Welcome to Volume 1, Issue 3 of McCarthy Tétrault Co-Counsel: Litigation.

If there is one thread running through this edition, it would have to be ‘class.’

In the following pages, you will find much to reflect upon from the class action perspective.

Articles feature McCarthy Tétrault’s announcement of the second edition of Defending Class Actions in Canada, which includes the latest developments transforming class action litigation.

On the national front, three articles from Québec offer three case comments: a noise pollution matter that raises the issue of when an indeterminate class is proposed for certification, does the motion judge have to redefine that class for the representative?; a second from the Québec Court of Appeal that appears to raise doubts over the viability of truly national class actions in the Canadian context; and a third in which the Supreme Court of Canada for the first time hears a class action suit in an environmental matter originating from that province.

On the international front, we look at the significant risk that judgments approving a worldwide settlement class will not be enforced in most, if not all, European countries.

In his regular commentator post “Farley’s Reflections,” the Honourable James M. Farley, looks closely at the Supreme Court of Canada class action case, Kerr v. Danier Leather, drawing to our attention some very important ‘unanswered questions.’ Entitled “Leather’s Labour Lost — By Class Action Plaintiff” this article gives a nod to another classic, William Shakespeare’s Love’s Labour’s Lost.

With our eye on developments here and abroad, we also look at the preliminary report of the Ontario Civil Justice Reform Project from the Honourable Coulter Osborne, which provides recommendations on how to make civil litigation more accessible, affordable and, for members of the Bar themselves, more civil and classy.

In trade law, we examine the federal government’s near ratification of the International Centre for Settlement of Investment Disputes (ICSID) Convention, an important tool for Canadian investors abroad for international arbitration.

In competition, be sure to look at the analysis of Akzo Nobel Chemical Ltd. et al. v. Commission of the European Communities for a recent decision of the European Court of First Instance highlighting the differences in the treatment of legal privilege in other jurisdictions.
For in-house counsel, an article on managing the risk in records retention may also be of interest.

Lastly, in contract, we would be remiss if we didn’t give a promotional plug for Canadian Contractual Interpretation Law, a new classic by our own Editor-in-Chief, Geoff Hall, which will appeal to litigation lawyers from all walks of life.

In short, we think this edition is in a class all its own!

We welcome your questions and comments. If you are not a current subscriber and would like to receive it in the future, simply contact us to have your name added to our list.

Yours truly,

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February 2008
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Publications

Defending Class Actions in Canada: A New Edition for A New Period in Class Action Litigation

McCarthy Tétrault is pleased to announce the second edition of Defending Class Actions in Canada. This new edition reflects the major changes that are currently transforming class action litigation. Legislative initiatives, recent cases, hot button issues and strategic thinking are all discussed in this primer designed for the class action defendant. More than an overview of the law, Defending Class Actions in Canada, 2nd Edition provides managers and in-house counsel alike with useful advice on how to avoid, contest, settle and conduct class action proceedings. Compact and accessible, it is a must-read for businesses.

In recent years, class actions have grabbed the spotlight. More than any other area of civil litigation, they have entered the public vocabulary and caught the interest of average Canadians. Media from across the country regularly report on the latest high-profile cases, which can involve popular products, tragic events or controversial issues of social policy. Often, the damages claimed are considerable. It is not unusual to read about multi-billion dollar lawsuits which can potentially bankrupt corporate defendants. For these reasons, it is essential for the business community to understand the powerful forces that are reshaping the legal landscape.

- **New legislation** — Almost all the provinces and territories of Canada, including the federal government, have adopted class action statutes of their own. This additional layer of legislation means that companies operating in different parts of Canada are potentially subject to different rules and regulations. Accessing, understanding and applying this legislation are all key to protecting the rights of your business. Which laws apply to you?

- **New amendments** — In 2003, Québec amended its Code of Civil Procedure in order to facilitate the authorization of class actions. Plaintiffs are no longer required to file an affidavit with their motion to commence proceedings, which can now only be contested orally. This has made it more difficult for defendants to challenge class actions at the preliminary stage. Do you conduct business in Québec? If so, what might these amendments mean for you?

- **New targets** — Class actions are very adaptable procedures. They can involve everything from products liability to mass torts to environmental damage to financial services. In short, no sector of economic activity is immune from litigation. What risks are your company exposed to?

- **New problems** — As class actions increase in number and size, they are also growing in complexity. Issues that have never been
contemplated before are now being argued in courts across the country. Industry-wide class actions, class arbitration and securities class actions, to name but a few, point to new forms of litigation that are already taking hold in some provinces. What do defendants need to know about these innovations?

- **New solutions** — More than an analysis of important developments, *Defending Class Actions in Canada, 2nd Edition* provides readers with advice on how to avoid, manage and defend against class actions. Preventive measures, public relations, settlement tactics and litigation strategy are all discussed. More than a legal proceeding, a class action is a traumatic event in the life of any business. The stakes are often high and the public exposure significant. Although a book can never replace sound legal counsel, it can provide vital information and answer the big questions that all potential defendants must ask.

