LITIGATION - CANADA

Court of appeal certifies class action dominated by foreign investors

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Introduction

A divided Court of Appeal for Ontario recently granted certification to a global class of accredited investors in an auditor's liability claim, and held that there is no independent principle of restraint to which a court should adhere when certifying a global class.(1) In *Excalibur Special Opportunities LP v Schwartz Levitsky Feldman LLP*, the court of appeal held that Ontario's connection to a class action was sufficient where one member of the class carried on business in Ontario, the defendant was resident and carried on business in Ontario, and the class was small and all members were known.

Excalibur creates a precedent for parties seeking to certify global class actions in Ontario, but will also limit the comfort that parties take in their certification decisions. The court of appeal reversed the first-instance decision, which had been upheld by a majority of the Ontario Divisional Court.

Facts

Plaintiff Excalibur Special Opportunities LP (ESO) is organised under the provincial laws of Manitoba, but operates in Ontario. ESO was one of 57 'accredited investors' that invested in a Chinese hog production company, incorporated in Nevada, that planned a reverse takeover of a Delaware company and a private placement under the US Securities Act of 1993. The group of investors comprised 50 Americans, five global investors and one other Canadian investor from British Columbia. The defendant – SLF, a Toronto and Montreal-based accounting firm with stated expertise in auditing Chinese companies – prepared an audit report certifying that the financial statements presented by the hog producer were financially accurate. The US promoters of the private placement attached this clean audit report as an exhibit to a private placement memorandum circulated to the accredited investors.

Within a year, the accredited investors learned that the company lacked financial controls over its all-cash business. Within 22 months of that disclosure, ESO lost its US$400,000 investment and the proposed class lost a total of US$7.5 million when the hog producer went out of business. The plaintiffs alleged that all of the accredited investors relied on the clean audit report in their decision to invest in the hog producer and sought to certify a class action against SLF for the torts of negligent misrepresentation and negligence.

Lower-court decisions

At first instance,(2) Justice Perell held that *Excalibur* was not an appropriate case to certify a global class. In the judge's opinion, Ontario did not have a real and substantial connection with the claims of 56 of the 57 investors and Ontario's connection with ESO, a Manitoba partnership, was "modest if not trivial".(3) It would not be reasonable for the non-resident class members to expect that their rights

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would be determined by a foreign court, as they were "non-residents in Ontario making substantial investments in American dollars in an American corporation in a transaction that was governed by American corporate and securities law".(4) Assuming jurisdiction in this case would not demonstrate the "restraint required" of Ontario courts "under the principles of order and fairness".(5)

The judge also held that a class action was not a preferable procedure. He noted that *Excalibur* was far from the "quintessential case of a class proceeding for a purely economic loss",(6) where there is an economic barrier to access to justice because the individual cannot bring forward a claim because of the high cost that litigation would entail in comparison to the modest value of the claim.(7) Instead, *Excalibur* was a situation where joinder of claims would provide effective redress for ESO and other investors which could join as co-plaintiffs.

A majority of the Ontario Divisional Court upheld the decision both on jurisdiction and on preferable procedure.(8) With respect to the latter, the divisional court stated that "[j]oinder is not simply an alternative, it is the default position in considering whether a class proceeding is or is not the preferable procedure".(9)

Appeal decision

Jurisdiction

The plaintiffs successfully appealed and the Court of Appeal of Ontario held that the motion judge had erred in approaching the question of whether there was a real and substantial connection between Ontario and the cause of action with "restraint".(10) Rather, the court of appeal found that the test for whether a court should assert jurisdiction over foreign class members is the test for asserting jurisdiction articulated in *Club Resorts Ltd v Van Breda*.(11) Ontario had jurisdiction as the facts exhibited three of the four presumptive *Van Breda* factors: it was an action for negligence and negligent misrepresentation against a defendant resident and carrying on business in Ontario, which had drafted the impugned clean audit report in Ontario.

