# *SILVER V. IMAX* AND *AINSLIE V. CV TECHNOLOGIES*: WHAT HAS BEEN LEFT OUT OF THE LEAVE REQUIREMENT

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## A. INTRODUCTION

On 31 December 2005, with the enactment of Bill 198,[1] the new Part XXIII.1 of the Ontario *Securities Act*[2] came into force. Part XXIII.1, now comprising section 138 of the *OSA*, provides a statutory right of action against "responsible issuers" and various related parties for misrepresentations affecting the price of securities on the secondary market. The new legislation also implements a leave application pursuant to section 138.8 of the *OSA* in an effort to protect defendants from American-style "strike suits."[3] It is only now—over three years after the new Part XXIII.1 came into force—that leave applications seeking judicial approval to commence a proceeding under this new legislation are starting to be heard.[4] To the present date, no decision in respect of a leave application has been

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1 Bill 198, *Keeping the Promise for a Strong Economy Act (Budget Measures), 2002*, 3d Sess., 37th Leg., Ontario, 2002 (assented to 9 December 2002) [Bill 198].

2 *Securities Act*, R.S.O. 1990, c. S.5 [*OSA*].

3 Ontario Securities Commission, *CSA Notice 53-302 — Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definition of "Material Fact" and "Material Change"* (2000) 23 O.S.C. Bull. 7383 at 7389 [CSA Notice 53-302]. The term "strike suit" refers to the commencement and pursuit of a class proceeding where the claim is meritless but the nature of the claim is such that a sizeable settlement may nonetheless be extracted.

4 The first decision in respect of a leave application, pursuant to s. 138.8 of the *OSA*, above note 2, is expected to be rendered in *Silver v. Imax Corp.* [*Silver*]. The decision in respect of the refusals motion in *Silver*, which is the subject-matter of this paper, [2008] O.J. No. 1844 (S.C.J.), leave to appeal refused,

released. Consequently, members of the Ontario securities bar, eager for judicial analysis of the new secondary market liability provisions, must satisfy themselves for the time being with two sets of decisions that have been released in respect of preliminary evidentiary motions: *Silver v. Imax Corp.*[5] and *Ainslie v. CV Technologies Inc.*[6]

*Silver* considered the scope of permissible cross-examination on affidavits filed pursuant to the new section 138.8. Section 138.8 imposes a threshold test: in order pursue an action under Part XXIII.1, a plaintiff must first obtain leave from the court. On the leave application the applicant must demonstrate that the action is brought in good faith and that there is a reasonable possibility that it will be resolved at trial in its favour. Justice van Rensburg determined that the scope of relevance applicable for cross-examinations on affidavits filed on a leave application pursuant to section 138.8 should be determined in accordance with the same "semblance of relevance" test that applies on an examination for discovery, with the result that she ordered extensive production by the respondent.[7]

In the wake of *Silver*, it is understandable that the successful applicant's counsel has described the right to production of evidence of the merits at the leave stage as tantamount to early "discovery."[8] Nor is it

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[2008] O.J. No. 2751 (S.C.J.), was released on 6 May 2008, and the leave application itself was heard in December 2008.

5 *Ibid.*

6 [2008] O.J. No. 4891 (S.C.J.), supplementary reasons [2008] O.J. No. 4927 (S.C.J.), leave to appeal granted, in part, [2009] O.J. No. 730 (S.C.J.), Bellamy J. [*CV Technologies*].

7 *Silver*, above note 4 at paras. 12–17. At para. 17, van Rensburg J. held that the leave application is governed by its own procedure outlined in the *OSA*, above note 2, that "specifically requires proposed defendants to put forward information . . . and that specifically authorizes examination on such information." This is known as the "semblance of relevance" test.

8 Dimitri Lascaris [counsel to Silver], "Guest Column: Canadian Law Most Advantageous to Canadian Investors Suing AIG" *Securities Docket: Global Securities Litigation and Enforcement Report*, online: www.securitiesdocket.com/2008/11/16/guest-column-canadian-law-most-advantageous-to-canadian-investors-suing-aig/. Lascaris posits that the *OSA*'s evidence-based preliminary merits test does not compel a stay of discovery until resolution of said test; instead, the prospective defendants are "obliged to disclose essentially all evidence that has a 'semblance of relevance' to the issues raised by the preliminary merits test." Technically, however, as van Rensburg J. herself pointed out in *Silver*, *ibid.* at para. 20, the leave application does not amount to a discovery process "in the sense that the parties are not compelled to produce affidavits of documents disclosing all relevant documents within their power and control,

surprising that the decision has been met with strong criticism from the defence bar. Issuers, who were likely of the impression that they were the intended beneficiaries of the leave application, are concerned that they may now be faced with invasive production obligations before an action has even been commenced. Defendants' counsel have been quick to point to the irony that a leave application intended to prevent abusive proceedings now has a significant potential to itself become a vehicle for abuse.[9]

Plaintiffs and defendants alike will need to re-evaluate their positions in light of the more recent decision of Justice Lax in *CV Technologies*.[10] In *CV Technologies*, Lax J. considered a related, although not identical, question to that which was before van Rensburg J. in *Silver*—specifically, whether a respondent who contests a leave application may be compelled to file affidavit evidence in light of section 138.8(2) of the *OSA*, which provides that "the plaintiff and each defendant shall file and serve affidavits setting forth the materials facts on which each intends to rely." Justice Lax interpreted the obligation of respondents to provide evidence on a leave application in light of the underlying purpose of the leave requirement. In considering the legislative intent of the new provision, Lax J. determined that respondents are not required to file affidavit evidence, and that they may either file the affidavit of an expert or file no affidavit at all, thereby insulating themselves from the extensive cross-examination condoned by van Rensburg J. in *Silver*. Leave to appeal from Lax J.'s decision has been granted.

Despite the relatively limited scope of these procedural decisions, *Silver* and *CV Technologies* give securities class action counsel much to ponder. In particular, the decisions raise fundamental questions about the role of the judge as gatekeeper and the underlying objectives of the leave requirement. Undoubtedly, the reaction to these decisions foreshadows further discord, which can be expected to arise once the first decisions granting or denying leave start to be released. At least for the immediate future, until appellate courts provide direction as to how section 138.8 is to be construed, counsel and their clients will need to make difficult strategic decisions about how to respond to leave applications in the face

and they are not subject to examination on everything having a semblance of relevance to the action, including the common law claims." As would be the case on any cross-examination, the applicant must still pose the right questions in order to elicit production.

9 Sandra Rubin, "Bay Street Hears Growling at the Gate" *The Globe and Mail* (18 November 2008).

10 *CV Technologies* (original decision), above note 6. The leave application and the motion for certification were scheduled to be heard together in June 2009.

of a great deal of uncertainty. To help facilitate these decisions, this paper provides an overview of the new Part XXIII.1 of the *OSA* and, in particular, the origins and objectives of the leave requirement in an attempt to identify strategic areas of concern for defendants' counsel in light of the recent decisions rendered in *Silver* and *CV Technologies*.

## B. BACKGROUND TO BILL 198: RESTORING INVESTOR CONFIDENCE

Bill 198 was developed with the intention of restoring investor confidence in the Canadian securities market at a time when several corporate accounting scandals in the United States had eroded the investing public's trust.[11] Central to achieving this objective was the creation of a statutory cause of action for misrepresentation that would be available to investors who trade on the secondary market. The Ontario legislature believed that providing investors with a mechanism to pursue civil actions for misrepresentations or omissions in public disclosures would strengthen confidence in our capital markets by offering additional deterrence beyond what was being achieved by regulatory or criminal enforcement initiatives.

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11 At Bill 198's first reading, the Honourable Janet Ecker (at the time, Minister of Finance) commented upon the crisis of confidence that served as a catalyst to the Bill, stating:

> I'd like to start with the investor confidence piece that's in the legislation . . . . [T]his government is committed to keeping our securities laws, the laws that govern people's investments, up to date and accurate so that our capital markets can remain competitive and strong . . . . People in Ontario have seen the fallout from the accounting scandals in the United States and that has caused them to have concerns about what may be happening in Canadian markets. That's why . . . simply patting ourselves on the back because Enron hasn't happened here doesn't mean we can be complacent. Ontario, Legislative Assembly, *Official Report of Debates (Hansard)* (7 November 2002) at 1600 (Hon. Janet Ecker).

See also *Five Year Review Committee Final Report — Reviewing the* Securities Act *(Ontario)* (Toronto: Queen's Printer, 2003) at 3–4 [Crawford Report]. Released after Bill 198, the Crawford Report specifically mentioned the collapse of several major companies in the US as the catalyst that led to a significant decrease in investor confidence, which led to many of the provisions within Bill 198. In particular, the Crawford Report noted the corporate scandals of Enron Inc., WorldCom Inc. and Adelphia Communications Corporation, which led to a crisis of investor confidence in the US, and eventually the *Sarbanes-Oxley Act of 2002*, Pub. L. 107-204, 116 Stat. 745.

Prior to the enactment of Bill 198, the law of Ontario and other Canadian provinces limited investors who did not purchase securities pursuant to a prospectus to common law causes of action for misrepresentation.[12] Yet, the common law requirement that a plaintiff prove reliance had demonstrated itself to be a major impediment to the certification of class proceedings for secondary market misrepresentation because the question of reliance has generally been found by Ontario courts to raise complex individual issues that made such claims inappropriate for determination on a common basis.[13] The new statutory cause of action is essentially the common law tort of negligent misrepresentation, without one crucial requirement—the onus on the plaintiff to prove that he relied, to his detriment, on the misrepresentations at issue. As a result, a central objective of Bill 198 was to facilitate the certification of securities class actions by eliminating the hurdle posed by the reliance component of the common law tort, thereby helping tip the balance of power in favour of the prospective plaintiff and empowering the individual investor.[14]

Notwithstanding the desire to encourage securities class actions, the legislative drafters sought to temper this potent new statutory cause of action with measures designed to limit the exposure defendant-issuers would face and, in particular, to discourage abusive strike suits and the significant settlement pressure that such suits create. One measure adopted to further these ends was the implementation of liability caps that limit the amount of damages plaintiffs may ultimately recover.[15]

12 Note that s. 130 of the *OSA*, above note 2, already provided a statutory remedy for misrepresentation in a prospectus.