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**Canadian Contractual Interpretation Law**

Most contract disputes involve issues of interpretation. Even seemingly innocuous contract language can give rise to vehement disagreements over its proper meaning. Indeed, one famous American contractual interpretation case began with the sentence, “The issue is, what is chicken?”: *Frigaliment Importing Co. v. B.N.S. International Sales Corp.* What followed was a comprehensive examination of the meaning of the word “chicken” — a word which would hardly seem to be one that could engender much debate — in the context of the particular agreement.

Resolving questions of contractual interpretation is everyday work for the courts, which face such issues far more often than they face issues of substantive contract law. Doctrines such as offer and acceptance, consideration and unconscionability may be standard fare in first-year contracts courses in law school, but they rarely arise in practice. For the parties, the financial stakes of an interpretation case can be enormous: consider, for example, the famous “Rogers comma,” in which a $2-million dispute turned on the effect of a comma.

Yet until now no book has focused exclusively on contractual interpretation by Canadian courts. This void in the legal literature has now been filled by Geoff R. Hall, a litigation partner in the firm’s Toronto office (and also the Editor-in-Chief of this publication), who has authored *Canadian Contractual Interpretation Law*, published by LexisNexis Canada Inc. in October 2007.
Canadian Contractual Interpretation Law undertakes a thorough overview of the law of contractual interpretation in all common law provinces. It begins with an examination of certain fundamental precepts which are the cornerstone of contractual interpretation in all cases, including the factual matrix, commercial efficacy, the parol evidence rule and the contra proferentem rule. It then considers a number of other elements of contractual interpretation, such as whether prior drafts, subsequent conduct and dictionaries can be considered by a court when interpreting a contract. It discusses the interpretation of a number of different types of contracts (such as employment contracts, guarantees and releases) and the interpretation of a number of different types of clauses (such as arbitration clauses, best efforts clauses, entire agreement clauses, exemption clauses and time-is-of-the-essence clauses). It also reviews implied terms, agreements to agree, rectification and the ever-confusing duty of good faith in the performance of contractual obligations.

McCarthy Tétrault Notes:

The book is designed to be of use for litigation lawyers arguing contract interpretation cases, transactional lawyers seeking to avoid interpretive disputes and judges hearing contract interpretation cases. It is available at www.lexisnexis.ca/bookstore.

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Class Actions

Enforcing Canadian Class Action Judgments Abroad — No Easy Task

There is a growing trend in class action settlements, particularly in price-fixing actions, for defendants to seek certification of a worldwide settlement class. However, there is a significant risk that judgments approving a worldwide settlement class will not be enforced in most, if not all, European countries. As a result, defendants may pay for a worldwide release of their liability that they will not actually receive.

Canada and the United States have class action legislation. European countries do not. Some European countries are beginning to investigate and/or to introduce various forms of ‘collective redress’ actions which have some similarities to class actions. The European Commission announced this past March, in an initiative supported by the European Parliament, that it was studying the viability of continent-wide collective redress legislation. However, whether and on what basis a class action judgment from Canada will be enforced in Europe or a European collective redress judgment will be enforced in Canada are open questions.

Existing laws and treaties for enforcing conventional foreign judgments are not well suited to deal with the unique due process, jurisdictional and other issues created by cross-border class action judgments. The assumption is that, at a minimum, the requirements set out in these existing laws in each country will have to be met before a class action judgment from one jurisdiction will be enforced in another jurisdiction. The issue is whether these general rules can be applied to determine whether a foreign class action judgment should be enforced or whether additional rules are necessary.

In considering this question, one has to look at the types of plaintiffs or ‘claimants’ against whom a class action judgment might be enforced. Such claimants can include:

- the representative claimant named in the action;
- claimants who are permitted to opt into a class action that is commenced by others; and
- “absent” claimants, that is, claimants who are included in an action as a result of the governing class action legislation unless they take active steps to opt out of the action.

Generally speaking, named claimants and claimants who opt into an action cannot complain later if a judgment in the action is enforced against them elsewhere. The effect of the judgment on their rights is usually contemplated by the existing rules for recognizing and enforcing judgments in named-party litigation.
Absent claimants give rise to the most difficult issues, both substantive and procedural. With respect to substantive issues, a fundamental question will be whether a class action judgment should be recognized regardless of the original jurisdiction’s criteria for permitting such an action. That is, should enforcement be available only where the statute or rules authorizing the class action impose certain minimum requirements?

On the procedural side, the issue is one of fairness and due process — what notice and opportunity to be heard should be provided to claimants, particularly absent claimants, before a court enforces a class action judgment from another country so as to bind all claimants?

There are significant differences between legal regimes around the world which highlight the challenges in attempting to assess whether a class action judgment will be enforced globally. For a defendant, the enforceability of a class action judgment will arise most commonly in situations where the defendant will be seeking to prevent an absent claimant from re-litigating a claim that has been resolved by the defendant’s foreign class action judgment.

At the simplest end of the ‘enforcement’ spectrum are jurisdictions such as Canada, the United States and Australia because each of these countries has true class action legislation. Presumably, these jurisdictions will be more open to enforcing class action judgments from other class action jurisdictions because each country is familiar with and permits similar types of class actions in its own jurisdiction.

