

File No. CI 05-01- 42765

THE QUEEN'S BENCH
Winnipeg Centre

BETWEEN:

BERNARD W. BELLAN,

Plaintiff

- and -

CHARLES E. CURTIS, PETER OLFERT, WALDRON (WALLY) FOX-DECENT, LEA BATURIN, ALBERT R. BEAL, RON WAUGH, DIANE BERESFORD, SYLVIA FARLEY, ROBERT HILLIARD, ROBERT ZIEGLER, JOHN CLARKSON, DAVID G. FRIESEN, HUGH ELIASSON, SHERMAN KREINER, JAMES UMLAH, JANE HAWKINS, JANICE LEDERMAN, PRICEWATERHOUSE COOPERS LLP, NESBITT BURNS INC., WELLINGTON WEST CAPITAL INC., CROCUS CAPITAL INC., THE MANITOBA SECURITIES COMMISSION and THE CROCUS INVESTMENT FUND

Defendants

Proceedings under *The Class Proceedings Act*, C.C.S.M. c. C130

File No. CI 06-01-46955

THE QUEEN'S BENCH
Winnipeg Centre

BETWEEN:

BERNARD W. BELLAN, and ROBERT NELSON,

Plaintiffs,

- and -

THE GOVERNMENT OF MANITOBA,

Defendant,

Proceedings under *The Class Proceedings Act*, C.C.S.M. c. C130

PLAINTIFFS' REPLY BRIEF

(Contested Certification before Hanssen J. on February 25-29, 2008)

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- and -

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PART I

Documents to be Relied Upon

1. *Bellan v. Curtis et al*, Amended Amended Statement of Claim, (“Bellan #1 SOC”)
2. *Bellan and Nelson v. Government of Manitoba*, Amended Statement of Claim, (Bellan #2 SOC)
3. Affidavit of Bernard Bellan, sworn September 30, 2005
4. Affidavit of Professor Lawrence Rosen, sworn September 26, 2005; Supplemental Affidavit of Professor Lawrence Rosen, sworn October 16, 2007; and Further Supplemental Affidavit of Professor Lawrence Rosen, sworn November 23, 2007
5. Affidavit of Matthew Sokolsky, sworn October 31, 2005
6. Affidavit of Norman Boudreau, sworn January 17, 2008
7. Affidavit of Penny Chan, sworn October 16, 2006
8. Affidavit of Navnish Dhanoa, sworn November 14, 2007
9. Transcript of Cross-Examination of Bernard Bellan, held Decemeber 4, 2007
10. Transcript of Cross-Examination of Lawrence Rosen, held December 20, 2007

PART II
Authorities Relied Upon

Statutes

1. *Class Proceedings Act*, C.C.S.M. c. C130
2. *Securities Act*, C.C.S.M., c.S50

Authorities

3. *1176560 Ontario Ltd. v. Great Atlantic Pacific Co. of Canada*, (2002) 62 O.R. (3d) 535 (S.C.J.) at para 45; affirmed, [2004] O.J. No. 865 (Div. Ct.)
4. *Bellan v. Curtis*, [2007] M.J. No. 325 (Q.B.)
5. *Bellan v. Curtis et al.*, transcript of decision of Hanssen J., dated May 22, 2007
6. *Cassano v. The Toronto Dominion Bank*, [2007] ONCA 781
7. *Cholakis v. Cholakis*, [2006] M.J. 151 (Q.B.)
8. *Cohen v. Jonco Holdings Ltd. et al.*, [2005] M.J. No. 126, 2005 MBCA 48
9. *Escott v. Bar Chris Construction et al.* 283 F.Supp 643 (S.D.N.Y. 1968); 1968 U.S. Dist LEXIS 3853
10. *Feit v. Leasco Data Processing Equipment Corporation et al.*, 332 F. Supp 544 (E.D.N.Y. 1971); 1971 U.S. Dist LEXIS 11885
11. *Hollick v. Toronto (City of)* (1999) 46 O.R. (3d) 257 (C.A.)
12. *Hollick v. Toronto (City of)*, [2001] 3 S.C.R. 158
13. *Home Insurance Co. of New York et al. v. Lindal & Beattie*, [1934] 1 D.L.R. 497 (S.C.C.)
14. *Kerr v. Danier Leather Inc.* [2007] S.C.J. No. 44
15. *Kerr v. Danier Leather Inc.*, [2004] O.J. NO. 1916 (S.C.J.)
16. *Manitoba Securities Commission v. Crocus Investment Fund*, [2006] MBQB 87
17. *Markson v. MBNA Canada Bank*, [2007] O.J. No. 1684 (C.A.)
18. Ontario Law Reform Commission, *Report on Class Actions*, 1982, pp. 127-8 and 139
19. *Williams v. Fleetwood Holdings Ltd.* (1973), 41 D.L.R. (3d) 626 (Sask. C.A.)

