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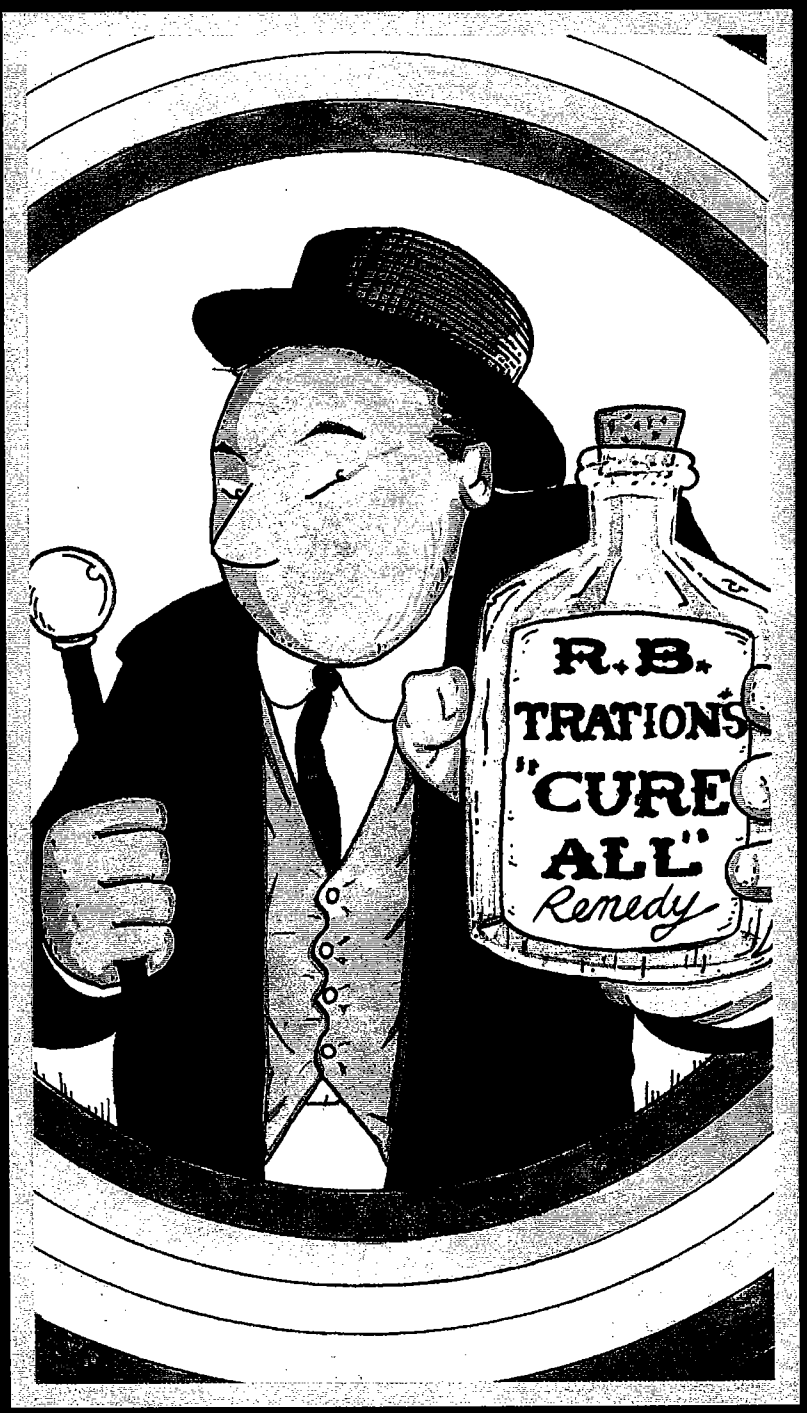
Choking on the medicine



Canada

Should businesses fear Canadian class actions?

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Canadian provinces are moving to establish class actions on the US model. As this happens, companies dealing with North American consumer and capital markets are asking whether doing business in Canada will expose them to the risks of large-scale, high-stakes litigation that have recently come to prominence in the US media and on US legislative agendas. This article compares class proceedings in Canada with those in the US and considers the effect of differences in procedural aspects of litigation in the two countries to evaluate the extent to which such apprehension is warranted.