13 The American "fraud on the market" theory, which presumes reliance by an investor on the market price of a security rather than any specific representation (thereby eliminating the reliance hurdle) has supported the certification of class actions for secondary market misrepresentations in the US (albeit based on American statutory causes of action). Plaintiffs' attempts to introduce the concept into Canadian common law have been rejected by the courts. See *Carom v. Bre-X Minerals Ltd.*, [1998] O.J. No. 4496 (Gen. Div.); *Boulanger v. Johnson & Johnson Corp.*, [2002] O.J. No. 1075 at paras. 12–13 (S.C.J.); *Menegon v. Philip Services Corp.*, [2003] O.J. No. 8 at para. 14 (C.A.); *Serhan v. Johnson and Johnson*, [2004] O.J. No. 2904 at para. 57 (S.C.J.); *Lawrence v. Atlas Cold Storage Holdings Inc.*, [2006] O.J. No. 3748 at para. 92 (S.C.J.); *Deep v. M.D. Management*, [2007] O.J. No. 2392 at para. 20 (S.C.J.); and *Wuttunee v. Merck Frosst Canada Ltd.*, [2007] 4 W.W.R. 309 at para. 58 (Q.B.).

14 See Bradley Davis, "Bill 198 Will Bring a New Era in Class Action Litigation in 2006" *The Lawyers Weekly* (14 October 2005). See also Patrick J. O'Kelly, "Bill 198 Offers Remedy for Secondary Stock Purchasers" *The Lawyers Weekly* (28 January 2005).

15 Section 138.7 of the *OSA*, above note 2, limits the damages payable by a defen-

Another was an affirmation that traditional "loser pays" cost rules, in effect, in Ontario will govern actions under Part XXIII.1, notwithstanding the plaintiff-friendly provisions of section 31(1) of the Ontario *Class Proceedings Act*, 1992[16] which provide courts with the discretion to allow unsuccessful plaintiffs to avoid liability for costs when certain criteria (such as the action having been commenced in the "public interest") are met.[17] A further balancing measure was the introduction of the section 138.8 leave requirement, which is the subject of this paper.

## C. THE MECHANICS OF THE SECTION 138.8 LEAVE REQUIREMENT

Section 138.8 of the *OSA* provides as follows:

> **Section 138.8 – Leave to Proceed**
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> **138.8** (1) No action may be commenced under section 138.3 without leave of the court granted upon motion with notice to each defendant. The court shall grant leave only where it is satisfied that,
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> (a) the action is being brought in good faith; and
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> (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

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dant when the actual damages assessed by the courts are greater than the liability caps listed under the s. 138.1 definition of "liability limit." For example, a responsible issuer or a non-individual influential person is held to a liability limit that is the greater of $1 million or 5 percent of the issuer's market capitalization (as such term is defined in the regulations).

Section 138.7(2), *ibid.* provides that the liability caps do not apply to a person or company, other than the responsible issuer, if the plaintiff proves that the person or company authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure, or influenced the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure.

16 S.O. 1992, c. 6 [*CPA*].

17 *Ibid.*, s. 31(1). In exercising its discretion with respect to costs under s. 131(1) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, the court may consider whether the class proceeding was a test case, raised a novel point of law, or involved a matter of public interest.

See also *OSA*, above note 2, s. 138.11. Section 138.11 of the *OSA* outlines the "loser pays" costs provision. "Despite the *Courts of Justice Act* and the *Class Proceedings Act, 1992*, the prevailing party in an action under section 138.3 is entitled to costs determined by a court in accordance with applicable rules of civil procedure."

(2) Upon an application under this section, the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely.

(3) The maker of such an affidavit may be examined on it in accordance with the rules of court.

(4) A copy of the application for leave to proceed and any affidavits filed with the court shall be sent to the Commission when filed.[18]

## D. THE ORIGINS OF THE SECTION 138.8 LEAVE REQUIREMENT

The extension of statutory civil liability to secondary market disclosure preoccupied securities regulators for several decades preceding the enactment of Bill 198. The concept was first introduced at the federal level in the 1979 report entitled *Proposals for a Securities Market Law of Canada*, a document intended to facilitate discussion about how to improve regulatory policy within the Canadian securities market.[19] Although the proposals in the 1979 report were never implemented, the discussions that led to the report resulted in the Ontario Securities Commission (OSC) releasing a request for comments on proposed draft legislation in 1984 that included an attempt to introduce civil liability for continuous disclosure documents under the *OSA*.[20] Although the 1984 proposal did not result in the creation of legislation, like the 1979 federal report that preceded it, the 1984 proposal provided a framework for continuing discussions of civil liability for secondary market disclosure.[21] This discussion culmi-

18 *Ibid.*, s. 138.8.

19 Philip Anisman *et al.*, *Proposals for a Securities Market Law for Canada* (Ottawa: Consumer and Corporate Affairs Canada, 1979). This document recommended, among other things, a statutory civil liability regime covering continuous disclosure.

20 *Civil Liability for Continuous Disclosure Documents Filed under the* Securities Act *— Request for Comments*, O.S.C. Request for Comments (1984) 7 O.S.C. Bull. 4910.

21 See CSA Notice 53-302, above note 3 at 7386, note 6:

> While both the 1979 Federal Proposal and the OSC Proposal stimulated a considerable amount of public debate at the time and elicited significant public comment (most of which was opposed to the idea of civil liability for continuous disclosure) neither led to legislative change. Finally, in 1993, the Quebec Government recommended a limited version of the proposed regime aimed at small investors, see Minister of Finance Louise Robic, *Quinquennial Report on the Implementation of the* Securities Act (Gouvernement du Québec, ministère des Finances, December 1993).

nated in the release of the Allen Committee Report in 1997.[22]

The Allen Committee was mandated to review current corporate disclosure practices and to determine whether investors should be empowered with enhanced private remedies when companies fail to comply with disclosure requirements.[23] In the end, the Allen Committee agreed with its predecessors and recommended the introduction of a statutory civil liability regime for secondary market disclosure in Canada. Notably, the Allen Committee expressly rejected the idea of providing the courts with a gatekeeper function:

> Although the gatekeeper role has initial appeal and would represent an answer to those who are concerned that statutory civil liability opens a door to irresponsible plaintiffs (for which door there should be a gatekeeper), this appeal is superficial. *Creation of a gatekeeper role would clearly require identifying the test the gatekeeper would apply to legitimize a plaintiff. Such a role would also introduce into the system the risk of a duplication of process.* We do, however, recommend that it be clearly stipulated in any legislation implementing a statutory civil liability remedy that each [Securities Regulatory Authority] have status to intervene in any civil action launched under that legislation, either at the request of a third party or on its own initiative. [24]

In retrospect, the Allen Committee's cautionary language is prescient, but its concerns regarding the difficulties that would be associated with developing the threshold test to be applied on a leave motion, and the potential duplication of judicial processes that may result, do not appear to be reflected in the legislation that was ultimately enacted. In light of

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> Whereas, in 1994, the BC Government also developed a proposal to introduce a limited scheme of civil liability for certain disclosure in response to the Matkin Inquiry and recommendations reflected in the Matkin Report (J.G. Matkin & D.G. Cowper, *Restructuring for the Future; Towards a Fairer Venture Capital Market: Report of the Vancouver Stock Exchange & Securities Regulation Commission* (Victoria, BC: The Commission, 1994)). However, by this point in time, the Allen Committee had been established, and so the Quebec and BC governments agreed to await the outcome of their report in the hopes that any eventual recommendations could be adopted nationally.

22 The Toronto Stock Exchange Committee on Corporate Disclosure, *Responsible Corporate Disclosure: A Search for Balance/Final Report by the Committee on Corporate Disclosure* by Thomas A. Allen (Toronto: Toronto Stock Exchange, 1997) [Allen Committee Report].

23 *Ibid.*

24 *Ibid.* at 61 [emphasis added].

the fact that a determination was made to proceed with the introduction of a leave requirement, notwithstanding the Allen Committee's consideration and rejection of the notion, one would expect to find evidence of further consultation and debate regarding the specific leave test to be adopted, but no such evidence appears to exist — at least not in the public record.

The Allen Committee also concluded that statutory civil liability would not "open the doors to strike suits."[25] In the Committee's view, the combination of statutory civil liability with Canadian class action legislation and procedural rules would discourage the flood of strike suits that was experienced in the US. Commenting on the differences between the Canadian and American legal systems that contributed to this analysis, the Allen Committee concluded that even actions *with* merit tend to be discouraged as a result of the Canadian litigation system.[26] The differences that the Committee perceived were summarized (in CSA Notice 53-302) as follows:

> The Allen Committee reviewed the procedural provisions and other elements of the litigation environment that facilitate meritless class actions in the US and concluded that many of these elements are not present in Canada. For example, the Allen Committee noted that pre-trial discovery rules have traditionally been more liberal in the US than in Canada which in turn have allowed US plaintiffs to engage in fishing expeditions. The Allen Committee also noted that jury trials for securities actions, while prevalent in the US, are rare in Canada. In this context, the Allen Committee concluded that defendants should be better able to assess their likelihood of success and should be less inclined to settle actions lacking merit and plaintiffs should be less inclined to commence lawsuits in the search of a shakedown settlement.[27]

The Allen Committee also identified the "loser pays" costs rules and relatively conservative damage awards in Canada as compared to the US as factors that led it to conclude that strike suites would not be a problem here.[28]

Following the Allen Committee Report, the Canadian Securities Administrators[29] (CSA) published draft legislation for comment in May

25 *Ibid.* at 29.
26 *Ibid.* at 26.
27 CSA Notice 53-302, above note 3 at 7389.
28 Allen Committee Report, above note 22 at 31–33.
29 See Ontario Securities Commission, *Canadian Securities Administrators (CSA)*,