PART III

List of Points to be Argued

1. Wellington West's assertion of an indemnity claim is not an impediment to certification.

2. The Plaintiffs have provided a full and appropriate evidentiary record to support certification.

3. Notwithstanding the settlement in principle that has been reached with the Directors and Officers, there is a sufficient claim in direct liability against the Province to support certification.

PART III
ARGUMENT

Overview

1. The Plaintiffs have reached agreements in principle to settle the claims of the class against the Directors, the Officers, PricewaterhouseCoopers, Nesbitt Burns, and the Receiver on behalf of Crocus Investment Fund and Crocus Capital Inc. The most recent of these agreements in principle was reached on February 14, 2008. The Plaintiffs and the settling Defendants are working to conclude formal settlement agreements and will present these to the court for approval when finalized.

2. This leaves Wellington West, the Manitoba Securities Commission and the Province as the remaining three Defendants with whom settlements have not been reached. The Plaintiffs seek certification against these non-settling Defendants. The Plaintiffs respond to arguments raised by these Defendants as follows.

Wellington West

(a) The Indemnity

3. Wellington West's primary argument against certification is based on a contractual indemnity claim it asserts against Crocus Investment Fund. In effect, it says that certification should not be granted because it will be successful at trial in asserting this indemnity, and that it will also use this indemnity to delay or prevent a distribution of Crocus Investment Funds' assets to class members.

4. Wellington West's argument falls outside the parameters of the issues that are usually considered on a certification application, as the argument is based on the merits of the underlying action. As set out in the Plaintiffs' certification brief, a certification hearing deals with procedural matters – not the ultimate merits of the underlying action.

In response, however, the Plaintiffs point out that no contractual indemnity is absolute and there are a number of bases on which the trial judge may deny Wellington West's indemnity claim. These include:

- (a) the contract may be held to be void as against public policy. Wellington West is attempting to avoid compliance with its statutory obligations, and to escape liability to class members by paying the class members with their own money;
- (b) wrongdoing by Wellington West may disentitle it to any indemnity;
- (c) the indemnity may be barred by the *Pierringer* order that will be sought in the settlement with Crocus Investment Fund;
- (d) as with any contract, Wellington West has a duty to mitigate. At the conclusion of trial, the trial judge may consider whether written offers to settle were exchanged between the parties, and whether these have capped or cancelled the asserted indemnity; and
- (e) the indemnity is self-defeating. If Wellington West reduces the estate by its indemnity, this adds to class member damages which may be claimed against Wellington West. The court may hold that this circularity nullifies the indemnity.

5. There is a good possibility, for the reasons set out below, that key terms of Wellington West's underwriting agreement, including the provisions for indemnity, are void as against public policy. On its face, Wellington West's underwriting agreement represents an unlawful abdication of its statutory duties under the *Securities Act*. Wellington has either fundamentally misconstrued, or deliberately shirked, its obligations as underwriter.

6. The purpose of securities legislation is investor protection. This has been described by the Supreme Court of Canada as follows:

“The *Securities Act* is remedial legislation and is to be given a broad interpretation: *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557. It protects investors from the risks of an unregulated market, and by its assurance of fair dealing and by the promotion of the integrity and efficiency of capital markets it enhances the pool of capital available to entrepreneurs. The Act supplants the "buyer beware" mind set of the common law with compelled disclosure of relevant information.”

Kerr v. Danier Leather Inc. [2007] S.C.J. No. 44 at para 32

7. To achieve that purpose, section 53(1) of the *Securities Act* creates an express obligation on underwriters to ensure the accuracy of a prospectus before a security can be sold to the public. Section 53(1) reads as follows:

“Certificate in prospectus by underwriter

53(1) A prospectus shall contain a certificate in the following form, signed by the underwriter or underwriters who, with respect to the securities offered by the prospectus, are in a contractual relationship with the person or company whose securities are being offered by the prospectus:

“To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part VII of The Securities Act, and the regulations thereunder.”