At the other end of the ‘enforcement’ spectrum are European countries that do not have class action legislation, do not have the same legal regimes (e.g., civil law vs. common law) and do not recognize legally some aspects of class actions such as punitive damages and contingency fees. In such jurisdictions, there is no certainty that a Canadian class action judgment will be enforced and given the required preclusive effect. New and additional rules are required to eliminate this uncertainty.

**McCarthy Tétrault Notes:**

John P. Brown is the Chairman of the International Bar Association Task Force on International Procedures and Protocols for Collective Redress. The Task Force is comprised of lawyers, academics and jurists from around the world, including Eric Gertner, the head of the firm’s Research Department. Over the past year, the Task Force has studied the issues relating to the enforcement of foreign class action judgments. The Task Force released its report on this subject at the International Bar Association Conference in Singapore in October 2007. The report includes draft Guidelines for Recognizing and Enforcing Foreign Judgments for Collective Redress.

The Guidelines are intended to describe the minimum procedural and substantive rights which a foreign court should be
satisfied were addressed by the court which issued the original judgment before a foreign court should consider enforcing the judgment. These Guidelines are necessary because the existing judicial tests for analyzing traditional ordinary judgments are inadequate for assessing judgments in collective redress actions. The Task Force is currently distributing the Guidelines to select legal, judicial and government officials in various countries around the world for comment.

Québec Court of Appeal Decision re National Class Actions

The recent Québec Court of Appeal decision in Société canadienne des postes v. Lépine appears to raise doubts as to the viability of truly national class actions in the Canadian context of recognizing and enforcing a non-Québec national class action settlement.

The case involves three parallel class claims filed in British Columbia, Ontario and Québec. The B.C. and Québec proceedings were instituted on behalf of residents in each province. The Ontario class action was instituted on behalf of Canadian claimants, excluding those in Québec. Prior to authorization in any jurisdiction, a settlement was reached in the Ontario proceedings. The settlement initially covered Ontario and B.C. claims and was subject to approval by the courts in those two provinces. At the defendant’s request, the settlement was expanded to include all Canadian claims.

At the hearing to approve the settlement in Ontario, legal counsel for the Québec representative claimant argued unsuccessfully that the Ontario court should decline jurisdiction regarding Québec residents who had refused the proposed settlement. The Ontario judgment approved the settlement for all persons in Canada other than those in B.C.

Subsequent to authorization and the institution of a class claim in Québec, the Québec defendant sought recognition of the Ontario settlement judgment and rejection of the Québec claim. The Québec Superior Court refused to recognize the Ontario settlement
judgment, and the Québec Court of Appeal confirms that decision.

While the Québec Court of Appeal recognized the initial jurisdiction of the Ontario courts, it stated that the Ontario court should have declined jurisdiction over Québec residents on the basis of “comity”, the principle that one jurisdiction will extend courtesy to another by recognizing the latter’s judicial acts. The initial decision of the plaintiffs’ lawyers to initiate proceedings in three provinces for the residents in each province was an appropriate and practical way to ensure respect for the principles of order and fairness for each group of claimants.

1. The Court of Appeal recognized the possibility for national and international class actions in principle, particularly where there is a connection between the cause of action and the court chosen as regards all members of the class of claimants. Nonetheless, as the size of the group increases, the court must be vigilant to protect class members outside its jurisdiction, particularly in respect to the question of notices. More specifically, the Court of Appeal could not understand why the Ontario court was guided by a principle of equity as regards the B.C. courts, while not showing the same attitude towards the courts of Québec where the class proceedings were first instituted.

2. The Ontario settlement judgment also failed the requirement that it conform to the fundamental principles of procedure. According to the Québec Court of Appeal, notices published in relation to the Ontario settlement judgment created confusion for Québec residents given prior notices of the Québec class claim. Adequate and clear notices are fundamental to the exercise of class members’ rights to remain with or opt out of a class proceeding.

3. The Court of Appeal found a third basis to refuse recognition of the Ontario judgment in *lis pendens* finding that the Québec and Ontario class claims have the same parties, facts and object, and that the Québec proceedings were pending at the time of the Ontario judgment.

**McCarthy Tétrault Notes:**

The Court of Appeal judgment in *Lépine* applies a rigorous standard to non-Québec class action notices with a view to protecting the rights of Québec residents. More importantly, the decision appears to indicate that, in the context of class actions on a national scale, the rights of class members within each province are best protected through the institution of separate proceedings in each province. Further, recognition of this source of protection appears to be inherent in the principle of comity.

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Keeping Class Definition On the Radar Screen: *Mawhood v. Aéroports de Montréal* and the Pragmatic Approach to Class Definition

When an indeterminate class is proposed for certification, does the motions judge have to redefine that class for the representative? In *Mawhood v. Aéroports de Montréal*, the Québec Court of Appeal found that no such obligation exists. It is the petitioner’s responsibility to identify an ascertainable group of plaintiffs according to the relevant facts. Although a judge may choose to limit the scope of a class, this is a discretionary decision that should only be made under the appropriate circumstances.

