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MITIGATING CLASS ACTION RISKS WITH EFFECTIVE ARBITRATION CLAUSES AND CLASS ACTION WAIVERS: A GUIDE FOR CANADIAN CORPORATIONS

Lawrence Thacker
PARTNER
LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP

Mark Veneziano
PARTNER
LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP

Introduction

For some time now, Canada has been thought of as an "arbitration-friendly jurisdiction". This title, however it was earned, is well deserved. In 2003, the Supreme Court of Canada ("SCC") recognized in *Desputeaux v. Éditions Chouette (1987) inc.*,[1] that arbitration in Quebec (and, by extension, all Canadian jurisdictions) is an autonomous and integral part of the legal system. The SCC held:

(a) arbitration clauses should be construed liberally;

(b) arbitrated justice is equal, not inferior, to adjudicated justice; and

(c) arbitration is a legitimate alternative to litigation "designed to provide parties to a contract with an effective and efficient forum for resolving their disputes".[2]

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In the ensuing decade, Canadian courts have considered the applicability of arbitration clauses in the context of another judicial procedure created and utilized "to ensure its fair and expeditious determination"[3] of legal issues — class proceedings. With each decision, legal commentaries have questioned whether arbitration clauses could be relied upon with certainty to guard against class action lawsuits. Despite this doubt, recent judicial decisions suggest that arbitration clauses may eliminate, or at least reduce, the risk of class action liability in some circumstances.

The uncertainty surrounding arbitration clauses became more pronounced following the SCC's 2011 5:4 split decision in *Seidel v. TELUS Communications Inc.*[4] The majority allowed a statutory claim to proceed as a class action notwithstanding a mandatory arbitration clause and express class action waiver while sending other statutory claims and common law claims to arbitration. Meanwhile, recent jurisprudence in the United States has confirmed that American companies can rely upon arbitration clauses with confidence to prevent class proceedings. Finally, in Canada, the Federal Court of Appeal's 2013 decision in *Murphy v. Amway Canada Corp*.[5] brought some clarity to the confusion: "express legislative language in a statute is required before the courts will refuse to give effect to the terms of an arbitration agreement".[6] In other words, determination of the arbitrability of disputes in the class action context is made on a statute-by-statute basis.

Recent developments in Canadian law suggest that companies can utilize arbitration and class action waiver clauses as risk management tools with reasonable confidence for targeted issues and industries. This article will begin by summarizing how courts in recent years have approached arbitration clauses in the class action context. Next, looking at the United States' courts approach we see how American law treats arbitration clauses and class action waivers differently and discuss why it matters in the multinational corporate context. As necessary with the current Canadian law, this article surveys industries in which such clauses might be effective risk management tools and those in which they are prohibited. We then consider the key potential benefits and disadvantages of arbitration and

class action waiver clauses in determining whether such clauses will be an effective and appropriate litigation risk management tool for a company's particular circumstances. Ultimately, a well-crafted arbitration clause and class action waiver, in the proper industry context, can be employed as one tool in a company's arsenal to reduce the risk of class action litigation and liability.

Class Actions and Arbitration: Cross-Purposes Or Complementary Procedures

It has been clear since the 2001 trilogy of SCC decisions[7] that class actions serve three important purposes: serving judicial economy, improving access to justice and causing behaviour modification by ensuring that obligations to the public are not ignored.[8] The SCC has also recognized that class proceedings "facilitate access to justice for citizens who share common problems and would otherwise have little incentive to apply to the courts on an individual basis to assert their rights".[9] While it is true that arbitration as a "private justice system" exists "parallel to the state's judicial system", this does not mean that the two are at cross-purposes.[10] As Justice LeBel and Justice Deschamps noted in dissent in *Seidel*:

> In an effort to promote and improve access to justice, and to make more efficient use of scarce judicial resources, legislatures have adopted new procedural vehicles designed to modify or provide alternatives to the traditional court action. These alternatives include class actions and arbitration, both of which have been endorsed by this Court.[11]

Courts recognize arbitration can "enable parties to deal disputes efficiently, effectively and economically"[12] and "secure prompt, final and binding settlement of disputes".[13] The SCC has affirmed arbitration is as legitimate and important to the Canadian justice system as is adjudication by the courts.[14]

Arbitration certainly achieves the purposes of economy and access to justice and arguably has an effect on behaviour modification for corporations that know they face the prospect of arbitrating any number of disputes. It is possible to imagine an arbitration clause that could, in the words of Chief Justice McLachlin describing the purposes of class actions: "free judicial resources that can be directed at resolving other conflicts, and can also reduce the costs of litigation"; "mak[e] economical the prosecution of claims that would otherwise be too costly to prosecute … [and] ensures that injuries are not left unremedied"; and "deters potential defendants who might otherwise assume that minor wrongs would not result in litigation".[15] Such a clause, in the appropriate circumstances, discussed herein, is likely to be interpreted favourably by the courts.