Securities Act, s.53(1)

8. Wellington signed this certificate in the Crocus Prospectus. It pledged the accuracy of this disclosure. Pursuant to the terms of its underwriting agreement, it was then paid commissions, administrative fees and bonuses.

Sokolsky Affidavit, Exhibit G, pg. 63

Ross Affidavit, Exhibit H, para 3.1., 3.4 and 3.7

9. By the terms of the underwriting agreement, it is not apparent that Wellington West did anything to comply with its obligations as underwriter. Paragraph 4 of the underwriting agreement reads:

“4. The Fund hereby represents and warrants and acknowledges and agrees that the Agent will be relying on such representations and warranties in entering into this Agreement that:...

4.15 Each of the Current Prospectus and the Prospectus, as of its date:

- (a) contains or will contain full, true and plain disclosure of all Material Facts relating to the Common Shares, the Fund and the business which it conducts.”

Ross Affidavit, Exhibit H, para 4 and 4.15

10. Wellington West appears to have relied upon management rather than independently verify the accuracy of the Prospectus. Wellington West collected substantial fees but does not appear to have done anything, other than sell shares to the public, to have earned these fees. Further, by the terms of paragraph 9.1(a) of the underwriting agreement, Wellington West sought to place financial responsibility for any misrepresentation in the Prospectus back onto the Fund. Thus, in addition to shifting Wellington West’s statutory responsibilities back onto the issuer, the agreement purported to remove any economic incentive for Wellington West to comply with its obligations as underwriter.

Ross Affidavit, Exhibit H, para 9.1(a)

11. The obvious purpose for having an underwriter sign the certificate in the prospectus is to add an extra layer of protection for investors. The underwriter functions as an independent check on the securities issuer. Underwriters cannot accept management’s word, but must undertake their own independent investigation. In *Feit v. Leasco Data Processing Equipment Corporation et al.*, the U.S. District Court held:

“The courts must be particularly scrupulous in examining the conduct of underwriters since they are supposed to assume an opposing posture with respect to management. The average investor probably assumes that some

issuers will lie, but he probably has somewhat more confidence in the average level of morality of an underwriter who has established a reputation for fair dealing.”

Feit v. Leasco Data Processing Equipment Corporation et al., 332 F. Supp 544 (E.D.N.Y. 1971) at pg. 581; 1971 U.S. Dist LEXIS 11885 at pg. 104; cited by Lederman J. in *Kerr v. Danier Leather Inc.*, [2004] O.J. NO. 1916 (S.C.J.) at para 103 and 191

12. Similarly, in *Escott v. Bar Chris Construction*, the U.S. District Court concluded that underwriters bear responsibility for the prospectus, and cannot shift this responsibility onto management. The Court held:

“In order to make the underwriters participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them. They may not rely solely on the company’s officers or on the company’s counsel.”

Escott v. Bar Chris Construction et al. 283 F.Supp 643 (S.D.N.Y. 1968) at page 697; 1968 U.S. Dist LEXIS 3853 at page 141; cited by Lederman J. in *Kerr v. Danier Leather Inc.*, [2004] O.J. NO. 1916 (S.C.J.) at para 191

13. Although an underwriter will not have the same intimate knowledge of company affairs as the company itself, that does not excuse the underwriter from the obligation of making some attempt to confirm the veracity of the information contained in a prospectus. As stated by the District Court in *Feit*:

“Dealer-managers cannot, of course, be expected to possess the intimate knowledge of corporate affairs of inside directors, and their duty to investigate should be considered in light of their more limited access. Nevertheless they are expected to exercise a high degree of care in investigation and independent verification of the company’s representations. Tacit reliance on management assertions is unacceptable; the underwriters must play devil’s advocate.

Feit v. Leasco Data Processing Equipment Corporation et al., 332 F. Supp 544 (E.D.N.Y. 1971) at page 106

14. It is long settled law that a contract may be struck as void if it offends public policy. Contracts which offend public policy include those which are harmful to the public if enforced, or which seek to indemnify a wrongdoer against his or her own wrongful act. The Supreme Court of Canada has described this principle as follows:

“The principle which, in our opinion, is applicable to the present case is that stated by Kennedy J. in *Burrows v. Rhodes* [[1899] 1 Q.B., at 828], as follows:

It has, I think, long been settled law that if an act is manifestly unlawful, or the doer of it knows it to be unlawful, as constituting either a civil wrong or a criminal offence, he cannot maintain an action for contribution or for indemnity against the liability which results to him therefrom. An express promise of indemnity to him for the commission of such an act is void.”

