. Div.) at pp. 440 and 444

[51] *Ontario New Home Warranty Program et al. v. Chevron Chemical Company et al.,*

In determining whether to approve a proposed settlement, the court may take into account the following factors:

(i) the likelihood of recovery or likelihood of success;

(ii) the amount and nature of discovery evidence;

(iii) the settlement terms and conditions;

(iv) the recommendation and experience of counsel;

(v) the future expense and likely duration of litigation;

(vi) the recommendation of neutral parties, if any;

(vii) the number of objectors and nature of objections;

(viii) the presence of arms-length bargaining and the absence of collusion;

(ix) the degree and nature of communications by counsel and the representative plaintiff with class members during the litigation; and

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supra note 45, at p. 147

(x) the information conveying to the court the dynamics of and the positions taken by the parties during the negotiation.[52]

These factors should be a guide in the process and it is not necessary that all factors receive the same consideration. In any particular case, certain of these listed factors will have greater significance than others and weight should be distributed accordingly.

Therefore, the parties proposing a settlement have an obligation to provide sufficient evidence to permit the court to exercise an objective, impartial, and independent assessment of the fairness of the settlement in all the circumstances. One of the reasons for the court's high level of scrutiny is that the usual safeguards of the adversarial process may not protect members of the class in negotiations between the representative plaintiffs and the defendants. Where the court is satisfied that the settlement was negotiated at arms-length by counsel for the class, particularly under the auspices of the court, there is a strong initial presumption of fairness, which presumption will be overridden if the judge concludes that the settlement does not fall within a range of reasonable outcomes.

(c) does the proposed settlement must set out a workable plan

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[52] *Parsons v. The Canadian Red Cross Society* (1999), 40 C.P.C. (4th) 151 (S.C.J.) at pp. 172-173, paras. 71 and 73 and *Dabbs v. Sun Life Assurance Co. of Canada*, [1998] O.J. No. 1598 (S.C.J.) at para. 13

The settlement proposal must provide an adequate plan for the resolution of the proceeding, or certification will not be ordered in a settlement context.[53]

Before the settlement is approved, the court must be satisfied that there is a workable procedure or plan for the administration of the settlement which makes clear who is responsible to do what, sets deadlines for the completion of all the necessary stages of the administration of the settlement, and anticipates potential problems or disputes. Someone must be identified as responsible for driving the settlement to completion so that it proceeds as quickly and cost-efficiently as possible. The complexity (and thereby the cost) of the settlement will depend upon a variety of factors, including the number of members of the class, the estimated amount of each class member's claim, and the total amount of the proceeds available for distribution to the class members.

Securities class actions may give rise to unique issues that must be addressed. Such issues include: If the shares are held in trust, is the proper plaintiff the trustee or the beneficiary or both? If the shares are held in a fund and the holders of units in the fund change over time, are the settlement monies paid to the fund (for the benefit of the current unit holders) or to the holders of units at the relevant time?

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[53] *McKrow v. Manufacturers Life Insurance Co.* (1998), 9 C.C.L.I. (3d) 161 (Ont. Gen. Div.) at para. 8

A typical settlement agreement should deal with the following issues, some of which are practical and some of which are required by the *CPA*:

(a) The definition of the proposed class must be clear so that those who are entitled to a distribution can easily be identified and the defendants are protected from future claims;

(b) Estimate as to damages. The class members with proven claims may be entitled to a proportionate share of a settlement fund paid by the defendants or, alternatively, they may be entitled to damages based upon a mechanism or formula. In any event, the court must be provided with sufficient information about each shareholder's loss as compared to the class members' expected return to be able to determine the fairness of the settlement. In securities class actions, the court may wish to compare the expected recovery with that in similar cases in the United States;

(c) How the settlement funds are to be paid and held. The proposed settlement agreement must indicate whether the settlement funds are to be paid in a lump sum, by installment over time, or such other method. It must provide for how the funds are to be held and by whom prior to their distribution to class members. There may be specific protocols or requirements regarding how those funds are to be invested for the benefit of class members;