1998 in order to provide a forum for interested individuals and companies to voice their opinions regarding the prospect of implementing a civil liability regime for secondary market disclosure in Canada.[30] Despite the Allen Committee's dismissal of concerns about the possibility of American-style strike suits, the fears of many commentators were not allayed. The general consensus among these commentators was that only the introduction of a gatekeeper mechanism could prevent this potential abuse.[31]

Subsequently, the CSA published CSA Notice 53-302, which argued that the dismissal of the possibility of strike suits in Canada by the Allen Committee was premature. The CSA suggested the depth of concern on the part of the issuer community since the release of the Allen Committee Report, coupled with concurrent examples of entrepreneurial litigation in Canada,[32] supported the recommendation of measures such as a preliminary screening mechanism.[33] To emphasize this concern, the CSA identified the potential for strike suits as a threat to capital markets *generally*, not just to defendant issuers and their directors and officers:

> [T]he concern about strike suits must be addressed regardless of whether, and to what extent, one believes this will be the result if the legislation is adopted. Strike suits could expose corporate defendants to proceedings that cause real harm to long-term shareholders and resulting damage to our capital markets.[34]

The CSA described the objectives behind the leave provision as follows:

> [T]his screening mechanism is designed not only to maximize the prospects of an adverse court award in the absence of a meritorious

online: www.osc.gov.on.ca/About/CSA/csa_index.jsp. According to the OSC website, the CSA is

> a forum for the thirteen securities regulators of Canada's provinces and territories to coordinate and harmonize regulation of the Canadian capital markets . . . . The CSA is an "umbrella" organization, which is comprised of all provincial and territorial securities regulators and provides in essence, a "virtual" national securities regulator . . . . One of the activities of the CSA is to provide investor education materials for distribution by member regulators.

30 OSC, *Request for Comments*, (1998) 21 O.S.C.Bull. 3367.

31 CSA Notice 53-302, above note 3 at 7390. The screening provision is based on a test that was recommended by the Ontario Law Reform Commission in its *Report on Class Actions* (Ontario: Ministry of the Attorney General, 1982).

32 See *Epstein v. First Marathon Inc.* (2000), 2 B.L.R. (3d) 30 (S.C.J.).

33 CSA Notice 53-302, above note 3.

34 *Ibid.*

> claim but, more importantly, to try to ensure that unmeritorious litigation, and the time and expense it imposes on defendants, is avoided or brought to an end early in the litigation process. By offering defendants the reasonable expectation that an unmeritorious action will be denied the requisite leave to be commenced, the 2000 Draft legislation should better enable defendants to fend off coercive efforts by plaintiffs to negotiate the cash settlement that is often the real objective behind a strike suit.[35]

In an attempt to address the concerns raised by the CSA, the legislature went against the recommendation of the Allen Committee and adopted the gatekeeper provision.

Despite the fairly extensive debate, rejection, and re-introduction of the leave requirement into the draft legislation that ultimately became Part XXIII.1, there does not appear to have been much if any consideration by the legislative drafters (or by the proponents of the leave provision) of the potentially negative implications of a preliminary merits test for *defendants*, including the potential that the leave application could be used cynically by plaintiffs to obtain documents and other evidence that could then be used to plead new or more threatening allegations. As the *Silver* case illustrates, a defendant who chooses to contest leave may be placed in the previously inconceivable position of being required to: disclose confidential documents to a prospective plaintiff before an action has even been permitted to be commenced, bear the cost of making extensive disclosure before the leave application is even determined, and face the threat that new claims could arise from such pre-action "fishing expeditions." Even when the claim advanced is wholly without merit, the risks, expenses, and inconveniences associated with opposing leave may be greater than those associated with simply defending or settling the case. Thus, in many instances the leave requirement will have no deterrent effect because a defendant may be better off simply consenting to leave.

35 *Ibid.* at 7390.

## E. THE RELATIONSHIP, IF ANY, TO OTHER LEAVE TESTS AND PRELIMINARY CHALLENGES

On its face, section 138.8 does not reflect a struggle on behalf of the legislative drafters to articulate a test that would further the seemingly contradictory objectives of screening potentially meritless claims while protecting respondents against invasive inquiries into the merits of the allegations made against them. As mentioned above, despite the concerns expressed by the Allen Committee about the difficulties that would be associated with developing an appropriate test, the legislative history of section 138.8 is devoid of any commentary or debate over the standard ultimately adopted, or the evidentiary requirements placed on the parties to the leave application. In fact, the only mention of the leave provision is contained in an explanatory note, which states: "[P]rocedural matters are addressed in the new sections 138.8 to 138.14 . . . A proceeding cannot be commenced without leave of the court."[36] As is often the case, the devil is in the procedural detail.

### 1. Leave to Commence a Derivative Action

The closest relative to the section 138.8 leave requirement would appear to be the test for leave to commence a derivative action pursuant to section 239 of the *Canada Business Corporations Act*[37] and the parallel provisions in provincial securities acts.[38] Section 239 permits a complainant to apply to court for leave to bring an action in the name of a corporation or to intervene in an action in which a corporation is a party for the purpose of prosecuting, defending, or discontinuing the action on behalf of the corporation. The test for leave is that the court must be satisfied that:

36 Bill 198, above note 1. See the Explanatory Note available online: www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=1067&isCurrent=false&detailPage=bills_detail_about.

37 R.S.C. 1985, c. C-44 [*CBCA*].

38 Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9, s. 240; British Columbia *Business Corporations Act*, S.B.C. 2002, c. 57, s. 232–33; Manitoba *The Corporations Act*, C.C.S.M. c. C225, s. 232; New Brunswick *Business Corporations Act*, S.N.B. 1981, c. B-9.1, s. 164; Newfoundland and Labrador *Corporations Act*, R.S.N.L. 1990, c. C-36, s. 369; Northwest Territories, *Business Corporations Act*, S.N.W.T. 1996, c. 19, s. 241; Nova Scotia *Companies Act*, R.S.N.S. 1989, c. 81, s. 135A; Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 246; Saskatchewan *Business Corporations Act*, R.S.S. 1978, c. B-10, s. 232; Yukon *Business Corporations Act*, R.S.Y. 2002, c. 20, s. 241.

> (a) the complainant has given notice to the directors of the corporation or its subsidiary of the complainant's intention to apply to the court under subsection (1) not less than fourteen days before bringing the application, or as otherwise ordered by the court, if the directors of the corporation or its subsidiary do not bring, diligently prosecute or defend or discontinue the action;
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> (b) the complainant is acting in good faith; and
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> (c) it appears to be in the interests of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.[39]

There are some obvious similarities between the two types of leave provision. For one thing, a good faith requirement is found under the various provincial Business Corporation Acts and section 138.8 of the *OSA*. For another, caselaw interpreting section 239(2) and comparable provisions in provincial legislation establish that the merits of the action that the applicant wishes to pursue are a factor for consideration in determining whether it would be in the best interests of the corporation; an arguable case on the merits must be established at the leave stage.[40]

Further, the underlying purpose of the section 239 leave requirement is also similar to that of section 138.8 of the *OSA* to the extent that it is designed to prevent the commencement of unmeritorious litigation in circumstances where the prospective plaintiff may have an ulterior motive. In the context of a derivative action, the legislature has seen fit to impose the leave application to ensure that there is good reason to override the exercise of business judgment by the corporation's directors in deciding not to pursue the litigation.

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39 *CBCA*, above note 37, s. 239(2).

40 See: *Bellman v. Western Approaches Ltd.*, [1981] B.C.J. No. 1548 at para. 19 (C.A.) [*Bellman*], Nemetz C.J.: "The section does not say that the court must be satisfied that it is in the interests of the corporation. It says that no action may be brought unless it appears to be in the best interests of the corporation to bring the suit. I take that to mean that what is sufficient at this stage is that an arguable case must be shown to exist." A potential variation on this test, which arguably imposes a higher standard, is applied by the Alberta Court of Appeal in *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 60 Alta. L.R. (2d) 122 at 221: "the Court should, after considering the views of independent directors of the corporation and without endeavoring to try the case, decide whether the action has a reasonable prospect of success." Note also that courts have held that this analysis requires considerable deference to the business judgement of the Board. See *Peel Financial Services Ltd. v. OMERS Realty Management Corporation*, (7 August 2009) CV-08-7650-00CL (Ont. S.C.J.) at paras. 55-67.

However, notwithstanding these initial similarities to section 138.8 of the *OSA*, the dynamic of an application pursuant to section 239 will be entirely different. While the respondent to an application to commence a derivative action faces a judicial evaluation of its exercise of business judgment, it will not be exposed to the same risks and pressures as a prospective defendant to a secondary market securities class action because the proposed action will not be brought *against* the respondent corporation but effectively *by* it. If the application succeeds, the action will be brought by the applicant in the name of the respondent corporation against a third-party defendant. Although the respondent may face the inconvenience, and in some instances the expenses, associated with being required to pursue litigation its board did not see fit to commence, the corporation is not *itself* going to be forced to defend a highly threatening piece of litigation.

The focus of an application pursuant to section 239 of the *CBCA* is on the good faith of the applicant, the reasons for the board's decision not to pursue the litigation, and the validity of those reasons. To the extent that production is ordered on the leave application it will go to these issues. Documents in the possession of the respondent corporation that relate to the merits of the proposed action would be producible, but the application can not result in the prospective defendant, who is not a party to the application, being ordered to produce any documents. Thus, "pre-action" production in this context will not pose the same threat to the respondent (or to the prospective defendant) as it does in the context of an application pursuant to section 138.8. Accordingly, caselaw interpreting the derivative leave provisions simply may not engage the same policy considerations and may have little relevance to the fundamental issues at stake in the context of a leave application pursuant to section 138.8.[41]

## 2. Preliminary Motions Available Under the *Rules of Civil Procedure*

Although there has not been judicial consideration of the issue as yet, the test as to whether there is a "reasonable possibility that the action will be resolved at trial in favour of the plaintiff" would appear to be similar to

41 Indeed, there appears to be scant consideration by Canadian courts of the scope of permissible cross-examination and production on applications to commence derivative actions and the decisions that do exist (see, for example: *Primex Investments Ltd. v. Northwest Sports Enterprises Ltd.* [1995] B.C.J. No. 1241 (Master)) involve straightforward applications of the semblance of relevance test.

the tests applied on a motion for summary judgment or a motion to strike under rules 20.01 and 21.01, respectively, of the Ontario *Rules of Civil Procedure*.[42] It is unclear whether these rules were considered by the drafters of section 138.8 or whether their availability to dispose of an action of questionable merit at a preliminary stage *in any action* was considered inadequate to counter the risk of strike suits in the context of a securities class action. It is also unclear whether, once an applicant succeeds in obtaining leave to commence an action pursuant to section 138.8, any recourse remains for the defendant under rules 20.01 and 21.01. Despite the differences in the tests and the party on whom the onus is placed, plaintiffs could argue that all potential preliminary challenges that a defendant may raise have been "spent" on the leave application.