Home Insurance Co. of New York et al. v. Lindal & Beattie, [1934] 1 D.L.R. 497 (S.C.C.)

15. In *Williams v. Fleetwood Holdings Ltd.*, the Saskatchewan Court of Appeal struck a mortgage as void where the purpose of the mortgage had been, among other things, to escape the requirements of the Ontario Securities Commission. *Williams* is analogous to the case at bar, where the purpose of Wellington West’s underwriting agreement appears to have been to off-load its statutory obligations as underwriter contrary to s.53(1) of the *Securities Act*.

Williams v. Fleetwood Holdings Ltd. (1973, 41 D.L.R. (3d) 636 (Sask. C.A.)

16. Given the over-riding purpose of securities legislation, namely the protection of the investing public through the requirement of full and complete disclosure, it would be contrary to public policy to allow the persons who failed in their duty to provide full disclosure, (or to make appropriate inquiries to satisfy themselves that full disclosure had been made), to then seek to be indemnified by the people to whom they owed their duty. In the context of this case, it would defeat the purpose of the legislation if an underwriter such as Wellington West could shirk its obligations to Crocus shareholders and then be indemnified by the very same shareholders it had a legal obligation to protect.

17. To the extent that an argument over the merits has any bearing on certification, it is only with respect to whether the pleadings disclose a cause of action, and such arguments are subsumed by s.4(a) of the CPA. It is not plain and obvious that Wellington West's indemnity claim will succeed at trial. On the contrary, it may give rise to further common issue which supports certification. The validity of Wellington West's alleged indemnity could be determined once and for all, at a single trial, for the benefit of all class members.

1176560 Ontario Ltd. v. Great Atlantic Pacific Co. of Canada,
(2002) 62 O.R. (3d) 535 (S.C.J.) at para 45; affirmed, [2004] O.J.
No. 865 (Div. Ct.)

(b) Wellington West can no longer block distribution

18. Wellington cites a decision by Justice McCawley made April 7, 2006, in which an interim distribution of Crocus Fund assets to shareholders was blocked, and suggests that this situation will continue. However, circumstances have changed since April 2006, and Wellington West should not presume that it will be successful in blocking a distribution in the future. Justice McCawley's decision was based on the fact that there were multiple defendants with contractual indemnity claims, many of whom lacked resources to pay for legal representation, and that with so many defendants, the court could not estimate the contingent liabilities.

Manitoba Securities Commission v. Crocus Investment Fund,
[2006] MBQB 87

19. Now there is only one Defendant, Wellington West, asserting a contractual indemnity claim. There is no evidence that Wellington West lacks for resources to pay its lawyers. Further, the recent settlements allow the Plaintiffs to limit the contingent liability related to the class action. If the action is certified, the Plaintiffs will limit the claim against Wellington West for its proportionate liability to the class to a maximum of \$20 million. This will facilitate an application by the Receiver for a distribution of Fund assets to shareholders.

20. The Receiver has valued the Fund at approximately \$88 million. Capping Wellington West's contingent liability at \$20 million frees up a significant portion of the Fund for distribution. This is subject to court approval of the settlements with the settling Defendants, and satisfaction of the conditions to those settlements, such that Wellington West would be the only remaining Defendant asserting an indemnity claim. Distribution of Fund assets can occur at the same time as distribution of the settlement proceeds for the settlements reached with the Directors and Officers, PricewaterhouseCoopers and Nesbitt Burns.

Dhanoa Affidavit, Exhibit D

(c) A class action is manageable; Wellington West offers no alternative

21. Wellington West opposes certification by arguing that the costs of litigating share values will be "monumental". This argument is neither supported by the evidence nor the law. Professor Rosen opines that the issues in this litigation are manageable, and that the Receiver has already done much of the work. As well, the jurisprudence does not permit a defendant to block certification by asserting that the costs of determining its own wrongdoing might be expensive. With only three non-settling Defendants remaining in this action, litigation costs have been reduced. With fewer lawyers and parties involved, and with only one party asserting a contractual indemnity claim against the Fund, this action can proceed to trial in an expeditious and cost effective manner.