Class actions come to common law Canada

In 1992 and 1995 respectively, the provinces of Ontario and British Columbia joined the province of Québec and the US in the ranks of jurisdictions permitting class actions. The key difference between class actions and traditional forms of litigation is the provision for a court to certify a defined class of persons who, except for those persons who take steps to be excluded (opt-out), will be bound by the results of the class action.

In support of class actions, it has been said that they increase judicial economy by enabling common issues to be resolved in a single proceeding and, in the case of claims too small for individual plaintiffs to pursue cost-effectively, they provide a means to sue defendants who might otherwise, practically speaking, be immune from suit. Some have also argued that, at least in some circumstances, class actions benefit defendants who can thereby avoid the cost and inconvenience of defending multiple related law suits. But it has been concluded in several quarters that the US experience, which has been the most extensive, has not been entirely satisfactory.

The US makes reforms

Many businesses that have defended major US class actions have regarded the mechanism as facilitating an abusive and intimidating form of entrepreneurial advocacy known in the securities field as strike suits or shakedown litigation. In the worst scenario, attorneys maintained rosters of clients with shares in many companies ready to serve as representative plaintiffs. Claims of dubious merit were filed on behalf of all holders of a security immediately following a significant drop in its market price. Issuers, accountants, lawyers and other institutional defendants marginally associated with some allegedly wrongful conduct were left to calculate, in the absence of any prospect of cost indemnification in the event of a successful defence, whether it was better to settle than to defend.

The situation in the US has not gone unnoticed. The Securities Litigation Reform Act of 1995, passed in December, seeks to alter several of the factors encouraging abusive claims under the civil liability provisions contained in Rule 10b-5 of the 1934 Securities Exchange Act. For example:

(1) joint and several liability, which encouraged plaintiffs to pursue deep pocket defendants only remotely connected to an alleged misrepresentation, is replaced with proportional liability for defendants who do not act deliberately;

(2) the private right of action for aiding and abetting securities fraud is eliminated;

(3) initial plaintiffs are required to notify other shareholders who may apply to be designated lead plaintiff; and

(4) the court is required to consider cost sanctions for frivolous actions.

Will multi-jurisdictional classes increase the stakes?

By facilitating multi-party litigation, class actions have fuelled the drive to reduce the barriers of provincial and national borders to the pursuit of claims that are substantially multinational in scope. The early Canadian experience, like that in the US, has been that these kinds of claims are not readily confined within political boundaries. This is because the geographic composition of plaintiff classes naturally tends to mirror the distribution patterns of the products or the securities that are the subject of complaint.

In the US, where class actions are federally regulated, certifications were once limited to US classes and efforts to certify international plaintiff classes met with little success. For example, in *Bersch v Drexel Firestone Inc*, 519 F 2d 974 (2nd Circ 1975), a securities-based class action precipitated by the winding up of a Canadian corporation, the proposal to include Europeans in the class was rejected. The US court was concerned both that it could be unfair to bind potential plaintiffs overseas who did not respond to notices sent in English, and that overseas courts might refuse to recognize its judgment as precluding those plaintiffs from commencing their own claims.

Canadian provinces are moving to establish class actions on the US model

Similarly, in the US mass tort litigation consolidated from hundreds of individual actions and dozens of class actions relating to breast implants (*In re Silicone Gel Breast Implant Products Liability Litigation*, 94-WL-578353 (ND Ala 1994)), claimants from Ontario, Québec and Australia were presumptively excluded from the class. The proposed set-

tlement, negotiated by local claimants' counsel, sought to cap the portion of the fund available to foreign claimants to 3% of the total. Concerned that dissatisfied foreign claimants would not be regarded by their own courts as precluded from suing afresh, the court reversed the procedure for their inclusion in the class by requiring them to take steps to indicate their wish to participate (opt-in) if they so desired. This was intended to ensure that all those participating in the settlement would be bound by the court's judgment and those not bound would not participate in it. Litigants on both sides would know where they stood.

Since that judgment, the situation has become less clear. Last year, in *In Re Telectronics Pacing Systems Inc Accufix Atrial "J" Leads Product Liability Litigation*, 95-MDL-1057 (SD Ohio. 1995), a US court in the Southern District of Ohio certified a world-wide plaintiff class in a claim relating to the long term functioning of pacemakers.

In Canada, where class actions are the product of legislation within provincial authority which, under the Constitution, must be aimed primarily at matters within the province, it has been thought that the Constitution would limit plaintiff classes to those comprised of persons in the province where the action was certified. This could include persons in the province and persons opting-in. Now, as in the US, the situation is less clear.