*Mawhood*, a noise pollution case, involved a class action brought against the airports of Montréal on behalf of persons who allegedly suffered damages because of airplanes flying overhead or motoring on the tarmac. The class purported to include residents living throughout the city’s greater metropolitan area, including neighbourhoods with a comparatively small amount of air traffic. The class action was dismissed in first instance because of the absence of geographic specificity and the subjective nature of nuisance, which can only be assessed on an individual basis.

In appeal, Justice Pelletier, speaking for the majority, explained that when petitioners inflate a class in order to exercise pressure on defendants, they are taking a strategic risk that could backfire. Here, the claim was for the impressive sum of $183 million, the dice were thrown accordingly and the representative lost. The judge of first instance correctly found that the common issues were drowned in a sea of individual considerations.

Pelletier J. went on to state that although courts should not be unnecessarily harsh towards petitioners — particularly in environmental cases — they should not be indulgent either. Commenting on the reasoning of the Supreme Court in *Western Canadian Shopping Centres v. Dutton* and *Hollick v. City of Toronto*, he noted that a class definition should never be circular or so expansive as to be unintelligible. While a court can redefine a class, it is not called upon to create one on its own initiative.

**McCarthy Tétrault Notes:**

Like *Lallier v. Volkswagen Canada Inc.*, another recent Court of Appeal decision, *Mawhood* states that the onus is on the petitioner, not the judge, to put forward a class that is clearly defined. The case also suggests that, in instances where individual questions qualitatively outweigh common questions, dismissal may well be a more appropriate approach than mere redefinition.

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Environmental Law

The Supreme Court of Canada Hears for the First Time a Class Action Suit in an Environmental Matter Originating from Québec

On May 3, 2007, the Supreme Court of Canada (SCC) agreed to hear an appeal in Ciment St-Laurent inc. v. Barrette (St. Lawrence Cement). This is the first time the SCC will hear an environmental class action originating from Québec. The decision will also serve as a guide to Québec courts in these industries and have significant ramifications for businesses operating in Québec and throughout Canada.

In this case, a group of occupants or owners of residences located near a cement factory in the Québec City area initiated a class action. The members alleged that the business was at fault in operating its plant and that it failed to act in a good neighbourly fashion. They claimed damages for harm suffered due to dust, noise and odours which, according to the members, had reached excessive levels.

At trial, the Québec Superior Court granted relief, although it held that the cement plant had not been guilty of any wrongdoing. The court held the view that the cement plant, as a result of its operations, had caused abnormal inconvenience exceeding tolerable limits. Consequently, it had to be held liable, in the absence of any wrongdoing, pursuant to the applicable rules in matters of private nuisance provided for in Article 976 C.C.Q.

The Court of Appeal of Québec (CAQ) reversed the decision of the Superior Court on this point, unanimously holding that the liability scheme for nuisance claims did not create a personal right of action and could not be the basis for a class action. The CAQ also held that liability could not exist without wrongdoing. The mere evidence of abnormal inconvenience (which, essentially, stems from a subjective appreciation of said inconvenience) was insufficient.

The CAQ decided that Article 976 C.C.Q. could not be the basis for a class action since this provision, in its opinion, creates rights in rem. A class action, by contrast, is a procedural vehicle created exclusively to enable the exercise of personal rights.

After revisiting the evidence, the CAQ reversed the decision of the Superior Court that the cement plant was not guilty of any wrongdoing. In so doing, the CAQ laid down a principle stating that any business must maintain its anti-pollution equipment in optimal working condition at all times during production. In this respect, the CAQ attached greater significance to the compliance or lack of compliance by the business with the statutory duties provided for in the Environmental Quality Act (EQA) and, in particular, Section 12 of the Regulation respecting the application of the Environmental Quality Act (Regulation). On this basis, the CAQ held that the action taken by St. Lawrence Cement was insufficient and that it was guilty of wrongdoing.
McCarthy Tétrault Notes:

Although the fact situation originated in Québec, the decision goes beyond the borders of this province, raising issues of national importance such as the protection of the environment and an analysis of the liability of businesses. Specifically, it raises the significant issues of:

- potential liability of a business for having caused environmental nuisance to its neighbours;
- the extent to which legislative standards in environmental matters are relevant to assessing such liability; and
- the role class actions play in environmental disputes.

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Ontario Government Releases Report on Civil Justice Reform: Recommendations Aim to Reduce Expense and Delay in Civil Litigation

On November 22, 2007, the Ontario government released the preliminary report of the Civil Justice Reform Project (the Project). The Project — headed up by the Honourable Mr. Coulter Osborne, a former Associate Chief Justice of Ontario — was charged with delivering practical recommendations on how to make civil litigation more accessible and affordable to Ontarians. The Project consulted broadly with members of the judiciary and the bar.

The preliminary report, which was presented to Attorney General Chris Bentley, makes over 80 recommendations covering issues that range from access for unrepresented litigants to the use of technology in courtrooms. In making his recommendations, Osborne was guided by the overriding principle of proportionality, recognizing that the “time and expense of any proceeding should be proportionate to the amount in dispute and the importance of the issues at stake.” We highlight some of the recommendations below.