Rosen Affidavit, #3, at para 5

Markson v. MBNA Canada Bank, [2007 O.J. No. 1684 (C.A.) at para 48-51

Cassano v. The Toronto Dominion Bank, [2007] ONCA 781 at para 47-50

22. Wellington West suggests that an alternative to a class action would be an action by the Receiver. This argument was already considered and rejected by this Honourable

Court on May 22, 2007, when it dismissed a motion by the Defendant, James Umlah, that this action must proceed as a derivative action. This Honourable Court held:

“I agree with plaintiff’s counsel that this is not a derivative action. A derivative action is, as the plaintiff’s counsel states, one where the injury and the wrong have been done to the company and not to the shareholders.”

Bellan v. Curtis et al., transcript of decision of Hanssen J., dated May 22, 2007

23. Wellington West raises what it says are the “real concerns” of shareholders. Conveniently for Wellington West, it views these “real concerns” as matching Wellington West’s own financial interests. Wellington West appears to believe that what shareholders really want is to just drop their suit against Wellington West without recovery, and accept their losses.

24. It is submitted that the real concern of class members is accountability by those who were responsible for the Crocus scandal. It does not serve the interests of justice to allow Wellington West to avoid accountability for its conduct by threatening to hold the Crocus estate hostage. Wellington West was the underwriter to the Crocus Fund for 10 years from December 12, 1994 until the cease trading order of December 10, 2004. It had a critical role in the operation of the Fund throughout the Fund’s history leading up to its collapse. Each year, Wellington West signed certificates to the Prospectus pursuant to s.53 of the *Securities Act*. These Prospectuses allowed Crocus shares to be sold to the public. Wellington West promised in these certificates that each Prospectus, to the best of its knowledge, information and belief, provided full disclosure, and was free from misrepresentation. As the underwriter, it knew or ought to have known of the Fund’s valuation problems. It was paid commissions for this work as underwriter. Given the fate of Crocus, one wonders what Wellington West actually did to earn these commissions. If Wellington West had done its job correctly, loss to shareholders would have been prevented. In addition to earning commissions, Wellington West had another financial interest in generating revenue for Crocus – it was an investee company of

Crocus. As such, it had a conflict of interest. The Plaintiffs allege that Wellington West chose to favour its own economic interests, and that it ignored its obligations to shareholders.

Bellan #1 SOC, para 59-62

Securities Act, s.53

25. These are serious allegations against Wellington West. The policy goals of the *Class Proceedings Act*, and in particular, access to justice and behaviour modification, are facilitated if this action is certified so that these allegations can be pursued on their merits. Wellington West should not be allowed to use an indemnity claim to insulate itself from all responsibility for its actions. Other Defendants with potential indemnity claims have decided to resolve the claims of class members, and to pay compensation. If Wellington West, as the lone holdout asserting a contractual indemnity, cannot reach agreement with shareholders, then the case should be certified so that the parties can resolve their dispute at trial.

26. The time for Wellington West to have advocated for the real concerns of shareholders was before it signed the Prospectus, when it should have been fulfilling its obligations as underwriter to serve as an independent check on management. Its professed concern for shareholders, at this stage, comes as too little too late.

(d) Evidence on Certification

27. Wellington West argues that the Auditor General's Report, the Receiver's Report and the Manitoba Securities Commission's Statement of Allegations are not admissible. It then claims that there is insufficient evidence to support certification.

28. In response, one must wonder how much more evidence the Plaintiffs can reasonably be expected to have at this stage of the proceeding. The Plaintiffs are not entitled to discovery prior to certification. Their only information concerning a securities

violation is through the public reports. Class certification is not an inquiry into the merits. This case is already remarkable in terms of the volumes of information that have been released regarding the Fund. These public reports are a necessary and appropriate source of evidence as to the nature of the issues. This Honourable Court, in dismissing Wellington's motion for particulars, wrote:

“In many instances, the particulars being requested are with respect to details which Bellan probably does not have and couldn't be expected to have until the discovery process has been completed. In fact, at this time, these defendants likely have more knowledge of many of the details they are requesting than Bellan does. They were actively involved in the matters which are the subject of the action. As well, they have as much access as Bellan does to the large volume of information which is in the public domain.

The balance of the information they are requesting is not necessary at this stage of the proceedings. There is a substantial difference between the particulars they require for the certification hearing or to file their statements of defence and the information they may later require for the purposes of trial.”