The first Canadian class action is certified

In the first class action to be certified in Ontario under the 1992 Act, which was also related to breast implants, the class was described through reference to the statistics concerning the numbers of women who had received implants in Ontario, suggesting that the court recognized this territorial constraint and intended to certify an Ontario-based class (*Bendall v McGhan Medical Corp* (1993), 14 OR (3d) 734). The first class settlement to be approved, coincidentally, also involved a breast implant manufacturer. Because approval of the settlement was sought on behalf of claimants in Ontario and Québec, the proposals were presented in parallel proceedings to courts in Ontario and Québec.

Recognition of the constitutional limitation on class definition has been reflected in British Columbia's 1995 Class Proceedings Act which requires non-residents who wish to participate in class actions in British Columbia to opt-in to a sub-class and thereby submit to the jurisdiction of the British Columbia courts. These legislative provisions should ensure that all class members are bound by the results and that the class proceedings legislation governs civil litigation only within British Columbia. In addition, the division into subclasses facilitates, where necessary in classes comprised of persons from other provinces or countries, the application of standards of liability appropriate to claims arising in those provinces and countries.

But recent court decisions in Ontario permitted certification of a nationwide class in a products liability claim. The claim, like that certified in the Southern District of Ohio, relates to pacemakers. The court in *Nantais v Telectronics Proprietary (Canada) Limited* (1995), 25 OR (3d) 331 rejected the defendants' argument that the inability to bind non-resident plaintiffs could place defendants in a double jeopardy-like situation and said it is "eminently sensible ... to have the questions of liability of these defendants determined as far as possible once and for all, for all Canadians". It was observed that the question whether this could, under the Constitution, preclude non-resident class members from suing in their own provinces was properly a matter for the courts before which such subsequent actions might be launched. The courts, it should be noted, were contemplating only a Canadian class. Even if national classes are ultimately regarded as constitutionally permissible in Canada, the certification of an international class would raise additional questions of jurisdiction that would need to be addressed.

Differences in litigation in Canada and the US

Despite the availability of class proceedings in Canada, and the possibility of multi-jurisdictional classes, there remain several important differences in the logistics of class actions, and litigation generally, in Canada from those in the US. Four differences are significant in assessing whether the introduction of class actions in Canada will be accompanied by the kinds of litigation risks that companies dealing in the US may fear most.

Juries in civil trials. One significant difference is the very limited use of juries in civil actions in Canada. Although there are statutory provisions, for example in Ontario, for a party to ask for determination of the issues of fact or the assessment of damages in a civil trial to be made by a jury, there are many types of matters that courts will not permit to be tried with a jury. In some American jurisdictions civil juries are noted for granting extremely high damages awards. In Canada, civil jury awards in matters that are tried with a jury have been much more controlled. Canadian businesses were astounded recently when a Mississippi jury's verdict turned a Canadian company's seemingly routine dispute with Mississippi businessmen over a $8.5 million business deal into a $500 million damage award. Settlement of the case for a reported $85 million may have done little to comfort Canadian businesses that have increased their cross-border activities in recent years.

Punitive and multiple damages. A second important difference is the limited availability of punitive damages in Canada and the general absence of US-style multiple (eg, treble) damages awards. Damage awards in Canada are largely compensatory. When punitive damages are awarded, the amounts are relatively modest. As a result, there is proportionately less incentive to litigate than in the US.

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Financing class litigation. More subtle, but arguably more profound, are differences concerning the financing of class litigation, in particular in the funding of claims and the potential for cost consequences in the event the representative plaintiff

loses. Where, as in the notorious large-scale US class actions, high contingency fees have rocketed the annual personal income of some plaintiffs' lawyers into eight figures, there is a real incentive for lawyers to pursue these claims as business ventures. But where rules governing contingency fees largely preclude dramatic windfalls for plaintiffs' lawyers, there is less incentive for plaintiffs' lawyers to approach class actions differently from other litigation.

Of the three Canadian provinces with class actions legislation, the one with the largest capital and consumer market, Ontario, has been the last to permit contingency fee arrangements. In fact, although there has been a recent resurgence of discussion about the possibility of permitting such arrangements for litigation generally, contingency fees are, at present, available in Ontario only in class actions and only in strictly-defined situations.