Reviewing Canadian Jurisprudence: How Courts Approach Arbitration Clauses in the Class Action Context

Canadian courts have not themselves compared the purposes of arbitration and class actions. Yet, jurisprudence has developed indicating the courts are willing, in the absence of legislative direction to the contrary, to allow freedom of contract to prevail over the "procedural right" of "access to class actions".[16]

The starting point, as mentioned, is *Desputeaux*, which establishes the principle of arbitral equality with the judiciary. Arbitration is not an exception or hindrance to access to justice, but rather an alternative, equally legitimate form of justice. Accordingly, courts must consider the existence of arbitration clauses when determining whether a class action is a preferable (or even available) procedure for the resolution of the dispute at issue.[17] This is subject to the SCC's more recent rulings concerning the competence-competence principle — that "arbitrators should be allowed to exercise their power to rule first on their own jurisdiction" unless the issue is a question of law alone.[18]

Since *Desputeaux*, Canadian courts have concluded that arbitration clauses in various circumstances can effectively defeat class proceedings. In *Bisaillon v. Concordia University*, the SCC held that the provisions of the collective agreement barred union members from bringing a class action against an employer: class actions are procedural vehicles which neither create substantive rights nor modify other rights or limitations.[19] The SCC affirmed this in *Dell Computer Corp. v. Union des Consummateurs*[20] and held that an arbitration provision in an online sale agreement could defeat a class action. In *Dell*, the court stressed the importance of statutory interpretation in determining the validity

of an arbitration clause in specific contexts: "An act should only be interpreted as excluding the possibility of arbitration if it is clear from it that the legislator purported to exclude the possibility of arbitration".[21] In *Dell*'s companion case, *Rogers Wireless Inc. v. Muroff*,[22] which involved an arbitration and class action waiver clause in a mobile telephone service agreement, the court indicated that certain 2006 amendments to Quebec's *Consumer Protection Act*[23] ("QC *CPA*") specifically prohibit any mandatory arbitration provision, "particularly if it deprives a consumer of access to class action procedures".[24] According to *Dell* and *Rogers*, the changes had no retroactive effect and legal situations occurring prior to December 2006, as in both of those cases, were not affected.

Courts have also emphasized the need to account for public policy considerations. For example, in citing *Dell*'s discussion of the competence-competence principle, the Ontario Court of Appeal held in *Jean Estate v. Wires Jolley LLP*,[25] that public policy considerations were a matter of law to be determined by the courts. Although no provisions in the *Solicitors Act*[26] prohibited the use of arbitration clauses in respect of solicitor-client disputes over contingency fees, the Court of Appeal held "public policy prevents the parties from contracting out of the statutory protections contained in the *Solicitors Act* and any arbitration must be conducted in accordance with them".[27] While public policy considerations are important, *Jean Estate* tells us that arbitrators are equally equipped to consider and protect public policy interests, unless the legislature determines otherwise.[28]

The majority decision in *Seidel* also considers public interest. Binnie J. held that it would be contrary to public policy to quash a claim under s. 172 of British Columbia's *Business Practices and Consumer Protection Act*[29] ("*BPCPA*"), a public interest remedy, by deferring to "low-profile, private and confidential arbitrations".[30] Section 3 of the *BPCPA* specifically invalidated any contractual waiver of a person's rights, benefits, or protections under the *BPCPA*, including the right to bring an action under s. 172.[31] The majority judgment in *Seidel* makes it clear that courts must take a textual, contextual and purposive approach to the interpretation of the relevant statute, in order to determine whether an arbitration agreement is enforceable:[32] "*Dell* and *Rogers Wireless* stand, as did *Desputeaux*, for the enforcement of arbitration clauses *absent legislative language to the contrary*."[33]

Despite some concern that *Seidel* had "muddied the waters"[34] with respect to Canada's pro-arbitration reputation, the SCC expressed broad support for arbitration generally, and remanded all of Ms. Seidel's common law claims and other statutory claims to arbitration. The Federal Court of Appeal in *Murphy* clarified this position in considering the arbitrability of disputes under the *Competition Act* and the validity of a class action waiver.[35] According to Justice Nadon, "the Supreme Court has made it clear that express legislative language in a statute is required before the courts will refuse to give effect to the terms of an arbitration agreement".[36] *Murphy* reaffirmed that the Canadian courts will adopt a non-interventionist approach in considering valid arbitration clauses and class action waivers.

Ultimately, a number of factors must be considered. The validity and enforceability of arbitration clauses and class action waivers will be determined on a statute-by-statute basis. Courts will apply basic rules of statutory interpretation and strike an appropriate balance between the public policy considerations relevant to the context and the fundamental principle of freedom of contract. The remaining question is what constitutes "legislative language to the contrary" for the purposes of voiding a mandatory arbitration clause? Before moving to survey specific issues and industries where Canadian courts have considered such clauses, it is also useful to compare the approach of courts in the United States.

Contrasting the American Approach: How It's Different and Why It Matters

The use of arbitration clauses as a tool to eliminate class action risk first surfaced in the United States ("U.S.") with consumer contracts for mobile phones and wireless devices, and the corresponding increase in class action misrepresentation claims. U.S. companies sought to curb the use of class actions by including arbitration provisions in their contracts. The U.S. Supreme Court, in a series of decisions, upheld the validity and effectiveness of such clauses, with the result that such clauses have become a standard feature of litigation risk management.