Bellan v. Curtis, [2007] M.J. No. 325 (Q.B.) at para 20-21

29. The public reports are relevant to the procedural questions on certification, namely class definition, common issues, preferability, litigation plan and behaviour modification. The reports show that it is not just Mr. Bellan who is concerned about the collapse of the Fund. Such concerns have also been raised by multiple independent sources, namely the Auditor General, the Receiver, and the MSC. These public reports speak to the apparent losses suffered by shareholders as a class. At this stage, the fact that such complaints have been raised is evidence that supports certification. The merits of such complaints are addressed after certification.

Hollick v. Toronto (City of), [2001] 3 S.C.R. 158

30. Wellington West argues that Professor Rosen's opinion should be given little or no weight because he has relied on the public reports. This defence argument fails for at least two reasons. First, Professor Rosen does not rely exclusively on these reports. He also relies on other sources of information, including the Prospectuses, the financial

statements, news reports, and the *Crocus Act*. Professor Rosen freely acknowledges the limitations of his report at this stage, and he reserves the right to amend his opinions after discovery. His report is based on the information that is currently available to him.

Rosen Affidavit #1, pg.12 and Appendix

31. Second, the Receiver's Report is directly relevant to Professor Rosen's opinion on the manageability of determining share loss. As already noted, Wellington West argues that it will be monumentally expensive to assess valuation negligence. Professor Rosen responds that this work can reasonably be done, and he points to the Receiver's Report as an example. It must be recognized that certification is a procedural motion. Whatever objections Wellington West might have to the admissibility of the Receiver's Report and the Auditor General's Report for the purposes of trial, that is not the question here. The Auditor General's Report and the Receiver's Report, as cited in Professor Rosen's affidavit, are relevant in assisting this Honourable Court to decide the narrow procedural issues presently before it.

Rosen Affidavit #3, para 5 and 6

32. Lastly, Wellington West tries to suggest that Mr. Bellan has conceded that a conflict exists among class members. Mr. Bellan made no such concession. Further, whether a conflict exists, and whether this alleged conflict is of any consequence to certification, are legal questions. This is a matter for the Court to decide - not a lay witness.

Bellan Cross-Examination, pages 161-2, question 561

Bellan Affidavit, para 9

Manitoba Securities Commission

33. The MSC's opposition to certification boils down to an argument about whether Mr. Bellan ought to have attached a copy of his complaint to the MSC as an exhibit to his certification affidavit. In the Plaintiffs' view, this is unnecessary, delves into the merits,

and is really just an effort by the MSC to re-litigate its unsuccessful motion to strike. The nature of the complaint to the MSC is fully described in the Statement of Claim. The pleadings have been upheld. The MSC had an opportunity to cross-examine Mr. Bellan but chose not to.

Bellan #1 SOC, at para 96

34. The Statement of Claim is brought on behalf of the class. It alleges that Mr. Bellan “brought to the attention of the MSC the irregularities (as set out in detail in the statement of claim), including, without limitation, information pertaining to the misleading valuation of the Crocus Fund”. The pleadings go on to state that the MSC then conducted a review of Crocus, and that it botched this review. These are not allegations which are limited in scope only to Mr. Bellan. These are allegations which pertain to shareholders as a class. Mr. Bellan was complaining not just on his own behalf in 2002, but on behalf of shareholders generally. The MSC investigation of 2003 was not just relevant to Mr. Bellan, but also to other shareholders. Had the MSC not been grossly negligent in responding to the information provided to it by Mr. Bellan, and in its subsequent investigation, then it could have acted to protect all shareholders, not just Mr. Bellan.

Bellan #1 SOC, at para 96 and 97

35. If the MSC truly thought that Mr. Bellan’s complaint exonerates it on certification then it could have filed the complaint itself as an exhibit to an affidavit from the MSC representatives who received and mishandled the complaint. Instead, the MSC has chosen to file no evidence of its own, and to present no witnesses.

36. In any event, if this Honourable Court found that a copy of this complaint was essential for certification, then the remedy is not to deny certification as the MSC contends. The remedy is to direct that a copy of the complaint be filed pursuant to s.5(1) of the *Class Proceedings Act*.