Disposing of Matters Summarily

Civil actions do not always require a full trial; many can be dealt with in a more summary fashion. Under Rule 20 of the Rules of Civil Procedure, a court can grant summary judgment where there is “no genuine issue for trial.” The report recognizes, however, that the current functioning of the summary judgment procedure is flawed. Osborne acknowledges that the Ontario Court of Appeal’s interpretation of the powers of a summary judgment motion judge or master “has limited the effectiveness of the rule.”

The report recommends granting the court “the express authority to do what some decisions of the Court of Appeal have said a motion judge or master cannot do.” Specifically, courts should be permitted on a summary judgment motion to weigh evidence, draw inferences and evaluate credibility in order to determine if no genuine issue for trial exists.

The report also recommends introducing new procedures to dispose of matters summarily. If, in the course of a summary judgment motion, the need arises for a brief trial on one or more issues, the motion judge or master should be permitted to conduct a “mini-trial.”

Further, Osborne recommends the adoption of a new summary trial mechanism, similar to that used in British Columbia, where issues can be decided on written evidence alone. He notes that a summary trial procedure would allow for the early disposition of cases without the cost and delay associated with other pre-trial steps.

Reducing the Cost and Delay Associated with Discovery

Much work has been done in the area of document discovery, particularly regarding best practices for electronic discovery. The Ontario
Discovery Task Force has developed a set of non-binding e-Discovery Guidelines, and a working group of the Sedona Conference has published a draft set of principles related to document discovery in Canada. Rather than introducing new rules, Osborne recommends encouraging greater compliance with the already established e-Discovery Guidelines and Sedona Canada Principles. A practice direction issued by the court could provide judges and masters with the authority to sanction parties when these guidelines are not followed.

In a further effort to reduce cost and delay, Osborne recommends narrowing the scope of discovery. The current state of the law requires that all documents be disclosed and all answers on discovery be answered if they bear a “semblance of relevance” to a matter in issue in the case. In his report, Osborne recommends moving to a stricter test of “relevance.” This is needed, Osborne notes, “to provide a clear signal to the profession that restraint should be exercised in the discovery process.”

Also of note, Osborne recommends:

- reducing the time and cost associated with motion and trial scheduling by eliminating trial assignment court and setting more specific times for motions;

- increasing the monetary jurisdiction of the Small Claims Court from $10,000 to $25,000 over a period of two years;

- increasing the monetary jurisdiction of the Simplified Procedure rules from $50,000 to $100,000 as soon as practicable;

- mandating the use of a litigation budget, whereby lawyers would set out the expected costs of a proceeding to their clients at the outset of any litigation;

- rethinking the current case management regime so that cases are only managed by the courts when necessary; and

- reforming the rules relating to the use of experts to reduce costs.

A final report is expected to be delivered shortly. It will then be up to the Attorney General to determine if and how these recommendations should be implemented.

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Scope of Solicitor-Client Privilege in Europe

In the context of international cartel investigations by competition law authorities, a recent decision of the European Court of First Instance highlights the differences in the treatment of legal privileges in other jurisdictions.

In *Akzo Nobel Chemical Ltd. & al. v. Commission of the European Communities*, the court had to determine whether certain documents seized by the Commission in the context of a competition law investigation were covered by the “legal professional privilege,” also referred to as solicitor-client privilege. These documents consisted of the following:

1. a memorandum from a general manager to one of his superiors, containing information gathered from employees for the purpose of obtaining outside legal advice in connection with the company’s competition law compliance program; the memo bore handwritten notes referring to contacts with outside counsel, including his name; and

2. the general manager’s handwritten notes from discussions with employees, which were used to prepare the above memorandum; and

3. two e-mails exchanged between the general manager and a lawyer from the company’s legal department.

The court pointed out that European law recognizes the right of every person to consult, without constraint, a lawyer whose profession entails giving independent legal advice. The court also acknowledged that the protection of the confidentiality of written communications between lawyer and client is an essential corollary to that right. This means not only that the Commission cannot use privileged documents as evidence in a decision imposing a penalty, but that the Commission must refrain from reading the contents of documents over which privilege is claimed until a final decision is made. However, because privilege is an exception to the Commission’s powers of investigation, it must be construed restrictively. Thus, the person claiming privilege bears the burden of proving that the protection actually applies.

The court accepted that preparatory documents, such as working documents or summaries which present the information necessary for the lawyer to understand the context, nature and scope of the facts for which legal assistance is sought, could be privileged even if they were not exchanged with a lawyer or not created for the purpose of being sent physically to a lawyer. However, privilege over preparatory documents will be recognized only if such documents were drawn up exclusively for the purpose of seeking legal advice. The mere fact that a document has been discussed with a lawyer is not sufficient. The court held that the general manager’s memorandum and handwritten notes, which
were not addressed to a lawyer and which made no mention of seeking legal advice, did not meet that test and were not privileged.

As for the e-mails exchanged between the general manager and in-house counsel, the court reaffirmed its controversial jurisprudence denying privilege to communications with in-house lawyers. The court held that to attract privilege, legal advice must be provided “in full independence,” which means by a lawyer who is a third party, structurally, hierarchically and functionally, in relation to the corporation receiving the advice. A lawyer bound to his or her client by a relationship of employment does not meet this requirement. As a result, only communications with outside lawyers for the purpose of seeking legal advice are protected by privilege.