The U.S. Supreme Court has determined that the purpose of the *Federal Arbitration Act*[37] is to reverse judicial hostility to arbitration agreements and allow for the resolution of federal statutory claims through arbitration.[38] State legislation cannot mandate a judicial forum for the resolution of claims that the contracting parties agreed to arbitrate.[39] The U.S. Supreme Court recently reaffirmed this position in *AT&T Mobility LLC v. Concepcion*.[40] In that case, the Supreme Court confirmed the "fundamental principle that arbitration is a matter of contract", and like other contracts, arbitration agreements should be enforced according to their terms and "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract".[41]

While the American approach does provide for the consideration of whether a potential litigant will be in a worse position in arbitration than they would have been as a member of a class action, the key issue is whether arbitration would deny a potential litigant any substantive legal rights. That is, litigants must show that arbitration would prevent them from fully asserting their legal rights.[42] In earlier cases, the risk of prohibitive costs of arbitration was also a factor in this consideration,[43] but in its 2013 decision in *American Express Co. v. Italian Colors Restaurant*,[44] the U.S. Supreme Court held that contractual waivers of class arbitration will not be invalid on the ground that a plaintiff's cost of individually arbitrating a federal statutory claim exceeded potential recovery.

While the American approach is not directly applicable to Canadian cases, it is relevant. Canadian courts often look to their U.S. counterparts, particularly in areas relating to class actions where the American experience is more developed. Additionally, countless corporate entities now operate transnationally and must be aware of variances in the treatment of arbitration and class action waiver clauses across jurisdictions.

Statute-by-Statute: A Survey of Applicable Issues and Industries

In Canada, courts of various jurisdictions have considered arbitration clauses in different issues and industries. The emerging pattern is one of statute-specific interpretation and context-specific policy consideration. Situations in which courts will consider such questions will continue to grow; what follows are some representative examples, and not a comprehensive survey.

On one hand, we know that the *Consumer Protection Act* in both Ontario and Quebec, and portions of the *BPCPA* in BC, prohibit mandatory arbitration and class action waivers.[45] Similarly, in 2014 the Manitoba Court of Appeal held in *Briones v. National Money Mart Co*.[46] that the same was true of *The Unconscionable Transactions Relief Act*[47] and the *Consumer Protection Act*.[48] Under Alberta's *Fair Trading Act*,[49] any arbitration clause in a consumer contract must be approved by the Minister for Service Alberta. Without such approval, the Alberta Court of Appeal recently held,[50] claims under the *Fair Trading Act* and the *Unconscionable Transactions Act*[51] will not be remanded to arbitration notwithstanding any arbitration clause or class action waiver. In another context, s. 4(4) of Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000*[52] explicitly voids any provision in a franchise agreement that "purport's to interfere with, prohibit or restrict a franchisee from exercising any right under [section 4]" including the right to associate and the right of action against the franchisor for contravention of the section.[53]

On the other hand, there are numerous examples in non-consumer contexts that confirm the enforceability of arbitration clauses and class action waivers in those industries. In *Murphy*, the Federal Court of Appeal stated the *Competition Act* did not prevent a defendant from relying on an arbitration or class action waiver agreement. *Desputeaux* was decided in the context of the *Copyright Act*[54] and determined that disputes under that Act were arbitrable. *Jean Estate* held that nothing in the *Solicitors Act* prevented disputes under the Act from being arbitrated, as long as public policy was considered by the arbitrator. Similarly, in the 2014 case, *Harrison v. UBS Holding Canada Ltd.*,[55] the New Brunswick Court of Appeal remanded a shareholder action under the *Securities Act*[56] to arbitration pursuant to an applicable arbitration clause.

This range of outcomes suggests consistency with the principle laid down in *Seidel* and clarified in

Murphy that each unique arbitration clause or class action waiver must by assessed on a statute-by-statute basis.

On the whole, Canadian courts appear supportive and willing to uphold the validity of arbitration clauses and class action waivers in the absence of legislative language to the contrary.

An Effective Tool for Risk Management? Considerations Regarding Arbitration Clauses and Class Action Waivers

The foregoing suggests arbitration clauses and class action waivers are available to corporations and may be an effective tool to mitigate the risk of class action litigation, when used properly in the appropriate circumstances. Before simply injecting its contracts and agreements with arbitration clauses and class action waivers, a corporation would be prudent to consider the benefits and disadvantages of utilizing such clauses and of arbitration generally. In general terms, arbitration affords a number of advantages to a corporation including, but not limited to

- flexibility in rules and procedures;
- influence over the choice of arbitrator with subject-matter expertise and experience;
- privacy and confidentiality;
- prompt determination of issues;
- choice of no appeal, or limited appeal rights, promotes finality;
- avoidance of enormous costs in time and money of defending class actions; and
- effective, efficient and economical resolution of disputes.[57]

Meanwhile, corporations seeking to use arbitration clauses must consider the potential disadvantages of arbitration and the use of such clauses in. These include

- additional fees and costs for arbitrators and facilities;
- in some circumstances, delays in commencement and completion of arbitrations;
- difficulties and lack of jurisprudence on consolidation of arbitrations;
- limitations on discovery that may affect the availability of evidence to both sides;
- lack of precedential value, thereby creating uncertainty of outcomes;
- limited grounds for judicial review or erroneous decisions;[58] and
- potential backlash against such clauses by actual or potential parties to an agreement.

The above lists capture only a sliver of the considerations that might be applicable in a given context. Each factor will impact the desirability of arbitration clauses and class action waivers differently in various circumstances and affect the risk-management utility of such provisions.

A How-to-Guide: Structuring Arbitration Clauses and Class Action Waivers for Litigation Risk Management

It is possible to propose a general guide for structuring arbitration clauses and class action waivers to be an effective (and judicially acceptable) risk management tool.