Class Proceedings Act, s.5(1)

37. The MSC goes on argue about whether there is a “history of town meetings” to support certification. This defence argument is misplaced for at least two reasons. First, the Ontario Court of Appeal’s decision in *Hollick* which the MSC cites for this argument was over-turned by the Supreme Court of Canada on this very issue. There is no requirement for town meetings, or the like, before there can be a class action. The Ontario Court of Appeal in *Hollick* had been concerned as to whether there was an identifiable class on the basis of a limited number of complaints from residents near a landfill. The Supreme Court of Canada concluded, however, that a class existed on that evidence, and that a limited number of complaints, without any examination of their merits, satisfied the class definition requirement.

Hollick v. Toronto (City of) (1999) 46 O.R. (3d) 257 (C.A.); [2001]
3 S.C.R. 158

38. Second, this case has demonstrated a high degree of class member interest and involvement, including meetings of shareholders. Even if the MSC was correct on the law (which it isn’t), the facts do not support the MSC’s argument. Class members are very concerned about what has happened to their investments. The Auditor General raised questions about the MSC’s conduct regarding Crocus, and the adequacy of its 2003 investigation. Class members are entitled to answers.

Bellan Affidavit, para 16

Chan Affidavit, para 6

Sokolsky Affidavit, Exhibit I, pp 153-163

39. The Supreme Court of Canada in *Hollick* deliberately set a low threshold for evidence necessary for class certification. As Chief Justice McLachlin held, the Plaintiffs need only show “some basis in fact to support the certification order.” There are abundant facts in this case to support certification. It is a fact that the Crocus Fund is in receivership and that shareholders have not been able to recover their savings. It is a fact that serious allegations regarding the operation of the Fund have been made, not just by the Plaintiffs, but by the Receiver, the Auditor General, and the MSC itself. This is not a

lawsuit that comes out of nowhere, nor can the MSC characterize this case as the invention of an artful pleader. The MSC ordered the Fund to stop trading in 2004. This had real consequences for class members. The Plaintiffs allege that if the MSC had been minimally competent in response to the complaint made, and the investigation undertaken, it should have stopped trading in the Crocus Fund years earlier. The MSC had an opportunity to strike the Plaintiffs' allegations and lost. These allegations should now be certified so that they may proceed to a resolution on their merits.

Hollick v. Toronto (City of); [2001] 3 S.C.R. 158 at para 25

40. The MSC also seeks to attack Professor Rosen's evidence. Essentially the MSC's argument is that only people who have worked at the Manitoba Securities Commission can testify about the Manitoba Securities Commission. This defence argument fails for at least three reasons. First, Professor Rosen has regularly published on issues relating to securities regulation in this country, he has advised provincial and federal governments on such issues, and he has testified as an expert witness in proceedings before securities commissions. He is an expert on financial reporting and is able to opine on matters which should have been important or obvious to the MSC when it was investigating Crocus in 2002 and 2003.

Rosen cross-examination, pp.106-8

Rosen Affidavit #1, 3,7 and 8

41. Second, Professor Rosen is not the Plaintiffs' only expert. The Plaintiffs' litigation plan makes clear that Plaintiffs anticipate filing expert reports from additional experts after certification and discovery on the merits. This may include an expert who formerly worked inside another provincial securities commission. Professor Rosen's affidavits are presented for the purposes of certification. The MSC should not confuse these with the evidence that may be called at trial.

Chan Affidavit, Exhibit F, para 19

42. And third, the MSC's cross-examination of Professor Rosen was an attempt to re-argue its motion to strike, and was not relevant to the case actually pled. The Plaintiffs are not alleging that the MSC has a due diligence obligation for every document filed with the regulator. But the MSC cannot be a rubber-stamp either. Where the MSC receives a detailed complaint regarding problems at a Fund in which 34,000 Manitobans have invested, and where the MSC chooses to investigate that Fund, then the MSC has an arguable legal duty to avoid gross negligence. If the MSC completely botches the investigation it has undertaken in response to a specific complaint, then it may be held liable for its gross negligence. It must be remembered that not only did the MSC fail to halt trading of Crocus shares in 2002 or 2003, but it actually granted exemption orders to Crocus to encourage the sale of even more shares. Professor Rosen's evidence speaks to whether critical valuation concepts, defined by the *Crocus Act*, should have been obvious to the MSC. The Crocus Fund did not trade on secondary markets, but rather set its own share price. Oversight by the MSC was therefore especially important because there was no secondary market to provide an external reality check on share value. A minimally competent regulator would have attached a high level of scrutiny to a Fund so widely marketed in the province, which set its own share price, especially after receiving a detailed complaint about that Fund's share valuations. Such a regulator would not have granted exemption orders to make it easier to sell shares in that Fund. If the MSC had done its job properly, it should have stopped trading in the Fund years earlier.