(d) The cost of administering the settlement. The plan must clearly

state how the costs of the settlement are to be funded. Commonly, those costs come out of the settlement proceeds and the court will require an estimate of those costs and an accounting and approval after those costs have been incurred to ensure that they are reasonable;

(e) Whether the defendants' consent to certification is conditional. The defendants will undoubtedly consent to certification only if the settlement is approved and not dissolved;

(f) The settlement should provide for the dissemination of information to class members [s. 19 *CPA*]. Much of this can be done through a web-based data base, which allows class members to obtain information about the status of their claim and the progress of the administration of the settlement;

(g) There should be a means to notify class of their right to opt out of the settlement approval of the contents of that notice. The court must be satisfied that the notices are likely to come to the attention of class members, whatever means are used [ss. 17, 18, 19, 23, and 29(4)];

(h) Court approval of the contents of the notices is necessary [s. 20 *CPA*];

(i) There must be a procedure and deadline for those shareholders

who wish to opt out of the settlement [s. 9 *CPA*];

(j) A friend of the court may be appointed to represent the interests of anyone who either objects to the proposed settlement or later seeks advice as to whether to opt out. This enables objectors to have independent representation and ensures that the court receives submissions from objectors in an organized and efficient way. That person may be paid out of the settlement funds;

(k) There must be a procedure for determining class members' claims. Common methods are proof of claim forms and affidavit evidence;

(l) There must be time limit imposed upon potential class members for making claims [s. 24 *CPA*];

(m) There must be a procedure for appeals by class members of the administrator's decision as to eligibility and quantum of damages. There must be someone designated to hear the appeals and a procedure approved;

(n) A person must be appointed to administer the settlement, who will give notice, communicate with class members and provide them with information on the progress of the settlement, hold the settlement funds pending their distribution to class

members, receive claims from class members, make initial decisions about entitlement, and distribute the funds to each class members. There should also be a procedure to see that the administrator of the settlement paid [s. 26 *CPA*]. Increasingly, that role is being assumed by a professional who is familiar with class actions and whose job it is to process claims, to ensure the funds are paid out in accordance with the settlement terms, and to account to the court;

(o) There must be a procedure for approval of plaintiffs' counsel's legal fees [ss. 32(2) and (3), and 33 of the *CPA*];

(p) What event(s) triggers dissolution of the settlement. The settlement may dissolve automatically if the parties are unable to obtain "global peace" or the number of class members opting out have claims which exceed a predetermined threshold amount. Usually this threshold amount is kept confidential to prevent some class members from holding the entire settlement hostage by trying to bargain for more favourable terms in exchange for their agreement not to opt out;

(q) There must be a plan and deadline for resolving litigation in other jurisdictions if "global peace" is a term;

(r) The settlement must provide for the ability of parties or the administrator to seek further directions from the court if some

unanticipated issue arises; and

(s) There should be provision for distribution of settlement funds (if any) that are not distributed to class members [s. 26(10)]. The settlement may provide that the funds are to be returned to the defendants.

F. CONCLUSION

What has been made clear in the ten years since the *CPA* was passed, is that securities class actions litigation is complex, expensive, and risky. It is not for the faint of heart! But it is the only recourse that the victims of securities fraud have.

There are still many issues which have not been finally determined in this area. Recent jurisprudence indicates the potential (not yet realized) for an expanding scope of liability at common law by a broader class of persons for inaccurate statements and information made available to members of the public, upon which they rely to make their investment decisions. Recent amendments to the *Securities Act* found in Bill 198, which provide for a "fraud on the market" cause of action, are a welcome change for many shareholders. However, the legislative changes, if proclaimed, have some limitations. In particular, the leave requirement means that actions will be allowed to proceed only where the plaintiff can establish "a reasonable possibility that the action will be resolved at trial in favour of the plaintiff". The monetary liability limits may also prove to be a disincentive for some

claims. Time will tell whether these provisions will expand recovery for meritorious claims and deter strike suits and unmeritorious claims or have the opposite effect.

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