The first step is to consider what legislation could give rise to an action and determine whether that statute contains "express legislative language" prohibiting the use of arbitration clauses or class action waivers. In the consumer context such clauses will certainly be found invalid. Otherwise, there are scarce examples of clear legislative intent to prohibit the use of arbitration clauses.

In the absence of such language, some general and some specific advice may assist in drafting an arbitration clause with which a court will be loath to interfere. The general rules of drafting written contracts apply: use clear and simple wording to communicate the intent of the provision; where reasonably possible, ensure the clauses are known to the other party and can be proven to be known; clearly identify the particulars of the clause, such as what types of disputes will be arbitrated, under what circumstances, in what forum and by what arbitrator. This will avoid ambiguity and deny the courts the opportunity to invoke *contra preferentum* and interpret the provision against the drafter.

Considerations of specific application to class action waiver and arbitration clauses might include stating the required qualifications of an arbitrator, including being fully impartial and perceived as such; identifying the location of arbitration if it can be set cost effectively; designing a process that is as fair as possible to the arbitrating parties; and ensuring that arbitration will not place a litigant in a worse position than they would be in as a class member. It would be particularly effective to draft an arbitration clause that expressly declares its purposes to include access to justice, economical and efficient dispute resolution, and full cost accounting of all potential harms caused — precisely the same purposes of class proceedings.

Conclusion

The law in Canada on the use of arbitration clauses in the context of class actions may not be as definitive as the jurisprudence in the U.S. However, Canada remains an arbitration-friendly jurisdiction. The SCC has repeated the need for judicial deference to arbitrators to determine their own jurisdiction and affirmed that arbitration clauses should be given effect absent legislative direction to the contrary. This gives corporations hope in avoiding or reducing the risk of class proceedings.

Although courts determine the arbitrability of disputes in the class action context on a statute-by-statute basis, courts will always give due consideration to the fundamental principle of freedom of contract. What matters most are the relevant and applicable statutes. Where no statutory claims are made or there is no legislative prohibition on arbitration clauses or class action waivers, such provisions are legitimate and effective tools in mitigating the risk of class action litigation. Corporations and their counsel would be wise to consider the inclusion of such tools in their risk management arsenal — especially if they can be framed as achieving the same goals as class actions.

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2 *Ibid*., paras. 35, 64, 65.
3 *Class Proceedings Act, 1992*, S.O. 1992, c. 6, s. 12.
4 [2011] 1 S.C.R. 531, [2011] S.C.J. No. 15, 2011 SCC 15 [*Seidel*].
5 [2013] F.C.J. No. 154, 356 D.L.R. (4th) 738, 2013 FCA 38 [*Murphy*].
6 *Ibid*., para. 60.
7 *Western Canadian Shopping Centres Inc. v. Dutton*, [2001] 2 S.C.R. 534, [2000] S.C.J. No. 63, 2001 SCC 46 [*Dutton*]; *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158, [2001] S.C.J. No. 67, 2001 SCC 68; *Rumley v. British Columbia*, [2001] 3 S.C.R. 184, [2001] S.C.J. No. 39, 2001 SCC 69.
8 *Dutton*, *ibid.*, paras. 27–29.
9 *Bisaillon v. Concordia University*, [2006] 1 S.C.R. 666, [2006] S.C.J. No. 19, 2006 SCC 19, para. 16 [*Bisaillon*].
10 *Desputeaux*, *supra* note 1, para. 40.
11 *Seidel*, *supra* note 4, para. 52.
12 *Hayes Forest Services Ltd. v. Weyerhaeuser Co.*, [2008] B.C.J. No. 108, 289 D.L.R. (4th) 230 (C.A.), para. 1.
13 *Toronto Board of Education v. O.S.S.T.F., District 15*, [1997] 1 S.C.R. 487, [1997] S.C.J. No. 27, para. 36.
14 *Desputeaux*, *supra* note 1, para. 40.
15 *Dutton*, *supra* note 7, paras. 27–29.
16 *Dell Computer Corp. v. Union des consommateurs*, [2007] S.C.J. No. 34, 2007 SCC 34, para. 224 (*per* Bastarache and LeBel JJ.), para. 105 (*per* Deschamps J.) [*Dell*].
17 *MacKinnon v. National Money Mart Co.*, [2004] B.C.J. No. 1961, 50 B.L.R. (3d) 291, 2004 BCCA 473; *Kanitz v. Rogers Cable Inc*., [2002] O.J. No. 665, 58 O.R. (3d) 299 (Ont. S.C.J.), para. 54. (Here, Nordheimer J. also contemplated the possibility of an arbitrator ordering the consolidation of individual arbitration claims in the absence of any prohibition in the arbitration agreement itself.)
18 *Dell*, *supra* note 16, para. 70; *Seidel*, *supra* note 4, paras. 27–30.
19 *Bisaillon*, *supra* note 9, paras. 17–19.
20 *Dell*, *supra* note 16, paras. 105, 224.
21 *Ibid*., para. 221 (*per* Bastarache and LeBel JJ.).
22 [2007] S.C.J. No. 35, 284 D.L.R. (4th) 675, 2007 SCC 35 [*Rogers*].
23 C.Q.L.R. c. P-40.1; *An Act to amend the Consumer Protection Act and the Act respecting the collection of certain debts*, S.Q. 2006, c. 56.
24 *Rogers*, *supra* note 22, para. 18.
25 [2009] O.J. No. 1734, 96 O.R. (3d) 171, 2009 ONCA 339 [*Jean Estate*].
26 R.S.O. 1990, c. S.15.
27 *Jean Estate*, *supra* note 25, paras. 9, 58.
28 *Ibid*., paras. 84–86; *Seidel*, *supra* note 4, paras. 157, 171.
29 S.B.C. 2004, c. 2.
30 *Seidel*, *supra* note 4, para. 37.
31 *Ibid*., para. 33.
32 *Ibid*., paras. 33–37.
33 *Ibid.*, para. 42 [emphasis in original].
34 Martin J. Valasek and Michael Kotrly, "Has the Supreme Court of Canada changed its attitude towards arbitration? A case comment on *Seidel v. Telus Communications*" (2011) 16:2 International Bar Association *Arbitration News* at 134.
35 R.S.C. 1985, c. C-34.
36 *Murphy*, *supra* note 5, para. 60.
37 9 U.S.C. 1.
38 *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 at 89, 121 S. Ct. 513 (Sup. Ct. 2000) [*Randolph*].