The majority took the view that the motion judge could not have concluded that Ontario had a "modest" or "trivial" connection to the claim had he properly characterised the nature of the proposed action. It was an error for the motion judge to re-characterise the claim in the way that he did. The action as pleaded in the plaintiffs' claim was an action against an accounting firm carrying on business in Ontario and Montreal, for audit work done in Ontario by a partner in SLF's Toronto office, and ESO was a Toronto-based company registered in Manitoba which had made the ill-fated investment out of its Toronto office.

In his dissent, Justice Blair opined that there was never a dispute as to whether the Ontario court had jurisdiction *simpliciter* over the proposed class proceeding; rather, the question was whether it was "appropriate" to certify a global class in this situation. As the motion judge had committed no error of fact or mixed fact and law in this analysis, Blair found that his decision should be accorded deference.

Preferable procedure

The court of appeal also addressed how the preferable procedure criterion should be analysed, explaining that plaintiffs need not show that a class action is necessary – only that it is preferable. In particular, the court of appeal rejected the divisional court's characterisation of joinder as the "default" procedure and clearly stated that there is no "default" procedure in the assessment of the merits of a class proceeding.

The court engaged in the analysis prescribed by the Supreme Court in *AIC Limited v Fisher*,(12) finding that a number of factors militated against adopting joinder as the preferable procedure, including:

- barriers to access to justice for proposed class members with smaller claims;
- lack of evidence on the feasibility of joinder;
- the fact that successful plaintiffs would have an enforceable Ontario judgment against an Ontario defendant; and
- the fact that class actions are more effective than individual actions in terms of regulatory oversight.(13)

In his dissent, Blair again emphasised that the court should be deferential to the motion judge's decision, in recognition of his role as "gatekeeper". In his view, the motion judge had conducted the preferable procedure analysis with a view to the goals of judicial economy, behaviour modification and access to justice. However, Blair agreed with the court of appeal that the divisional court had erred in characterising joinder as the "default position" in the preferable procedure analysis.

Comment

Class action counsel should take note of the court of appeal's decision in *Excalibur*, which offers perspective on the preferable procedure analysis and certification of a global class, as well as the deference accorded to the certification judge. Similarly, counsel advising auditors should also be aware that, if litigated on its merits (in this action or if followed in another case), this decision has the potential to expand the liability of auditors. At first instance, the motion judge held that the novel claim against the auditors for negligence in giving the clean audit report could stand alongside the claim for negligent misrepresentation relating to the false statements of the clean audit report, as it was not "plain and obvious" that the novel claim for negligence was legally untenable.(14) Despite the fact that this was not a main issue on appeal by the time the case made it way to the court of appeal, it remains a notable development.

For further information on this topic please contact Norm Emblem, Jessie Lamont or Aoife Quinn at Dentons Canada LLP by telephone (+1 416 863 4511) or email (norm.emblem@dentons.com, jessie.lamont@dentons.com or aoife.quinn@dentons.com). The Dentons website can be accessed at www.dentons.com.

Endnotes

(1) *Excalibur Special Opportunities LP v Schwartz Levitsky Feldman LLP*, 2016 ONCA 916 (CA).

(2) 2014 ONSC 4118 (Perell).

(3) Perell at para 147.

(4) Perell at para 130.

(5) Perell at para 129.

(6) Perell at para 202.

(7) Perell at para 203.

(8) 2015 ONSC 1634 (Div Ct) paras 28-36.

(9) 2015 ONSC 1634 (Div Ct) at para 13.

(10) CA para 26, citing the proposition in *Currie v McDonald's Restaurants of Canada Ltd* (2005), 74 OR (3d) 321.

(11) 2012 SCC 17.

(12) 2013 SCC 69.

(13) *Green v Canadian Imperial Bank of Commerce*, 2014 ONCA 90.

(14) Perell at para 21.

Appeal decision