**McCarthy Tétrault Notes:**

In the context of increasing globalization, it is useful to know the extent to which communications with lawyers will be protected in various jurisdictions. Despite heavy criticism, European authorities continue to deny protection to communication with in-house lawyers, and this should be kept in mind in all internal communications. As for documents that may be used in seeking legal advice, the European approach is more restrictive than Canadian law in requiring that such documents be prepared for the exclusive purpose of seeking legal advice. However, since in both cases the burden of establishing privilege falls on the corporation, the *Akzo Nobel* decision reinforces the importance of clearly identifying as privileged all documents which are prepared for the purposes of seeking legal advice.

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E-Discovery

Records Retention: An Overview

Records retention poses an increasing risk to businesses from the perspective of management and operations. The explosion in the frequency of use and amount of electronic records, including e-mail, has created a need to carefully manage records of all types, lest a company run afoul of the growing number of statutory requirements being enacted, as well as the evolving common law standards. Obviously the risks associated with the increasingly informal use of e-mail communication can create exposure for companies where it did not exist before.

To be prudent, each company should assess applicable statutory requirements. These include time, form and location of records, which may be prescribed by statutes specific to a company’s business lines or generally in the context of company’s business type (e.g., corporation, partnership, trust, etc.). This says nothing of requirements that will cut across many boundaries, such as those imposed by the Income Tax Act. Most statutes provide for sanctions for failure to comply with the requirements.

One of the most typical common law doctrines that arises regarding records retention is the doctrine of spoliation. In short, spoliation is “the destruction or material alteration of evidence, or potentially the failure to preserve property for another’s use as evidence in litigation that is pending or reasonably foreseeable.” This doctrine can apply to anyone who knows or ought to know of the significance of the evidence. It may apply to deliberate acts of destruction, as well as to unintentional acts of destruction.

A finding of spoliation may result in an adverse inference against the party who destroyed the evidence. Such a finding may also increase damages and could even potentially render the spoiler’s pleadings to being struck, not to mention the possibility of a contempt of court finding if the records were subject to an active process before the courts.

Courts in the United States have gone the furthest in this respect, including suggesting:

- significant damage awards may be appropriate for the destruction of potentially relevant evidence;
- the duty to preserve arises before litigation commences;
- counsel (both in-house and external litigation counsel) have a duty to ensure documents are preserved;
- counsel have a duty to ensure the client has a document retention and filing plan; and
- counsel may be personally sanctioned for failure to follow the foregoing.
McCarthy Tétrault Notes:

The key to minimizing the risk is to develop a company-wide records retention policy. Without an effective records retention policy, an organization faces numerous risks, such as:

- destroying records that it is required by law to keep;
- keeping records that it is required by law to destroy;
- destroying records that should be kept, based on sound litigation policy;
- exposing itself to allegations of spoliation, potential adverse inferences and costs penalties in litigation;
- exposing itself to litigation costs associated with recovering ‘destroyed’ electronic information; and
- exposing itself to unnecessarily high costs associated with document production during a lawsuit.

When preparing a firm-wide policy for records retention, key considerations include:

- specific retention periods that affect your organization;
- general application statutes and industry-specific statutes;
- form and location for maintaining records, as well as the proper duration;
- offence prosecution times;
- classification of documents included to assist in asserting the protection of privilege;
- breadth of policy (necessary documents are retained, and unnecessary ones are not);
- a cost/benefit analysis;
- clear identification of who will be responsible for ensuring compliance with and enforcement of the policy;
- how the employees will be informed;
- what discretion an employee will have; and
- how this will integrate with other company policies (IT, privacy, security, etc.).

Finally, the policy should address when and how to implement a ‘litigation hold’ to stop any automated destruction of records that the policy would otherwise permit when litigation is anticipated, or is active.

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Feds Near Ratification of ICSID — Important Tool for Canadian Investors Abroad

The federal government is near to completing its share of the legislative role in ratifying a very important tool for the resolution of investor-state disputes. On October 29, 2007, the Minister of Foreign Affairs introduced Bill C-9, *An Act to implement the Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention)* in the House of Commons. Canada signed the International Centre for Settlement of Investment Disputes (ICSID) Convention last December.

The bill passed first reading and second reading on October 29 and was referred to the Standing Committee on Foreign Affairs and International Development. The Committee reported on the bill, without amendments, on November 28. It will now pass back to the House of Commons for a third reading before being considered by the Senate and ultimately receiving Royal Assent, after which it becomes law.

Because of Canada’s federal structure, the provinces must also adopt legislation to support the ICSID Convention. To date, Ontario, British Columbia, Newfoundland and Labrador, Nunavut and Saskatchewan have passed such legislation. The federal government has promised that it will continue to seek support from the other provincial/territorial legislatures prior to ratification.

Once ratified, Canadian investors in other ICSID member countries and foreign investors in Canada will be able to avail themselves of the dispute resolution mechanisms under the ICSID Convention via investment treaties or investment contracts. Jurisdiction of the ICSID Convention is limited to those instances where a foreign investor’s home state and the host state where the investment is made are both ICSID member countries.