One may presume that the test for leave under section 138.8 is more onerous on plaintiff applicants than the test they must meet on a rule 21.01 motion to strike. In order to survive a motion to strike, a plaintiff must simply show that it is not "plain and obvious" that the pleadings fail to disclose a cause of action.[43] Plaintiffs benefit from the presumption that

42 R.R.O. 1990, Reg. 194 [*Rules of Civil Procedure*]. Rule 20.04(2) outlines the test for when summary judgment shall be granted:

> The court shall grant summary judgment if,
> (a) the court is satisfied that there is no genuine issue for trial with respect to a claim or defence; or
> (b) the parties agree to have all or part of the claim determined by a summary judgment and the court is satisfied that it is appropriate to grant summary judgment.

The relevant test under rule 21.01 is outlined in rule 21.01(1)(b):

> A party may move before a judge,
> (b) to strike out a pleading on the ground that it discloses no reasonable cause of action or defence, and the judge may make an order or grant judgment accordingly.

The test under rule 21.01 was set out in *Hunt v. Carey Canada Inc.*, [1990] 2 S.C.R. 959 [*Hunt*], which requires the deciding court to consider whether it is "plain and obvious" that the plaintiff's statement of claim discloses no reasonable claim.

43 *Hunt*, *ibid.* at para. 21:

> Assuming that the facts as stated in the statement of claim can be proved, is it "plain and obvious" that the plaintiff's statement of claim discloses no reasonable cause of action? . . . As in England, if there is a chance that the plaintiff might succeed, then the plaintiff should not be "driven from the judgment seat" . . . . Neither the length and complexity of the issues, the novelty of the cause of action, nor the potential for the defendant to present a strong defence should prevent the plaintiff from proceeding with his or her case. Only if the action is certain to fail . . . should the relevant portions of a plaintiff's statement of claim be struck out . . . .

they are entitled to pursue the action and have their day in court. Notably, the onus is on a defendant on a motion to strike, whereas under section 138.8 the onus is on the plaintiff (the applicant), who must justify her right to bring the action.

The leave test is perhaps closer to, but arguably more onerous than, the test applied on a motion for summary judgment. Rule 20.04(2)(a) of the *Rules of Civil Procedure* dictates that an action may be summarily dismissed if a defendant demonstrates, on the basis of a record consisting of affidavit evidence filed by the parties and cross-examinations thereon, that there is no "genuine issue for trial." The requirement of section 138.8, that the applicant demonstrate a "reasonable possibility" of resolution in favour of the plaintiff, suggests that the applicant must accomplish *something more* than showing that the issues are of a nature that cannot be summarily resolved on the basis of affidavit evidence and that a trial is warranted;[44] additionally, they must show a reasonable prospect of *success* at trial on those issues.

Unlike a motion to strike, which is determined solely on the basis of pleadings,[45] but similar to a motion for summary judgment, which is determined on the basis of affidavits (sometimes referred to as a "paper trial"),[46] there is a clear requirement that evidence must be filed on an application under section 138.8. No guidance is provided as to the nature of the evidence a court may consider in making a determination of the plaintiffs' "good faith" or "reasonable possibility of success" other than the fact that affidavits must provide evidence of the material facts to be relied upon. Section 138.4 of the *OSA* contemplates that evidence of the parties' intentions and levels of comprehension and knowledge of the falsity of certain statements may be material facts[47] and it is conceivable that

44 Compare *Mensink v. Dale* (1998), 39 O.R. (3d) 51 (C.A.). According to this decision, "[t]he issue [before a judge hearing a motion for summary judgment] is whether there was a triable issue, not how it should have been resolved." In other words, the question of whether the plaintiff has a reasonable prospect of success is, arguably, not is not at issue.

45 According to r. 21.01(2)(b) of the *Rules of Civil Procedure*, above note 42, no evidence is admissible on a motion to strike.

46 See *Dawson v. Rexcraft Storage & Warehouse Inc.* (1998), 26 C.P.C. (4th) 1 at para. 13 (C.A.) [*Dawson*].

47 See *OSA*, s. 138.4 for a discussion of the burdens on the parties and the defences available under the new Part XXIII.1, which includes a due diligence defence under s. 138.4(6). The extent to which some of these burdens and defences may involve a subjective evaluation of a respondent's level of belief or understanding is, as yet, undetermined. For example, s. 138.4 (1) allows for a finding of liability in relation to non-core documents and public oral state-

the scope of relevant evidence on a leave application pursuant to section 138.8 could go beyond that which would normally come before a court on a motion for summary judgment.[48] As the onus is on the applicant to establish a reasonable prospect of success, which, depending on the facts alleged, may require the applicant to demonstrate they have a reasonable prospect of proving aspects of the defendant's knowledge or belief, such evidence could conceivably stray into the realm of matters such as credibility, intention, and motive that are generally only considered appropriate for determination by the examination of live witnesses at trial.

Accordingly, the test to be applied on a leave application pursuant to section 138.8 is similar to, and yet different in potentially significant ways from, recognized standards applied to potentially unmeritorious actions under the provincial Business Corporations Acts and the *Rules of Civil Procedure*. As a result, it is unclear to what extent caselaw developed in these other contexts may apply, and to what extent our courts will have to establish an entirely new set of principles to determine which actions may obtain leave. Further, the standard that an applicant must meet is potentially higher than those imposed under rules 20 and 21, a factor that could be both helpful and harmful to respondents. While applicants may have a higher onus to meet under section 138.8 than a plaintiff facing a motion to strike or a motion for summary judgment, they might also have a correspondingly more expansive right to production of evidence from the respondent than they would on other, more familiar, types of preliminary proceedings. Herein lies the fundamental dilemma that section

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ments when a plaintiff proves a defendant "knew" the document or statement contained a misrepresentation or "deliberately avoided" acquiring such knowledge.

48 Caselaw considering this point has established that if credibility is at issue, the case is not appropriate for determination on the basis of summary judgment and must go to trial.

See *Esses v. Bank of Montreal*, [2008] O.J. No. 3675 at para. 46 (C.A.):

> "Frequently, proof of knowledge is much better canvassed by a trial judge, with the benefit on *viva voce* evidence, than by a motion judge on an arid printed record."

See *Aguonie v. Galion Solid Waste Material Inc.*, [1998] O.J. No. 459 at para. 32 (C.A.):

> In ruling on a motion for summary judgment, the court will never assess credibility, weigh the evidence, or find the facts. Instead, the court's role is narrowly limited to assessing the threshold issue of whether a genuine issue exists as to material facts requiring a trial. Evaluating credibility, weighing evidence, and drawing factual inferences are all functions reserved for the trier of fact.

138.8 presents. Frequent trips to our appellate courts can be expected before the law in this area is settled.

## F. TRADITIONAL ARGUMENTS AGAINST DISCOVERY OF EVIDENCE RELATING TO THE MERITS OF THE CASE PRIOR TO CERTIFICATION

If it was not already apparent on the face of the legislation, it is now clear in light of *Silver* that the section 138.8 leave requirement will open the door to an investigation into the merits of the underlying claim before an action is even commenced. Thus, an additional complexity is posed by the leave application because it represents a striking departure from the normal sequence of evidentiary disclosure in a class proceeding in Ontario. Indeed, there is no preliminary merits test under the *CPA*, and any consideration of the matters at issue in the action is generally deferred until after a certification order is granted.

The *CPA* itself is silent on the issue of what evidence, if any, must be disclosed by the parties prior to certification. While section 15(1) of the *CPA* provides that "[p]arties to a class proceeding have the same rights of discovery under the rules of court against one another as they would have in any other proceeding," there does not appear to have been any judicial consideration of whether the language of this section, which seems to presume that certification has already occurred, would apply in the pre-certification phase.

Parties to a proposed class action may obtain specific evidence from their opponent that is relevant to the test for certification;[49] however,

49 The test for certification as outlined in s. 5(1) of the *CPA* is as follows:

> The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,
>
> (a) the pleadings or the notice of application discloses a cause of action;
>
> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
>
> (c) the claims or defences of the class members raise common issues;
>
> (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
>
> (e) there is a representative plaintiff or defendant who,
>
> (i) would fairly and adequately represent the interests of the class,
>
> (ii) has produced a plan for the proceeding that sets out a

this test only evaluates the appropriateness of the case for resolution on a class-wide basis, a question that has no bearing on the merits of the action. Defendants have generally been successful in resisting full-scale production until after certification. Three basic arguments have been accepted by courts for deferring production in a class action:

i) Production prior to certification is unnecessary and potentially wasteful; a defendant should not be put to the expense and effort associated with full-scale production before the issues to be certified, if any, have been confirmed by a court.
ii) Onerous production obligations prior to certification may subject defendants to undue settlement pressure.
iii) Discovery of documents going to the merits prior to certification may lead to improper use of such evidence on the certification motion itself, which could unfairly prejudice a defendant.

## 1. Discovery Is Inefficient or Unnecessary Prior to Certification

In a class proceeding, delay of the discovery process normally results from defendants not being required to serve a statement of defence prior to certification; this defers the close of pleadings, which would otherwise trigger the discovery process under the *Rules of Civil Procedure*.[50] However, even in instances where a defence is filed prior to certification,[51] courts will generally also give effect to the suspension of discovery obligations.