39 *Southland Corp. v. Keating*, 465 U.S. 1 at 12, 104 S. Ct. 852 (Sup. Ct. 1984).
40 131 S. Ct. 1740, 179 L. Ed. 2d 742 (Sup. Ct. 2011).
41 *Ibid*., 1745; *Federal Arbitration Act* § 2.
42 *Johnson v. West Suburban Bank*, 225 F.3d 366 (3rd Cir. 2000); *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003).
43 *Randolph*, *supra* note 38; *Livingston v. Associates Finance, Inc*., 339 F.3d 553 (7th Cir. 2003).
44 133 S. Ct. 2304, 186 L. Ed. 2d 417 (Sup. Ct. 2013).
45 *Dell*, *supra* note 16; *Seidel*, *supra* note 4; *Griffin v. Dell Canada Inc.*, [2010] O.J. No. 177, 98 O.R. (3d) 481, 2010 ONCA 29; QC *CPA*, s. 11.1; Ont. *CPA*, s. 8; *BPCPA*, ss. 3, 172.
46 [2014] M.J. No. 154, [2014] 7 W.W.R. 423 (C.A.).
47 CCSM, c. U20.
48 CCSM, c. C200.
49 R.S.A. 2000, c. F-2, s. 16.
50 *Young v. National Money Mart Co*., [2013] A.J. No. 784, 87 Alta. L.R. (5th) 56, 2013 ABCA 264.
51 R.S.A. 2000, c. U-2.
52 S.O. 2000, c. 3.
53 See *Stoneleigh Motors Ltd. v. General Motors of Canada Ltd.*, [2010] O.J. No. 1621, 71 B.L.R. (4th) 271, 2010 ONSC 1965; *Landsbridge Auto Corp. v. Midas Canada Inc.*, [2010] O.J. No. 2845, 322 D.L.R. (4th) 177, 2010 ONCA 478.
54 R.S.C. 1985, c. C-42.
55 [2014] N.B.J. No. 97, 418 N.B.R. (2d) 328, 2014 NBCA 26.
56 S.N.B. 2004, c. S-5.5.
57 See J. Kenneth McEwan and Ludmila B. Herbst, *Commercial Arbitration in Canada: A Guide to Domestic and International Arbitrations* (Aurora, Ont.: Canada Law Book, 2004) at 2-1–2-2.
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FOUR SCORE: SUPREME COURT TO CONSIDER LEAVE ISSUE IN SECURITIES CLASS ACTION CASES

Aaron Kreaden
ASSOCIATE
STIKEMAN ELLIOTT LLP

Genna Wood
ASSOCIATE
STIKEMAN ELLIOTT LLP

Securities Class Actions in the Supreme Court

Rarely do securities class actions make it to the Supreme Court of Canada. Since the secondary market civil liability provisions in Part XXIII.1 of the *Securities Act* (Ontario)[1]-were enacted in 2005, a total of 52 securities class actions have been filed in Ontario. Of these, 31 cases are outstanding, 17 have fully settled and four have been dismissed.[2]

The few cases that have made their way to the Supreme Court have resulted in a significant impact on the practice of securities class action law. For example, in *Kerr v. Danier Leather Inc.*,[3] the Supreme Court made a definitive pronouncement on the standard of materiality in a prospectus misrepresentation claim, holding that disclosure requirements under the *OSA* are not to be subordinated to the exercise of business judgment. It also set the framework for subsequent securities class actions, and resolved the interplay between the disclosure requirements in ss. 56-58 of the *OSA* and an action for statutory misrepresentation in s. 130 of the *OSA*.

More recently, the Supreme Court addressed the certification of market timing class actions in *Fischer v. AIC Ltd.*[4] Notwithstanding that the Ontario Securities Commission ("OSC") had entered into a settlement which resulted in restitutionary payments by mutual fund managers to affected investors, the Supreme Court held that the mutual fund managers were not immune from a civil suit. The court held that a class action was a "preferable procedure" under s. 5(1)(*d*) of the *Class Proceedings Act, 1992*[5] that would overcome access to justice barriers that subsisted after the completion of the OSC proceedings.

It is therefore significant that the Supreme Court will be hearing appeals on the subject of certification of securities class actions in the coming several months.