The investment dispute settlement provisions of Canada’s free trade agreements (including NAFTA’s Chapter 11) and Canada’s Bilateral Investment Treaties (BITs), generally provide that disputes between investors and the host government may be resolved through arbitration under the ICSID Convention. However, until ratification, recourse must be made to either the Additional Facility Rules of ICSID or the ad-hoc UNCITRAL Rules under these instruments.

Among the parties to NAFTA, only the United States has ratified the ICSID Convention, meaning that until Canada’s ultimate ratification, NAFTA Chapter 11 arbitration under the ICSID Convention remains unavailable to both Canadian investors in the United States and American investors in Canada.

After ratification, Canadian investors will also have the option of negotiating arbitration clauses that provide for ICSID arbitration in any investment contracts with foreign governments that are parties to the ICSID Convention.
ICSID, an organization of the World Bank that offers facilities for arbitrating investment disputes, came into existence via the ICSID Convention in 1965. As of November 4, 2007, it has been signed by 155 countries, of which 143 have proceeded to ratification. The majority of Canada’s trading partners, including the United Kingdom, China, Japan, Germany, France and Chile, have already ratified ICSID. Notable trading partners who are not yet signatories include Brazil, India and Mexico. Bolivia, the first member ever to do so, recently withdrew from ICSID, effective November 3, 2007. There have been some rumblings that Venezuela and Ecuador will soon follow.

McCarthy Tétrault Notes:

The main advantage of conducting an arbitration under the ICSID Convention is that it contains its own review and enforcement mechanisms. Arbitral awards issued under the ICSID Convention are binding on the parties and not subject to review except as provided for under the ICSID Convention. An administrative ‘appeal’ may be made to the ICSID Secretary-General for an annulment of award on any one of five narrow enumerated grounds. Awards cannot be challenged outside of ICSID, and national courts have no power to review an ICSID Convention award. Parties to the ICSID Convention are bound to recognize the award as binding and to enforce it as if it were a final judgment of a national court.

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Farley’s Reflections

Leather’s Labour Lost — By Class Action Plaintiff

The litigation in the Kerr v. Danier Leather Inc. case finally wound its way to an end this past October with the release of the decision of the Supreme Court of Canada (SCC) written by Justice Binnie. The issued reasons at the various court levels raise some interesting questions which appear unanswered.

Danier’s initial public offering prospectus, filed as a preliminary on April 6, 1998, had a forward looking financial forecast for the balance of its fourth quarter ending June 27. An internal analysis, prepared after the final prospectus was held on May 6 but before the offering closed on May 20, showed Danier’s fourth quarter results falling substantially below its forecast. Danier did not disclose this forecast prior to closing.

The plaintiffs brought a class action proceeding for prospectus misrepresentation pursuant to s.130(1) of the Securities Act (Ontario). In finding Danier liable, the trial judge concluded that the prospectus impliedly represented that the forecast was objectively reasonable, not only as of the date of the prospectus but also as of the date of closing. The poor results were found to be material facts required by s.130(1) to be disclosed before closing. Thus the implied representation, though true on the filing date, was false on closing.

The trial decision was reversed on appeal since the appellate Court was determined that s.57(1) provides a complete code that only requires a material change, not a material fact, to be disclosed during the distribution period prior to closing. The SCC dismissed the appeal.

The case eventually boiled down to a question of statutory interpretation and the difference in the definition between “material fact” and “material change.” Material fact encompasses “a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.” The emphasized portion of that definition is repeated in the definition of material change, but this definition is narrowed by relating it to “a change in the business, operations or capital of the issuer.”

We now know from the Court of Appeal decision that if all 55 Danier stores had burned down in the interim period, this would have been a material change that would have required a prospectus amendment. Such an event would not have been merely a material fact as discussed by the trial judge.

It was eventually determined by Danier’s CEO and CFO that unseasonably hot weather was the problem in the significant sales downturn of the first portion of this fourth quarter. The traditional Victoria Day sale held immediately after closing was a flop. A press release was given on June 4 indicating sales and net income for that quarter would be substantially reduced as a result of the weather conditions. The share price of the new issue slumped immediately.
by 22 per cent. It took a year to recover from this drop. An extraordinary “50 per cent off everything in the store” promotion increased sales to somewhere close to the original forecast. Interestingly, not only did sales rebound, but net profits also came close to the prospectus forecast. This recovery appeared to impress at least the Court of Appeal. But how was it achieved?

In reviewing the wording of the relevant sections and policy reasons, the appellate courts held that only a material change had to be disclosed in the period of distribution between the date of the prospectus and the closing of the offering — not any material fact which would include weather and its effect upon financial results. Justice Binnie referred to the 1983 remarks of a former chair of the Ontario Securities Commission in discussing disclosure requirements that “This is an attempt to relieve reporting issuers of the obligation to continuously interpret external political, economic and source developments as they affect the affairs of the issuer, unless the external change will result in a change in the business, operations or capital of the issuer, in which case, timely disclosure of the charge must be made” [emphasis by Justice Binnie].