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workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
(iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

50 It was established in *Mangan v. Inco Ltd.* (1996), 30 O.R. (3d) 90 (Gen. Div.), Winkler J. [*Mangan*], that defendants to a class action are not required to file a defence; see also *Moyes v. Fortune Financial Corp.*, [2001] O.J. No. 4455 (S.C.J.), Nordheimer J.

51 This may occur, for example, when a defendant intends to move for summary judgment (which requires the filing of a defence) prior to or at the same time as the certification motion. In some instances, a particular defence may be central to the defendant's arguments on the certification motion, in which case the defendant may choose to plead the defence prior to certification. These are exceptions to the general practice of not filing a defence until after certification.

*Stern v. Imasco Ltd.*[52] is an early Ontario case that dealt with a defendant's obligation to make production prior to certification. In *Stern*, the plaintiff brought a motion for disclosure of various categories of documents prior to the close of pleadings. Justice Cumming found that, "to the extent that it is necessary, the discretion conferred by section 12 of the *CPA* is intended to supplement the *Rules* by accommodating the special nature of class proceedings. However, section 12 is not designed to circumvent the normative *Rules*."[53] In other words, the *Rules of Civil Procedure*, including the ordinary sequence of production, will apply to a proposed class proceeding unless the party seeking a departure from these rules can demonstrate "extraordinary circumstances due to the specific 'class' nature of the proceedings."[54]

In *Stern*, Cumming J. determined that the application of the *Rules of Civil Procedure* did not permit the "accelerated disclosure" sought by the plaintiff. In particular, rule 30.04(5), which confers a discretion on the court, at any time, to order production for inspection of documents in the possession, control, or power of a party, would not assist the plaintiff because the discretion conferred by that rule is generally only exercised prior to the close of pleadings if the documents are necessary for a party to plead. The plaintiff, who had already filed a statement of claim, clearly did not require the documents in order to plead.

The case is somewhat anomalous because Cumming J. found that following the normal procedural rules would result in the non-disclosure of documents. Other cases on this subject involve a plaintiff insisting that the conventional timelines be followed so as to require full-scale documentary production after a defendant has served a statement of defence, despite the fact that certification remains pending.[55] Other cases involve the question of whether a defendant may be required to file a statement

52 [1999] O.J. No. 4235 (S.C.J.) [*Stern*].

53 *Ibid.* at para. 27.

54 See also the recent decision of *Durling v. Sunrise Propane Energy Group Inc.*, [2008] O.J. No. 5031 at para. 15 (Master Dash) [*Durling*], which re-affirmed the principles articulated by Cumming J. in *Stern*, *ibid.*, but which found exceptional circumstances warranting an order for limited production from third parties prior to the certification motion.

55 This point was well articulated in the British Columbia case of *Matthews v. Servier Canada Inc.*, [1999] B.C.J. No. 435 (S.C.), Edwards J. at para. 5 [*Servier No. 2*]: "Document discovery, if ordered before certification in a case . . . where it will be an enormous task for the Defendants to produce all potentially relevant documents[,] will not be ordered automatically. The Plaintiff will be required to show discovery of documents is necessary in order to inform the certification process."

of defence so that the timelines for documentary production will start to run.[56]

In *Mangan*, Winkler J. considered whether a statement of defence must be filed prior to certification. He held that, although the *CPA* does not specifically contemplate that certification will be heard prior to the filing of a statement of defence, the discretion under section 12 of the *CPA* permits a court to dispense with the requirement that a defence be filed in accordance with the time frame dictated by the *Rules of Civil Procedure*. On the particular facts of that case, Winkler J. accepted the defendants' submission that a statement of defence, if filed, may have to be entirely reformulated in response to the outcome of the certification hearing. He concluded, based on the complexity of the matter, the amount of time and effort involved, and the fact that the original statement of claim came to "serve no useful purpose" after the certification motion, that leave should be granted to defer filing of the defence.[57] Indeed, as a general matter, if the pleadings or issues for certification were substantially revised as a result of the certification motion, a defendant that has already undergone extensive production would be forced to repeat the exercise in light of the newly articulated issues.

Notably, *Stern* and *Magnan* preceded the Supreme Court of Canada's decision in *Hollick v. Toronto*.[58] Although the foregoing point is perhaps

56 See above note 51. For a recent interpretation of this point, see *Glover v. Toronto (City)*, [2008] O.J. No. 604 at para. 8 (S.C.J.): "In most cases, the statement of defence will not be required for the certification motion and absent agreement of the parties, leave to defer filing a statement of defence pending disposition of the certification motion is normally granted."

57 *Mangan*, above note 50 at para. 95.

58 [2001] 3 S.C.R. 158 at paras. 22–25 [*Hollick*].

> I agree that the representative of the asserted class must show some basis in fact to support the certification order. As the court in *Taub* held, that is not to say that there must be affidavits from members of the class or that there should be any assessment of the merits of the claims of other class members. However, the Report of the Attorney General's Advisory Committee on Class Action Reform clearly contemplates that the class representative will have to establish an evidentiary basis for certification: see Report, at p. 31 ("evidence on the motion for certification should be confined to the [certification] criteria").
>
> Justice McLachlin at para. 25.
>
> See also *Taub v. The Manufacturers Life Insurance Co.*, [1998] O.J. No. 2694 at para. 4 (Gen. Div.), Sharpe J., which draws a similar distinction between the merits of the claim and the evidentiary basis that is necessary to support a certification order:
>
> The *CPA* clearly does not contemplate a detailed assessment of the merits

made implicitly in *Hollick*, the decision draws a distinction between evidence of the merits of the claim, which is not relevant to the certification motion, and evidence necessary to establish that the criteria for certification are satisfied. Since *Hollick*, courts have focused the inquiry on refusals motions in the context of pending certification hearings on the sole question that should be at issue: whether the information sought is relevant to issues on certification.[59]

The clear distinction that may be drawn between evidence relating to the merits of a claim and evidence relevant to issues on the certification motion is now generally reflected in distinct procedures in relation to the production of documents in the pre- and post-certification phases. Prior to certification, documents relevant to certification may be obtained through cross-examination on affidavits filed on the certification motion or, if necessary, by issuing a summons to witnesses, pursuant to rule 39.03 of the *Rules of Civil Procedure*, to give evidence on a pending motion.[60] As a result, there should be no need to produce documents that provide evidence relating to the merits of the claim prior to the certification motion because evidence is unnecessary for either side to argue the motion. The cost and effort associated with full-scale production is especially unwarranted in light of the fact that, if the pleadings or the issues for certification are revised following the certification motion, the defendant may be required to revisit the production exercise and documents produced prior to certification may no longer be relevant. Furthermore, certification could be denied entirely, which often results in the action being abandoned and efforts spent on production being wasted.

These concerns are equally, if not more, valid at the leave stage of a prospective action under Part XXIII.1 of the *OSA* when both preliminary questions—whether the action may be commenced and whether the claims are appropriate for certification—remain unanswered. The potential for the pleadings and the common issues to change before discovery obligations would normally arise under the *Rules of Civil Procedure* is significant.

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of the claim of the representative plaintiff or of the claims of the members of the proposed class. That is clear from 5(5). However, it is my view that in order to certify the proceeding, the judge must be satisfied of certain basis facts required by s. 5 of the *CPA* as the basis for the certification order.

59 See, for example, *Price v. Panasonic Canada Inc.*, [2001] O.J. No. 5244 at para. 16 (S.C.J.); *Pearson v. Inco*, [2002] O.J. No. 1842 at para. 12 (S.C.J.).

60 *Caputo et al. v. Imperial Tobacco Limited et al.* (2005), 74 O.R. (3d) 728 at para. 21 (S.C.J.), Winkler J.

## 2. Production May Place Undue Settlement Pressure on a Defendant

A significant number of BC's cases have also addressed the issue of a defendant's obligation to produce documents in advance of certification.[61] For example, Edwards J. of the BC Supreme Court addressed the issue of pre-certification disclosure in the context of a motion in the pre-*Hollick* case of *Matthews v. Servier Canada Inc.* and observed:

> The question of whether document discovery should be permitted before certification was addressed earlier in this case and in *Endean*. Document discovery, if ordered before certification in a case such as this where it will be an enormous task for the defendants to produce all potentially relevant documents will not be ordered automatically. The Plaintiff will be required to show discovery of documents is necessary to inform the certification process.
>
> This could lead to a "chicken and egg" debate over which comes first, but unless a plausible basis for requiring extensive pre-certification document discovery is demonstrated, *there is a risk that a requirement to make full disclosure before certification will be so onerous it will amount to an unfair imposition on defendants and potential settlement tool in the hands of a plaintiff who may not have a certifiable class action.*[62]

The possibility that a plaintiff may unfairly subject a defendant to the documentary production process as a means of coercing early settlement is one of the most significant justifications for declining to impose wide-scale discovery obligations at a pre-certification stage. This statement by Edwards J. is particularly relevant in the context of a securities class action for secondary market misrepresentations—a scenario in which the potential for unmeritorious claims has been expressly recognized and guarded against with the leave requirement.

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61 See, for example, *Scott v. TD Waterhouse Investor Services (Canada) Inc.*, [2000] B.C.J. No. 2524 (S.C.), Martinson J. Defendants' obligation to serve a statement of defence prior to certification: *Endean v. Canadian Red Cross Society*, [1997] B.C.J. No. 295 (S.C.); *Matthews v. Servier Canada Inc.*, [1998] B.C.J. No. 275 (S.C.), Edwards J. [*Servier No. 1*]; *Servier No. 2*, above note 55; *Hoy v. Medtronic, Inc.*, [2000] B.C.J. 1490 (S.C.) Kirkpatrick J.; *Kimpton v. Canada (Attorney General)*, [2002] B.C.J. No. 87 (S.C.), Macaulay J.; *Samos Investments Inc. v. Pattison*, [2001] B.C.J. No. 578 (S.C.), Bauman J.; and *Cooper v. British Columbia (Registrar of Mortgage Brokers)*, [1998] B.C.J. No. 3255 (S.C.), Tysoe J.