On August 6, 2014, the Supreme Court of Canada granted leave to appeal to a trilogy of secondary market securities class actions recently heard in the Ontario Court of Appeal: *Silver v. Imax Corp.*[6] ("*Imax*"), *Millwright Regional Council of Ontario Pension Trust Fund (Trustees of) v. Celestica Inc.*[7] ("*Celestica*") and *Green v. CIBC*[8] ("*Green v. CIBC*") (collectively, the "*Trilogy*"). The *Trilogy* is notable because a five-member panel of the Court of Appeal overturned its earlier decision in *Sharma v. Timminco Ltd.*,[9] holding that when representative plaintiffs announce their intention to seek leave to assert their statutory claims under s. 138.3 in a statement of claim, they are "invoking the legal

right" granted by the *OSA*, and thereby "asserting" a claim which suspends the running of the limitation period pursuant to s. 28 of the *CPA*.[10] In the *Trilogy*, the Court of Appeal also held that s. 138.8(1) of the *OSA*, which sets out the test for obtaining leave to bring an action under the provisions relating to liability for secondary market disclosure *(i.e.*, the leave test) was equivalent to s. 5(1)(*a*) of the *CPA.*[11]

Far less attention, at least in Ontario, has been given to the decision of the Court of Appeal of Quebec in *Theratechnologies inc. v. 121851 Canada inc.* ("*Thera*"),[12] which is the other securities-based class action that is scheduled to be before the Supreme Court in this upcoming term. This is understandable. *Thera* in part involves consideration of the *Code of Civil Procedure*, C.Q.L.R. c. C-25 which, of course, has no application outside of Quebec. However, much of the decision turns on provisions of the *Securities Act*, C.Q.L.R. c. V-1.1 (Quebec) that are based on and nearly analogous to s. 138.8(1) of the *OSA*, which sets out the test for obtaining leave to bring an action under the provisions relating to liability for secondary market disclosure.

While the leave test has typically been interpreted in a manner that sets a low bar for plaintiffs, if this issue is touched on by the Supreme Court it could potentially usher in new developments in this area of the law and securities practice more generally.

Leave Timing Trilogy

Unlike the common law cause of action for negligent misrepresentation, s. 138.3 of the *OSA* permits investors to recover for losses suffered *without* proving reliance on the misrepresentation in the purchase or sale of shares. However, in an effort to avoid, among other things, the undesirable practice of "strike suits" that has been common in securities litigation in the United States, s. 138.8 of the *OSA* requires that plaintiffs who seek to make a claim of secondary market misrepresentation must first obtain leave from the court, which will only be granted if (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.

Judges who have considered the leave test in Ontario have tended to add his or her own gloss to its application. In *Imax*, the first case to consider the leave test, Justice van Rensburg extensively considered the reasonableness requirement and noted that the phrase "a reasonable possibility that the action will be resolved at trial in favour of the plaintiff" did not appear to have "any direct antecedent in Canadian legislation". She found that the origin of this wording was in a screening mechanism for class actions that was proposed by the Ontario Law Reform Commission in its 1982 *Report on Class Actions*,[13] although the recommendation was not adopted as a part of the *Class Proceedings Act, 1992.* In light of this, her Honour turned to statutory interpretation and determined that

> "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.[14]

In *Zaniewicz v. Zungui Haixi Corp*. Justice Perell echoed van Rensburg J. in *Imax* and described the leave test as a "preliminary low-level merits based leave test".[15] In *Dobbie v. Arctic Glacier Income Fund*,[16] Justice Tausendfreund held that "good faith" is not to be presumed and must be established by the plaintiffs on a balance of probabilities and followed the test set down in *Imax.* At the Superior Court in *Green*, Justice Strathy (as he then was) interpreted the good faith requirement as "requiring the plaintiff to establish that he or she brings the claim in the honest and reasonable belief that it has merit and that he or she has a genuine intent and capacity to prosecute the claim if leave is granted".[17] It is difficult to tell from the language used by the courts and the outcome of the various cases whether linguistic differences in the analysis under the leave test are more a matter of form or of substance.

Another issue that was raised in the *Trilogy* but which applied exclusively to the appeal of *Green v. CIBC* was the interpretation of the "reasonable possibility" of success standard regarding the leave test. At the Court of Appeal the argument was raised that Strathy J. in *Green v. CIBC* set the bar for granting leave too low when he stated that this test is intended "to screen out cases that, even though possibly brought in good faith, are so weak they cannot

possibly succeed".[18] In determining this issue, Justice Feldman reasoned by analogy, noting that the "reasonable possibility concept is very familiar because it is used for determining whether the pleading discloses a cause of action as required by the first part of the test for certification in s. 5(1)(*a*) of the *CPA*".[19] In this context, the concept of a reasonable prospect of success is used to "weed out hopeless claims and only allow those to go forward that have 'some chance of success'".[20]

With this framework in mind, Feldman J. was satisfied that Strathy J. indeed applied the correct level of scrutiny to the leave test when he described his approach as follows:

> In my view, considering the purpose of the leave test and its legislative history, it would be unfair to the parties and to the court to expect the motion judge to engage in a finely calibrated weighing process. It seems to me that I should simply ask myself whether, having considered all the evidence adduced by the parties and having regard to the limitations of the motions process, the plaintiffs' case is so weak or has been so successfully rebutted by the defendant, that it has no reasonable possibility of success.[21]

Ultimately, the five-member panel of the Court of Appeal in *Green v. CIBC* equated the "reasonableness" component of the test for leave with the test for whether "the pleadings or the notice of application discloses a cause of action" under s. 5(1)(*a*) of the *CPA*,[22] holding that if leave is granted, this element of the certification test will also be satisfied, essentially reducing the hurdles for the certification of secondary market class actions.