Thus once a prospectus has been filed, it would seem that the major relevance of a material fact event would relate to the prohibition against insider trading while possessing undisclosed material facts. However if one steps back and analyzes the policy elements, query which entity in an IPO distribution situation functionally, if not legally, fits the role of the overwhelming major insider other than the issuer company itself. One wonders whether the Ontario Superior Court will request the government to amend the Securities Act to provide protection to purchasers in the distribution period from at least forecast material fact changes. After all, one presumes that a purchaser would be interested in that period over something that is within the control of the issuer (forecasting) and that has a significant effect on the value or price of what is being bought. It is curious that the legislation requires that a prospectus contain a certificate that there has been full, true and plain disclosure of all material facts prior to going final. However, the legislation does not require disclosure of internal material facts after the prospectus goes final notwithstanding that these would affect the value or price of the securities being distributed pursuant to that prospectus.

How does one conduct a 50 per cent off sale to increase sales (query whether there may also be some advertising issues regarding what was referred to as a two ticket policy) but at the same time increase profits and seemingly margins? If normal selling prices are slashed, but costs are fixed, then margins are squeezed and profits under siege, if not under water. This was unaddressed by Justice Binnie, but buried in the other reports is an indication that there was an $800,000 positive inventory adjustment which appears to be instrumental. Is it not reasonable to question on what basis this adjustment was made and why it was not made prior to the prospectus going final?
Danier cited its daily sales computer tracking system as one of its significant business tools; one would presume that management would be able to note discrepancies in year to year patterns reasonably easily and rather immediately. However, its CEO and CFO indicated that they were not all that concerned that the internal review prior to closing indicated revenues falling short of the forecast. Part of the explanation was that the sales in the quarter were front-end loaded by virtue of the incentives to the sales force that were designed to have sales occur earlier in the quarter to achieve bonus targets for the earlier portion. It was said that these sales would normalize over the full quarter so that the full quarter sales would be better. This would seem to be counter-intuitive (for if one front-end loads sales, then sales in the last portion of the period would logically have to be smaller to ‘average out’), but this point does not appear to have been questioned in the reasons.

The appellate courts whacked the representative plaintiff Durst with a costs award against him of well in excess of $1 million. Justice Binnie observed that Durst was a wealthy man who also had made $1.5 million on the eventual sale of the shares he bought in the IPO — but this ignores what he might have made if he had been able to sell earlier without the blemish of the price drop on the release of the revised forecast, all other things being equal. Justice Binnie went on to say that Durst had not “raised a ‘novel point of law.’” As we have seen, the heart of the case is simply a shareholder dispute over a lot of money requiring the application of well settled principles of statutory interpretation to particular legislative provisions. This is the usual fodder of commercial litigation.” Are the only representative plaintiffs entitled to enjoy the potential prospect of not having to pay costs in a losing cause? To those who are not wealthy? Does that possible attitude ignore the reality that, in many class proceedings, the functional plaintiff and driving force is the law firm which operates on a contingency basis and frequently gives an indemnity to the rather nominal named plaintiff?

Interestingly enough, the Court of Appeal stated in the first paragraph of its decision:

Does the prospectus contain an implied representation of the forecast that is objectively reasonable? If so, in assessing the objective reasonableness of the forecast should the court give any weight to the business judgement of the company’s senior management? Under Ontario’s Securities Act, does the company have a continuing obligation to disclose material facts that cast doubt on the objective reasonableness of the forecast, and that would likely adversely affect the company’s share price? These important questions all arise in this litigation, a class action for prospectus misrepresentation.

However, in its costs ruling, that court observed that “the case does not raise issues of genuine interest or importance to the public at large.” I may be mistaken, but I seem to recall that the appellate courts took the fairly unusual step of publicizing the release date of their reasons, so presumably they thought...
these decisions had more than the usual importance. The trial judge’s costs ruling disclosed that the defendants had made an offer which could be taken as compensation of $1.50 per share, so it would seem that there was a valid concern on their part as to potential liability. The plaintiff’s side held out for $2.35 a share being the full amount of the price drop. Certainly this would not have helped Durst when the appellate courts went against him. This also illustrates why it is dangerous not to appreciate that very few cases are absolutely certain one way or the other — except that once the final court has spoken, a bird in the hand that may be worth two excellent, but losing, legal arguments in court.

However, one issue was dealt with so as to set right an inadvertent misstep at the Court of Appeal concerning the Business Judgment Rule:

Justice Binnie set the record straight regarding the Business Judgment Rule (see my earlier reflections in the March – June 2007 issue of this publication as to the nature of this Rule) when it intersects with a statutory disclosure (or other statutory obligation) requirement. Contrary to the musings of the Court of Appeal, he correctly noted that the statutory requirement prevails. The Rule can only be invoked where the directors and officers have canvassed in a reasonable fashion the pros and cons of the alternatives open to them in making a decision. But in the case of a statute directing what must be done, there are no alternatives — only the course of action which the statute has laid out.

In conclusion, it gets curioser and curioser — and in the end, perhaps all that is left is the grin of the Cheshire cat who must be enjoying the appropriate analysis of the Business Judgment Rule in this context.

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