62 *Servier No. 2*, *ibid.* at paras. 5–6 [references omitted, emphasis added].

### 3. Production May Lead to Improper Use of the Evidence

Another important factor is the potential for improper use of evidence relating to the merits of the claim at the certification stage. This was identified to by Cumming J. in *Fehringer v. Sun Media Corp.*,[63] in which he quashed subpoenas requiring certain defendants to provide oral evidence pursuant to rule 39.03 in advance of certification. The subpoenas were quashed on the basis that such evidence could "give the misleading appearance of influencing the outcome of the certification motion."[64] This suggests that parties should be denied access to documents that relate solely to the merits of a claim prior to certification, not only because such evidence serves no useful purpose at that stage of the proceeding, but also because parties should be discouraged from introducing such evidence upon certification owing to its potential prejudicial effect. In other words, courts should be careful not to condone "fishing expeditions" for evidence that has no bearing on certification but may be used to "colour" the record.

In conclusion, justifications for denying a plaintiff (or prospective plaintiff) access to evidence of the merits prior to the certification motion range from technical, procedural points to issues of efficiency, to more fundamental issues of fairness between the parties. Over-reaching requests for production in the pre-certification stage have generally been discouraged by Canadian courts and should continue to be discouraged lest they become, in the words of Edwards J. "a potential settlement tool in the hands of a plaintiff who may not have a certifiable class action."[65] This rationale applies especially in instances where it has not yet been determined that the plaintiff will even be granted the right to commence its action, let alone have it certified.

## G. ADDITIONAL JUSTIFICATIONS FOR REFUSING EARLY DISCOVERY IN A SECURITIES CLASS ACTION

A further justification for deferring production in a securities class action emerges in cases where a parallel class proceeding is being advanced in the US or another foreign jurisdiction. In such circumstances, an Ontario

63 [2001] O.J. No. 5783 (S.C.J.).
64 *Ibid.* at para. 17.
65 *Servier No. 2*, above note 61 at para.6.

defendant may be particularly vulnerable to tactics designed to obtain early discovery. This point was certainly raised at the introduction of Bill 198; some critics noted the potential for American plaintiffs' counsel working in conjunction with Ontario lawyers to exploit the Ontario secondary market civil liability regime in an attempt to "detour around 'roadblocks' that currently impede the successful prosecution of U.S. class actions."[66]

While an important component of the leave test is that the application be brought in good faith, cross-examinations on affidavits filed on the leave application will precede any judicial determination of the *bone fides* of the applicant. To provide one example, the Ontario leave application process could be used to obtain particulars necessary to meet American requirements for pleading or proving *scienter*. In fact, Joe Groia has already identified a strategy that could be used to exploit section 138.8 in this fashion:

> The gift of prescient foresight is not required to anticipate cases where an Ontario action might be launched despite clear indications that it could never prove financially viable in isolation. Consider, for example, a claim where the class size is relatively small due to a limited number of Ontario trades made in the subject issuer's securities during the relevant period. However, working in concert, U.S. and Ontario counsel might utilize an Ontario action, and specifically the leave application, as a fact-finding opportunity intended, at least in part, to assist U.S. counsel in obtaining disclosure and evidence required to plead the necessary particulars in the U.S. The Ontario claim must nevertheless continue as the good faith and ethical requirements for lawyers must be considered and met.[67]

In the wake of the *Silver* decision and given the present uncertainty as to whether the one in *CV Technologies* will be upheld on appeal, there may be instances where a respondent to an application under Part XXIII.1 may be forced to consent to leave in order to foreclose the use of opportunistic strategies such as the one outlined above.

66 Joseph Groia, Karen Danielson, & Michael Zogala, "The Future of Securities Class Actions in Canada: A Comment on the Article of Philip Anisman and Garry Watson" (2006) 3 Can. Class Action Rev. 527 at 532.

67 *Ibid.* at 538.

# H. *SILVER* AND *CV TECHNOLOGIES* — A CLOSER READING

## 1. *Silver v. Imax*

### a) Background to the *Silver* Decision

In *Silver*, the prospective plaintiffs commenced an application pursuant to section 138.8 of the *OSA* to commence an action in which it was alleged that Imax's financial results were materially false and misleading as a result of improper revenue recognition practices. The plaintiffs alleged that on 17 February 2006 Imax erroneously announced that it had completed a record of fourteen theatre system installations in the most recent quarter.[68] In the wake of this achievement, Imax declared on 9 March 2006 with the release of its audited financial statements that it was placing the company up for sale. On 9 August 2006, Imax announced that the US Securities and Exchange Commission (SEC) had requested an interview to discuss potentially improper revenue recognition relating to the fact that of the fourteen theatre systems Imax previously stated were completed in the fourth quarter of 2005, "ten had not opened during that quarter, and the screens of seven of the ten were not installed until 2006." Consequently, the applicants in *Silver* alleged they were materially misled by the company during the relevant period by inaccurate financial statements, which adversely and materially affected their investment decisions.[69]

Central to the applicants' refusals motion, and no doubt a key component of Imax's due diligence defence to the claims proposed to be brought against it,[70] was an internet posting that was written on a Yahoo!

68 *Silver*, above note 4 at para. 7.

69 *Ibid.*

70 Above note 48. *OSA*, above note 2, Part XXIII.1 provides a due diligence defence under s. 138.4(6), "Reasonable Investigation":

> A person or company is not liable in an action under section 138.3 in relation to,
>
> (a) a misrepresentation if that person or company proves that,
>
> (i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and
>
> (ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation; or

internet message board, and which was referred to in the *Silver* decision as the "Delhi Post." The Delhi Post, which appeared in November 2005, alleged that Imax was the subject of an investigation by the SEC and contained numerous other allegations of fraud by Imax "with respect to faking theatre system installations, and in particular, the Delhi, India installation."[71] The message was left by an anonymous source; however, the allegation that Imax was under investigation by the SEC in November 2005 was false.[72]

### b) Adopting the "Semblance of Relevance" Test

Counsel for the respondents advanced two basic arguments for a more restrictive test. First, they argued that a plaintiff generally has no pre-action rights to compel production and disclosure from a prospective defendant.[73] Second, the respondents urged van Rensburg J. to consider the screening function of the court as the "counterbalance to the new statutory cause of action that relieves a shareholder in certain circumstances from having to prove reliance on an issuer's misrepresentation," noting that adopting the broad "semblance of relevance" test to the scope of cross-examinations on affidavits filed on the leave application would negate the gatekeeper function of the court.[74]

Justice van Rensburg rejected the respondents' argument that only narrow inquiries into the merits of the underlying claim should be allowed and ordered that most of the questions refused be answered. She adopted this approach by way of analogy to examination procedures that would apply once an action had already been commenced. As a result, van Rensburg J. determined that the same broad test for relevance that is

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(b) a failure to make timely disclosure if that person or company proves that,
  (i) before the failure to make timely disclosure first occurred, the person or company conducted or caused to be conducted a reasonable investigation, and
  (ii) the person or company had no reasonable grounds to believe that the failure to make timely disclosure would occur.

Further, s. 7 provides a list of eleven factors to be considered by the court in determining the due diligence defence. These factors allow the court to input the competency and experience of the company or individual at question into the decision. See *OSA*, *ibid.*, s.138.8(7).

71 *Silver*, above note 4 at para. 22.

72 *Ibid.*

73 See *Stern*, above note 52; see also *Durling*, above note 54.

74 *Silver*, above note 4 (motion) at para. 15.

applied on an examination for discovery (the "semblance of relevance" test) applies to evidence that is producible on the leave application.

Justice van Rensburg further rejected the restrictive approach advocated by the respondents on the basis of a plain reading of the statutory language.[75] While she acknowledged that prospective defendants are generally not required by the *Rules of Civil Procedure* to make documentary production and that, as a general rule, shareholders have no right of access to confidential records of issuers; she concluded that the special rights established under Part XXIII.1 make such general rules irrelevant.[76] Justice van Rensburg noted that the rights outlined in section 138.8 of the *OSA* are not generally afforded to plaintiffs in our court system; however, she found that the express intention of the legislature was to create special remedies and procedures for shareholders when they choose to avail themselves of Part XXIII.1.[77]

### c) The Evidence at Issue in *Silver*

In support of their motion, the applicants filed the affidavit evidence of the proposed representative plaintiffs, three proposed experts, and a member of the class counsel team. In opposition to the leave motion, each named respondent swore an affidavit. Additionally, the respondents filed affidavit evidence from a proposed expert for the defence, and the affidavit of a law clerk employed by the respondents' counsel.[78]

In cross-examination on these affidavits, the applicants sought background information to the events surrounding the recognition of revenue in 2006, as well as the investigation that was undertaken by the company after its discovery of the Delhi Post, which ultimately led to the financial restatements. The question concerning the Delhi Post to which the applicants sought answers included whether and to what extent the respondents were put on notice of a concern regarding the company's approach to revenue recognition in respect of as-yet incomplete theatre installations; the reaction of Imax management and the investigations undertaken; and the conclusions reached and relied upon by Imax management.[79] Justice van Rensburg held that the documents surrounding these questions were not covered by litigation privilege and, furthermore,

75 *Ibid.* at para 17.

76 *Ibid.*

77 *Ibid.*

78 *Ibid.* at para. 8. In particular, Imax's in-house counsel, the Chair of the Audit Committee of Imax, and a partner of PricewaterhouseCoopers (Imax's auditors), each filed an affidavit.

79 *Ibid.* at para. 26.

that "the full extent of [Imax's in-house counsel's] report respecting the Delhi Post, including all recommendations and advice is relevant to the due diligence defence, and any privilege that would otherwise apply has been waived."[80]

The respondents also refused to answer questions and undertakings concerning the 2005 year-end audit of Imax by PricewaterhouseCoopers (PwC). This line of questioning was aimed at ascertaining the underlying facts concerning the theatre systems, which was argued by the applicants to be important to the motion because it may have informed Imax management's decisions with regard to revenue recognition and in evaluating whether the respondents exercised the required due diligence to meet that defence.[81] Justice van Rensburg agreed with the applicants and ordered production of this information.[82]

A third line of questions involved requests that Imax divulge its revenue recognition policies, including internal memoranda on the subject, and provide amendments made to such policies after the investigation into the Delhi Post during the relevant time periods.[83] As Imax's approach to revenue recognition for its theatre systems was found by van Rensburg J. to lie at the heart of the matter because it would have informed the diligence process, such documents were deemed relevant and each of the related refused questions was ordered to be answered.