The Leave Test in Quebec: *Theratechnologies*

Not only is this interpretation of the leave test potentially up for consideration by the Supreme Court in the *Trilogy* appeal, but it is also a central point that is at issue in its consideration of the Quebec Court of Appeal's decision in *Thera.*[23]

Theratechnologies Inc. ("Thera") is a public company listed on the Toronto Stock Exchange that develops and markets therapeutic products. On June 1, 2009, Thera filed a new drug approval application with the Food and Drug Administration (the "FDA") in the United States with the hope of being able to market a product that treated excess abdominal fat in patients with HIV. As part of the approval process, Thera submitted a number of documents to the FDA and responded to various questions that were raised in respect to the clinical studies that had been conducted for its new product. In accordance with its procedural rules, the FDA published information that it had compiled during the approval process. This information attracted the attention of various media outlets which, based on their own interpretation of the clinical results, publicly raised questions as to whether Thera's product could increase the risk of diabetes.

121851 Canada Inc. ("121"), a shareholder of Thera, became aware of this publicized risk and promptly sold all of its holdings in Thera. In the coming days, Thera's share price dropped by around 58%. However, approximately a week after 121 sold its shares, a committee of the FDA voted to approve the drug and the price of Thera's stock returned to its previous levels. 121 subsequently sought leave to commence a class action relating to Thera's alleged failure to disclose the various questions that had been asked by the FDA as part of its approval process, which it alleged constituted a "material change" in the business, operations or capital of Thera. In reasons released on February 24, 2012, Justice Blanchard of the Quebec Superior Court granted 121 leave under the *QSA* to commence the class action.

On appeal, Thera argued that Blanchard J.C.S. set the bar too low in permitting 121 to proceed with its class action. It was suggested that the motions judge ought to have conducted a more complete and in-depth analysis of the evidence, including the merits of the defence.[24]

Before considering how the Quebec Court of Appeal dealt with these arguments, it is notable that the relevant provisions under s. 225.4 of the *QSA* are similar to the leave test under the *OSA*, which requires that the action be 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 specific wording of s. 225.4 of the *QSA* is as follows:

> 225.4 No action for damages may be brought under this division without the prior authorization of the court.
>
> *Request for authorization* — The request for authorization must state the facts giving rise to the action. It must be filed together with the

> projected statement of claim and be notified by bailiff to the parties concerned, with a notice of at least 10 days of the date of presentation.
>
> *Conditions* — The court grants authorization if it deems that *the action is in good faith and there is a reasonable possibility that it will be resolved in favour of the plaintiff.* [Emphasis added]

Not only did the court specifically comment on the similarity of wording between the two statutes,[25] but it also went to great lengths to describe how these provisions were derived from the same process that led to the analogous provisions in the *OSA*. Specifically, that it was important for the provincial legislature to ensure that the secondary market liability framework in Quebec be the same as that in Ontario or other Canadian provinces.[26]

Turning to the analysis itself, the Quebec Court of Appeal clarified that it was inappropriate to simply adopt the test that applies in Quebec to authorize the commencement of a class action. However, unlike the test under the *CPA* in Ontario which requires a "reasonable prospect of success", the test to authorize the commencement of a class action under the *Civil Code* simply requires that "the alleged facts appear to justify the conclusions sought".[27] The court noted that the leave test under the *QSA* is more stringent than this requirement.[28]

There appeared to be some ambiguity in the decision on the extent to which the court was prepared to adopt the leave test that arises from the Ontario jurisprudence. On the one hand, the court considered several Ontario decisions on the leave test, including van Rensburg J.'s decision in *Imax*, Tausendfreund J.'s decision in *Dobbie v. Arctic Glacier Income Fund* as well as Strathy J.'s decision in *Green v. CIBC.* A review of these cases was used as justification for the court's opinion that although the leave test is "more stringent than that of a simple colour of right, it is, however, less stringent than the criterion of the preponderance of the evidence".[29] At the same time, the court also cautioned against relying too heavily on Ontario decisions rendered in the certification context, which contain different legislative provisions relating to the type of evidence that is permissible, as well as the scope of cross-examinations.

Rather than formulate a bright line test, the court held that the determination of whether a plaintiff has adduced sufficient evidence to establish the reasonable possibility that the action will be resolved in its favour will vary according to the circumstances. The most that could be said is that "[i]t must…exist to a certain extent, by means of sworn statements, examinations for discovery, exhibits validly produced or otherwise".[30]

Returning to the facts of the case, the court noted that Thera knew that its drug had possible side effects that could cause diabetes and it had actively responded to the FDA's concern in this regard. However, at no point did Thera disclose this information to its shareholders and the information only became public when it was published by the FDA. 121 took the position that a "material change" occurred when that information was made public, which, in turn required some form of communication from Thera: for example, a press release confirming that Thera was aware of these issues and had already responded to them in its correspondence with the FDA.[31]

Thera, on the other hand, argued that it was impossible to conclude that a simple list of questions from the FDA could constitute a "change in the business and operations or capital of an issuer".[32] In its view, a simple question asked without regard to its answer could never effect a change.