Contingency fee arrangements in Ontario class actions must be court-approved to be given effect and they must be based on a multiplier, usually between 1.3 and three times the lawyer's billing rate, rather than on a percentage of the award. In addition, the reasonableness of the fees actually billed, both in terms of rates charged and time spent, must be assessed by the court before they become payable. In this way, compensation is provided for the risk associated with contingency fee litigation, but the incentive for lawyers to undertake the risk of prolonged litigation provided by the promise of a substantial portion of the settlement or judgment is significantly reduced.

The Ontario legislation differs from that in British Columbia which permits lawyers, subject to court approval, to set their fees as a percentage of the award. The effect of this difference will be clarified as the case law on court approval of lawyers' fees develops.

Cost-shifting is key

But it is in the area of cost-shifting that the differences between class actions in the US and, in particular, Ontario are the greatest. In the US, where there has been scant provision for plaintiffs being required to indemnify successful defendants for their costs, defendants have had to weigh the cost and risk of defending an action against the cost of settling, knowing that there is no hope of recovering costs if the claim is found to be without merit. In a classic contingency fee situation, US plaintiffs proceed with very limited risk because they are liable for their own lawyers' costs only if they are successful and then costs are paid from the award or settlement monies, and they are never liable for the successful defendants' costs. But in Ontario, although contingency fees have relieved plaintiffs of the risk of paying their own lawyer if unsuccessful in a class action, it remains likely that in most cases unsuccessful plaintiffs will be liable for at least a portion of the defendants' costs, as would an unsuccessful plaintiff in most Ontario litigation.

The disincentive to unmeritorious litigation that cost-shifting creates is even stronger in class actions than in ordinary litigation. Unnamed members of the class are not responsible for a successful defendant's costs – the representative plaintiff alone may be required to pay them. Accordingly, by pursuing a claim as a representative plaintiff, a person may incur significant financial risk for the benefit of unnamed class members. An Ontario court recently considered and rejected the attempt of one ingenious group of plaintiffs to shield themselves from the risk of adverse costs awards by seeking certification for a shell corporation created to serve as a nominee representative.

Aware that cost-shifting could deter the pursuit of meritorious class actions, Ontario established the Class Proceedings Fund. Funding granted by the Class Proceedings Committee may cover a representative plaintiff's disbursements. More important, when funding is granted, the representative plaintiff obtains indemnification from the Fund for the cost consequences of an award of costs to the defendant in the event the claim fails. The Committee's funding criteria, which includes the public interest of the litigation, has been interpreted by some as requiring the Committee to favour applications on behalf of the historically disadvantaged plaintiff classes. If this approach is followed, it would preclude funding for some, perhaps many, product liability actions and most securities claims. Accordingly, the Class Proceedings Fund provisions for reducing the disincentive to plaintiffs created by cost-shifting is likely to have little effect on many cases.

British Columbia chose to adopt the US approach by eliminating costs awards in class actions and, instead, providing courts with discretion to make awards in abusive claims. It would appear then that the risk of facing large-scale multi-jurisdictional class proceedings in British Columbia will be contained instead by the explicit requirement in its class actions legislation that non-residents take the affirmative step of opting in to a class. How this different combination of factors will affect the development of class proceedings in British Columbia remains to be seen. Indeed, in view of the trend to certify multi-jurisdictional classes, it remains to be seen as well whether British Columbia will become an attractive Canadian forum for claims that might otherwise be litigated as individual claims, or as class actions in Ontario or Québec.

What is and is not to be feared

The message for those doing business in Canada is that there is a need to be aware but not unduly afraid of large-scale high-stakes class litigation. In many respects, the rules governing class actions, and litigation generally, in those Canadian provinces that now permit class actions will prevent those doing business in Canada from being subjected to the perceived excesses that developed in the US. But it will be important in the coming years, as North American legislative and jurisdictional frontiers erode, for those doing business in North American markets to keep abreast of developments in the logistics of litigation, particularly class actions, on both sides of the Canada - US border. ■

In the Tory Tory DesLauriers & Binnington contribution to the February issue of *International Commercial Litigation* (The Sting (a case of international fraud)), co-author Monica Bond was incorrectly listed as a member of the firm. This is, in fact, not the case. Ms Bond is a principal in the London office of Linquist Avey Macdonald Baskerville Plc, an international firm of forensic and investigative accountants.