Finally, a fourth and fifth line of questions related to Imax's internal review of its draft 2005 Form 10-K and the restatement process, respectively. Again, this information was found to be at issue as it related to the information that would have been available during the relevant period and went to the diligence defence.[84] Justice van Rensburg ordered that both of the Imax internal review questions, as well as two of the three restatement-process questions, be answered.[85]

### d) The "Semblance of Relevance" Test: Preliminary Analysis

Given that the test to be applied on the leave application necessarily involves an evaluation of the merits of the proposed action, the imposition of the "semblance of relevance" test led to the conclusion that the

80 *Ibid.* at para. 28.
81 *Ibid.* at para. 30.
82 *Ibid.*
83 *Ibid.* at para. 31.
84 *Ibid.* at para. 33.
85 *Ibid.* at paras. 33–34. It is worth noting that one question was dismissed for being too broad.

scope of possible production obligations extended to practically every matter at issue in the proposed action. Provided that an applicant asks the right questions, it is hard to see why a respondent who files an affidavit on the leave motion would not be required to make full-scale documentary production as they would at the discovery stage. Indeed, based on the principles enunciated by van Rensburg J., it is difficult to understand why she rejected any of the applicants' requests for production.

More alarming for defendants, van Rensburg J. effectively acknowledged that "fishing expeditions" could result from the imposition of the "semblance of relevance" test, but she appears to have viewed this as an unavoidable result:

> In deciding this motion [for leave to commence proceedings] the court must take a hard look at what facts are potentially relevant and material to the statutory claim and defences, as presented in the draft pleading and in the respondent's affidavits. Any question which is clearly not tethered to this inquiry in the sense that it is pursing other potential wrongdoing or practices of Imax, would have no semblance of relevance. *However, a question that is potentially relevant to the facts alleged in respect to the statutory claims set out in the proposed statement of claim and in the defences raised in the responding affidavits must be answered even if it might reveal some other potential issues or wrongdoing not currently contemplated by the statutory claim.*[86]

She observed that, provided a line of questioning has a semblance of relevance to the allegations and defences advanced in respect of the statutory misrepresentation claim, cross-examinations on the leave affidavits may provide an opportunity for plaintiffs to obtain evidence of new wrongdoing they had not previously contemplated.

### e) Leave to Appeal Denied

The respondents sought leave to appeal the decision of van Rensburg J. to the Divisional Court. Langdon J. denied leave on the basis that the legislature's intent was to have respondents cross-examined on their affidavits in accordance with the rules of court. Accordingly, he found that the "semblance of relevance" test clearly applied. In his reasons, Langdon J. reviewed section 138.8 and concluded that van Rensburg J's conclusion was not inconsistent with the court's gatekeeper function because the court is granted the discretion to refuse to order answers to

86 *Ibid.* at para. 20 [emphasis added].

questions that go above and beyond the necessary scope of the inquiry.[87] Finally, Langdon J. endorsed van Rensburg J.'s broad articulation of the test stating that, "a question is relevant if the answer to it tends, directly or indirectly, to make the existence of a fact in issue either more or less likely."[88]

## 2. *Ainslie v. CV Technologies*

### a) Overview of the *CV Technologies* Decision

The proposed statement of claim in *CV Technologies* alleged that in CV Technologies' 2006 fiscal year, and in the first quarter of its 2007 fiscal year, the company inaccurately represented that its financial statements were prepared and reported in accordance with Generally Accepted Accounting Principles (GAAP).[89] The applicants alleged that the statements inappropriately recognized sales of Cold-FX products to customers in the US as revenue earned in those periods, thereby providing a misleading picture of CV Technologies' financial results. The issuer, the auditor, and several directors of the issuer were named as respondents to the application for leave.

The case dealt with section 138.8(2) and the issue of whether each proposed respondent to an application for leave is *required* to file an affidavit. The motion before Lax J. was brought by the applicants to compel each of the respondents to file an affidavit of the material facts upon which they intended to rely on the leave application or, in the alternative, compelling a representative of each respondent to attend and be cross-examined on the pending application pursuant to rule 39.03 of the *Rules of Civil Procedure*.[90] Although Lax J. considered a different question than van Rensburg J. in *Silver* (whether one must file an affidavit at all, as opposed to determining the permissible scope of the cross-examina-

87 *Ibid.*, at para. 8.

88 *Silver*, above note 4 (application for leave to appeal) at para 13.

89 *CV Technologies* (original decision), above note 6 at para. 3.

90 Rule 39.03 of the *Rules of Civil Procedure*, above note 42 reads as follows:

> (1) Subject to subrule 39.02 (2), a person may be examined as a witness before the hearing of a pending motion or application for the purpose of having a transcript of his or her evidence available for use at the hearing.
>
> ...
>
> (4) With leave of the presiding judge or officer, a person may be examined at the hearing of a motion or application in the same manner as at a trial.

tion upon an affidavit once a respondent has decided to file one), *CV Technologies* nonetheless provides a stark contrast to the *Silver* decision.

Justice Lax determined that there was no requirement on a respondent to file affidavit evidence on a leave application. She made this finding notwithstanding the language in section 138.8(2), which provides that "upon application under [section 138.8] the plaintiff and each defendant *shall* serve and file one or more affidavits setting forth the material facts upon which each intends to rely."[91] The implication of this determination is that it is open to a respondent to insulate itself from the extensive cross-examination permitted by van Rensburg J. in *Silver*. A respondent may achieve this by filing an affidavit from an expert or other third party who cannot expose the respondent to a "fishing expedition" into the merits of the case. A respondent may also opt to file no affidavit evidence at all and simply require the applicant to meet its onus through legal argument and/or cross-examining the affiants.

### b) The Evidence and the Arguments

On the leave application, the applicants delivered affidavits in support of both the leave application and the certification motion. The respondent issuer only filed the affidavits of two expert accounting witnesses, while the respondent auditor filed no affidavit material at all and indicated that it intended to rely upon the applicants' motion materials.

On the premise that section 138.8(2) creates a mandatory obligation, the applicants brought a motion to compel each of the respondents to serve and file its own affidavit, and to attend and be cross-examined on such affidavits. In response, the respondents argued that the applicants' efforts to compel them to provide evidence was an "improper attempt to dictate the evidence on which the defendants can rely in opposition to the leave motion," while providing greater disclosure rights to the applicants than would be afforded to a plaintiff to an action in which it is unnecessary to obtain leave.[92] The respondents argued that such compulsion was not consistent with the "plain meaning of the section," and thereby inappropriately shifted the onus from the applicants to the respondents, contrary to the legislative intent.[93]

91 Above note 2, s. 138.8(2) [emphasis added].

92 *CV Technologies* (original decision), above note 6 at para. 6. See also *CV Technologies Inc.*, [2008] O.J. No. 4891 (S.C.J.) (Factum of the Respondent at para. 5).

93 *CV Technologies* (original decision), *ibid.*

### c) Conclusion: Defendants Not Required to File Affidavits under Section 138.8(2)

As discussed, section 138.8 requires each party to file one or more affidavits setting out the material facts upon which they *intend to rely* on the leave application. Unlike van Rensburg J., Lax J. paid considerable attention to the underlying legislative intent and history of Part XXIII.1 and, in particular, to the gatekeeper provision under section 138.8. She reached an entirely different conclusion regarding the proper approach in interpreting the provisions of the leave requirement and determined that a respondent is *not* required to file an affidavit if it does not intend to rely upon one. In fact, Lax J. determined that the "gatekeeper provision" was only intended to set a bar and that a respondent that chooses not to file affidavit material accepts the risk that it may be impairing its ability to successfully defeat the motion for leave and is likely foregoing its right to assert the statutory defences available under Part XXIII.1 of the *OSA*.[94]

Justice Lax upheld the right of parties to present their case as they see fit, which includes the right to oppose the leave motion on the basis of the record put forward by the applicant, as the auditor intended, or on the basis of the affidavits of experts, as CV Technologies intended.[95] She explained her reasoning as follows:

> To accept the plaintiffs' submissions would require each defendant to produce evidence that may not be necessary for the leave motion and would serve no purpose other than to expose those defendants to a time-consuming and costly discovery process. It would sanction "fishing expeditions" prior to the plaintiffs obtaining leave to proceed with their proposed action. This is an unreasonable interpretation of section 138.8(2). It is inconsistent with the scheme and object of the Act. Properly interpreted, the ordinary meaning of subsection 138.8(2) is that a proposed defendant must file an affidavit only where it intends to lead evidence of material facts in response to the motion for leave.[96]

Justice Lax took a purposive approach to the seemingly mandatory language of section 138.8(2) and brought the scope of the respondents' production obligations in line with the legislative intention that the leave requirement curtail, rather than facilitate, abusive proceedings. She also

94 *Ibid.* at para. 24.

95 *Ibid.* Furthermore, Lax J. compared s. 138.8(2) with r. 20.04 of the *Rules of Civil Procedure*, above note 42, where the onus is on the plaintiff to establish the leave requirements have been met.