In the end, the court affirmed Blanchard J.C.S.'s analysis, noting that 121's theory rested on "a plausible analysis of the applicable legislative and regulatory provisions…[which] is sufficient at this stage. . .".[33] The court obtained further comfort from the fact that 121's theory of the case was particularized, stemmed from a specific event that was limited in time and well documented.

Conclusion

It is impossible to predict what issues will be at the forefront of the analysis of the Supreme Court of Canada in the *Trilogy* and in *Thera.* Indeed, it is possible that the court's analysis will not touch on securities laws whatsoever: the analysis in the *Trilogy* may be confined to the circumstances in which an appellate court will be permitted to revisit its own prior (recent) decision, and the analysis in *Thera* may focus on the extent to which an appeal of a "leave" decision is permissible under the *QSA*, which contains different provisions in this regard than the *OSA*.

However, it seems likely that these appeals will result in significant commentary affecting many securities class actions and is therefore of significance to practitioners across the country.

1 R.S.O. 1990, c. S.5 [*OSA*].
2 Bradley A. Heys, Mark L. Berenblut and Jacob Dwhytie, "Trends in Canadian Securities Class Actions: 2013 Update; Filings Steady, Law in Flux and Settlements on the Rise" (Nera Publications, February 19, 2014).
3 [2007] S.C.J. No. 44, 286 D.L.R. (4th) 601, 2007 SCC 44.
4 [2013] 3 S.C.R. 949, [2013] S.C.J. No. 69, 2013 SCC 69.
5 S.O. 1992, c. 6 [*CPA*].
6 [2009] O.J. No. 5573, 66 B.L.R. (4th) 222 (Ont. S.C.J.), leave to appeal to Ont. Div. Ct. refused [2011] O.J. No. 656, 105 O.R. (3d) 212, 2011 ONSC 1035; initial decision aff'd [2014] O.J. No. 419, 118 O.R. (3d) 641 (C.A.).
7 [2012] O.J. No. 5083, 113 O.R. (3d) 264, 2012 ONSC 6083, aff'd [2014] O.J. No. 419, 118 O.R. (3d) 641 (C.A.).
8 [2012] O.J. No. 3072, 29 C.P.C. (7th) 225, 2012 ONSC 3637, aff'd [2014] O.J. No. 419, 118 O.R. (3d) 641 (C.A.).
9 [2011] O.J. No. 1466, 2011 ONSC 8024, rev'd [2012] O.J. No. 719, 109 O.R. (3d) 569, 2012 ONCA 107, leave to appeal to S.C.C. refused (2012), 438 N.R. 400*n*.
10 The Court of Appeal held that the *Timminco* court's interpretation of the term "asserted" in s. 28 of the *CPA* was a viable one based on the arguments made and the record before it in that case. However, when the consequence of the interpretation, which leaves class members without s. 28 protection from the passage of the limitation period, was assessed in light of the purpose and intent of the new statutory claim, the Court of Appeal concluded that the interpretation was not correct and its earlier decision should be overturned.
11 *Trilogy*, para. 85.
12 [2013] Q.J. No. 7925, 2013 QCCA 1256. The authors have relied in the "Unofficial English Translation" provided at 2013 QCCA 1256 (CanLII).
13 Ontario Law Reform Commission, *Report on Class Actions (1982)*, Vol. III (Toronto: Ministry of the Attorney General), p. 862.
14 *Imax*, *supra* note 6, para. 324.
15 [2012] O.J. No. 4748, 2012 ONSC 6061, paras. 37, 40. Leave was granted on the unopposed motion as the defendants were noted in default and deemed to admit the truth of the allegations in the statement of claim
16 [2011] O.J. No. 932, 3 C.P.C. (7th) 261, 2011 ONSC 25.
17 *Green v. CIBC*, *supra* note 8, para. 356.
18 *Trilogy*, para. 81.
19 *Trilogy,* para. 85.
20 *Trilogy*, para. 88.
21 *Trilogy,* para. 93 (internal citations omitted).
22 *Trilogy*, para. 88:

> The purpose of the leave provision under Part XXIII.1 of the *Securities Act* is to discourage and eliminate bad faith strike suits that do not have a reasonable possibility of being successful. The statute asks the leave judge to first determine good faith, then whether there is a "reasonable possibility" that the action will be resolved at trial in favour of the plaintiff, *i.e.* that the plaintiff's case will be successful — a reasonable possibility of success. In order to make that determination, the motion judge applies the same test that is used for determining whether the claim has a reasonable prospect of success for the purpose of certification. As the Chief Justice has described it, the purpose is to weed out hopeless claims and only allow those to go forward that have "some chance of success".

23 The Quebec Court of Appeal also had to consider the novel issue of whether Thera had a right to appeal the decision of the motions judge under the circumstances. The *QSA* has no analogous provision to s. 138.8(6) of the *OSA*, which provides a statutory right of appeal of a decision of the court with respect to whether leave to commence an action under s. 138.3 is granted.
24 *Thera*, *supra* note 12, para. 123.
25 *Thera*, *supra* note 12, para. 110 (internal citations omitted).
26 *Thera*, s*upra* note 12, para. 89 (internal citations omitted).
27 *Thera, supra* note 12, para. 108.
28 *Thera*, *supra* note 12, para. 109.
29 *Thera*, *supra* note 12, para. 118.
30 *Thera*, *supra* note 12, para. 131.
31 *Thera*, *supra* note 12, para. 150.
32 *Thera*, *supra* note 12, paras. 157–158.
33 *Thera*, *supra* note 12, para. 173.