96 *Ibid.* at para. 25.

rejected the applicants' request to be permitted to examine a respondent witness pursuant to rule 39.03, finding that "to permit the plaintiffs to accomplish indirectly what they are prevented from doing directly would amount to an abuse of process."[97]

Finally, Lax J. found the decision of van Rensburg J. to be distinguishable and not binding:

> [Justice] van Rensburg . . . considered subsection 138.8(2) to prescribe a "mandatory requirement for each plaintiff and each proposed defendant to set out the facts by affidavit with the right to cross-examine." I respectfully suggest that these comments should be confined to the facts and circumstances at issue in *Silver*. These comments were made in *obiter* in resolving a refusals motion in circumstances where the defendants had filed affidavit material. It is important to recognize that in *Silver*, the court was not addressing the interpretation to subsection 138.8(2). The reasons make no reference to the Allen Committee Reports or CSA Notice 53-302, which are admissible as evidence of the purpose of the legislation and intention of the legislature. I regard these documents as interpretive tools, it would appear that they were not provided to the court in *Imax*.[98]

Justice Lax observed that, in finding that the respondents were required to answer questions that met the "semblance of relevance" test, van Rensburg J. "appears to have been influenced by the unfairness that would result if the defendants were able to file evidence asserting statutory defences but were immune to having that evidence fully tested by cross-examination."[99]

It is interesting to note that Lax J.'s observation that van Rensburg J. did not have the Allen Committee Report or the CSA Notice 53-302 before her was incorrect. In a supplementary judgment correcting this point, Lax J. conceded that van Rensburg J. was made aware of these materials, leading one to conclude that van Rensburg J. chose to disregard the reports in rendering her decision.[100]

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97 *Ibid.* at para. 29. Justice Lax also noted the plaintiffs had put forth an "unreasonable interpretation of section 138.8(2)" that is "inconsistent with the scheme and object of the [new legislation]." See *ibid.* at para. 25.

98 *Ibid.* at para. 23.

99 *Ibid.* at para. 22.

100 *CV Technologies* (supplementary reasons), above note 6 at para. 1.

### d) Leave to Appeal Granted in Part

Justice Bellamy granted leave to appeal on the question of whether section 138.8(2) imposes a mandatory obligation on respondents to file evidence, but she did not grant leave to appeal Lax J.'s decision that section 39.03 was not available to the plaintiffs. In granting leave she emphasized the broad significance of the issue:

> On a motion for leave to appeal under rule 62.02(4)(b), I do not need to conclude that the decision was wrong or even probably wrong or that, if I had been hearing the original motion, I would have decided it differently. It is sufficient if I am satisfied that the correctness of the order is open to very serious debate: *Ash v. Lloyd's Corp.* (1992), 8 O.R. (3d) 282 (Gen. Div.).
>
> In my view, this novel issue is one that is open to very serious debate and is of general public importance requiring the attention of an appellate court. The motions judge's decision was not specific to the facts of this case, but consisted of the first interpretation of a new section of the *OSA*. The result of her decision is that it will potentially affect the conduct of all or many future leave motions brought under Part XXIII.1 of the *OSA*, together with the conduct of proceedings of any other provincial legislation that that follows secondary market disclosure provisions of Part XXIII.1.[101]

## I. EVALUATION OF THE LEGISLATION IN LIGHT OF RECENT CASE LAW

The decision in *Silver* has been criticized for failing to interpret a respondent's production obligations narrowly in light of the pro-defendant gatekeeper function of section 138.8. However, some of this criticism might be fairly directed at the legislation itself rather than its judicial interpretation. Given the legislation's directions that affidavits "shall" be filed by both parties and that cross-examination on these affidavits is to be conducted "in accordance with the rules of court,"[102] it is difficult, without more express statutory guidance, to conceive of a standard other than the "semblance of relevance" that would not constitute a significant departure from established rules of court relating to cross-examinations

101 *CV Technologies* (application for leave to appeal), above note 6 at paras. 12–13.
102 *OSA*, above note 2, s. 138.8(3).

on affidavits.[103] It is fair to say that the procedural mechanisms prescribed by section 138.8 do not adequately address the concern that a leave provision intended to protect defendants may actually expose them to unprecedented and potentially threatening production obligations. However, it is also somewhat unfair to the judiciary to expect them to resolve this problem, especially in an area of the law in which the legislation is complex and designed to serve a myriad of policy objectives. As the *Silver* and *CV Technologies* decisions themselves demonstrate, individual judges will inevitably disagree about the appropriate boundary between permissible and potentially abusive evidentiary forays as they grapple with this new legislation. The result will be a period of great uncertainty for both applicants and respondents. While it is easy, with the benefit of hindsight (*and* the benefit of two seemingly contradictory lower court decisions), to criticize new legislation, it is also possible to conceive of provisions that might have provided a clearer direction to our courts. We offer three possibilities.

First, if the objective is to screen claims meaningfully without placing inordinate production obligations on a respondent, it should be possible to expressly vary the established rules of court that govern the

103 See r. 39.02(1) of the *Rules of Civil Procedure*, above note 42, which establishes the procedure for cross-examination on an affidavit filed on an application. Caselaw interpreting the scope of cross-examination under r. 39.02(1) has established that questions must be answered if they are (i) relevant to any matter in issue on the motion for which the affidavit is to be used, (ii) fair, and (iii) directed in a *bone fide* way to an issue on the motion or to the credibility of the witness. See, for example, *Seaway Trust Co. v. Markle* (1988), 25 C.P.C. (2d) 64 (Ont. Master); *Superior Discount Ltd. v. Perlmutter and Co.*, [1951] O.W.N. 897 (Master). Further, cross-examination does not need to be limited to the four corners of the affidavit, but may cover any matters relevant to the issue in respect of which the affidavit is filed; see *Re Lubotta and Lubotta*, [1959] O.W.N. 322 (Master). In *Silver*, above note 4 at para. 12, van Rensburg J. cited *Caputo v. Imperial Tobacco Ltd.* (2002), 25 C.P.C. (5th) 78 (Master), aff'd (2003), 33 C.P.C. (5th) 214 (S.C.J.) with approval as an articulation of the relevant principles:

- If you put it in, you admit its relevance and can be cross-examined on it—at least within the four corners of the affidavit;
- You can't avoid cross-examination on a relevant issue by leaving it out;
- You can't get the right to cross-examine on an irrelevant issue by putting it in your own affidavit; and
- You can be cross-examined on the truth of facts deposed or answers given but not on irrelevant issues directed solely at credibility.

scope of permissible cross-examination to allow some limited evidence to be adduced by the respondent without opening the door so wide as to subject it to potentially full-scale production obligations. A provision that cross-examination on filed affidavits is limited to matters addressed in those affidavits might achieve this purpose.

A second approach would be to add a provision that expressly permits a respondent to restrict its evidence to information in the public record and to correspondingly limit the scope of cross-examination to public information. This might provide some protection for a respondent's confidential information, while still allowing it some scope to contest factual allegations that are demonstrably untrue. Even in the absence of an express legislative provision, and with the endorsement that Lax J. provides for this approach in *CV Technologies* (provided that this endorsement survives appeal), counsel can try to achieve this objective by introducing public documents with the affidavits of law clerks or other witnesses who do not have any knowledge of the respondent's business. However, evidence introduced in this manner can be of limited persuasive force because it does not provide much opportunity for the party who tenders it to explain it and because it can be viewed with skepticism by the courts. If a corporate affiant could limit her evidence to public information without fear of being exposed to cross-examination on unrelated confidential topics, it may improve the court's ability to assess and screen claims.

Furthermore, a legislative provision could have given effect to the restrictions that Lax J. effectively read into the law in *CV Technologies*. A qualification of section 138.8 that permits a respondent to elect not to file an affidavit would allow a respondent to contest the leave application without exposing itself to a "fishing expedition." Such a respondent would still have the option of cross-examining the applicant to force it to meet its onus on the leave application. A respondent could also ask the court to draw negative inferences from a lack of evidence in the record, or it could try to defeat the applicant's case on the basis of legal arguments that take the pleadings "as true," as they would do on a motion to strike pursuant to rule 21. If the *CV Technologies* decision withstands appeal, this will ultimately be the outcome, but a legislative provision that made this clear from the outset would have avoided any uncertainty.

Finally, an express legislative direction to the court that it shall not draw negative inferences from a respondent's failure to adduce evidence in respect of a particular issue would help to level the playing field. Such an approach would neutralize the chilling effect that the application of

the "semblance of relevance" test may have on respondents who face the stark and unappealing choice of either consenting to the leave application or subjecting themselves to highly invasive discovery by an applicant who has, as yet, failed to establish their right to commence an action.

## J. CONCLUSION: WHERE DOES THIS LEAVE US?

It is certainly possible to reconcile the decisions in *Silver* and *CV Technologies* by concluding that a respondent may elect whether to file an affidavit on a leave application pursuant to section 138.8; however, once the respondent commits to this strategy, it must be prepared to submit to extensive cross-examination into the merits of the claim. While this still leaves defence counsel with strategic options, many defendants to actions brought pursuant to Part XXIII.I of the *OSA* will still find this to be an unsatisfactory compromise that will severely curtail the courts' ability to screen claims as the legislative drafters intended them to do.

Prospective defendants who contest applications for leave may find themselves exposed to an invasive "pre-action" discovery process that may be used by applicants to create embarrassment, plead new and more threatening or more particularized claims, create substantial settlement pressure at an early stage of the proceeding, and, in extreme cases, further the ulterior motive of funnelling information to plaintiffs' counsel in other jurisdictions. It will be a rare respondent who will dare open the floodgates to extensive production obligations by filing its own affidavit. It is conceivable that many, including those with highly compelling defences, will simply consent to leave rather than face this prospect, rendering the leave application irrelevant. Others will restrict their challenges to legal arguments based on the pleadings, converting the leave application into the equivalent of a motion to strike. If *CV Technologies* is upheld, others may attempt to shield their confidential documents by filing affidavits from experts or witnesses other than themselves, even when they are the best placed witnesses to provide this evidence. Clearly respondents are not left without recourses, but it is hard so see how section 138.8 can ever live up to its initial promise of protecting them from meritless claims.

While *Silver* is the first word on the degree to which a respondent, who chooses to contest a leave application, exposes itself to cross-examination on the merits of the claim, as *CV Technologies* demonstrates, it is far from the last. We can expect that the jurisprudence under this section will take many years to develop, and once the rules have been

established, it is reasonable to expect that the litigation of securities class actions will be an even more specialized field, with its own distinct evidentiary considerations and arguments. In the meantime, respondents and their counsel may wish to err on the side of caution when deciding whether they have the courage to challenge a leave application.