Bellan #1 SOC, para 94-101

43. The MSC acknowledged to the Auditor General that it knew that share valuation was a "high risk area" for Crocus. The Auditor General reported that the MSC had information on Crocus' valuations which it should have followed up on. The Auditor General wrote:

"A very limited review was performed on market value information and the weekly share prices. Given that company valuations are largely determined by internal CIF processes, and the MSC acknowledgment that valuation was a high risk area, additional scrutiny of the valuation processes and their application to a sample of companies was in order,

particularly in light of the information contained in the minutes reviewed by the MSC.”

Sokolsky Affidavit, Exhibit I, pg. 162

44. Finally, the MSC argues that the concept of behaviour modification cannot apply to it as regulator. This is another attempt to re-litigate the motion to strike. As was considered on that motion, s.142 of the *Securities Act* provides the MSC with a limited immunity for conduct done in good faith. The statute does not prevent claims of bad faith. The legislature has therefore addressed whether there is some conduct for which the MSC is answerable to the courts. Such accountability is desirable, and helps to ensure that the MSC does a better job in the future. This is precisely what is meant by behaviour modification.

Bellan v. Curtis, [2007] M.J. No. 325 (Q.B.) at para 87

Securities Act, s.142

The Province

45. The Plaintiffs have brought claims against the Province in direct and vicarious liability. In light of the proposed settlement with the Directors and Officers, the claims in vicarious liability may have been largely resolved. For the purposes of contested certification, the Plaintiffs are proceeding against the Province on their direct liability claims. If the proposed settlement with the Directors and Officers is not approved, then certification against the Province on the vicarious liability claims might need to be argued on another date.

46. The Province’s primary argument against certification is an attempt to distinguish itself from the other Defendants by claiming that, unlike the other Defendants, it could not have stopped the issuance of the Prospectus, and thus, could not have stopped the sale of Crocus shares. The Province argues that, at most, its regulatory powers under the *Crocus Act* were limited to canceling the tax credits on the shares. The Province argues that this cancellation of tax credits does not enable the Plaintiffs to prove liability against the Province on a “but for” analysis.

47. The Province's argument fails to recognize the special and many roles it occupied within the Fund, as described at the hearing on the motion to strike. The Province had sufficient power and avenues within the Fund's operations that it could have blocked issuance of the Prospectus and stopped the sale of shares. Even if all the Province had done was exercise its authority to cancel the tax credits, this would have stopped the sale of shares because the tax credits were fundamental to the Fund's ability to market itself. Canceling the Fund's tax status would have pulled the plug on the Fund as surely as blocking the Prospectus.

Bellan v. Curtis, [2007] M.J. No. 325 (Q.B.) at para 104-5
Bellan #2 SOC, para 29

48. The Province next argues that reliance must be proved individually. This Honourable Court previously held, in dismissing PWC's motion to strike, that negligence on the facts of this case might arguably be proved on a "but for" analysis without the need for individualized proof of reliance. This analysis is equally applicable to the claims against the Province. This Honourable Court wrote:

"Counsel for PWC stated he did not read the statement of claim as pleading a cause of action in negligence but if it did, there could be no breach of duty unless Bellan received the audit report.

I do not agree. Bellan alleges PWC was negligent in performing its audits of the Crocus Fund and as a result he and other members of the putative class suffered damages. He claims that if PWC had exercised due diligence in conducting the audits, the Crocus Fund either would not have continued trading as a public company or its shares would have been traded at a proper value. This claim by Bellan is not dependent on whether he saw or relied on the audit reports.

Accordingly, I am not satisfied that it is plain and obvious that Bellan and the other putative class members do not have a cause of action against PWC in negligence."

Bellan v. Curtis, [2007] M.J. No. 325 (Q.B.) at para 60-62

49. Further, a claim has been brought against the Province as a special shareholder for an oppression remedy under the *Corporations Act*. The oppression remedy exists to

protect the reasonable expectations of shareholders. These reasonable expectations may be determined on an objective basis. The focus is on the expectations created by the defendant, and not on the individual or subjective beliefs of shareholders. In *Cholakis v. Cholakis*, [2006] M.J. 151 (Q.B.) Beard J. summarized the law as follows:

“Reasonable expectation of the shareholder: Peterson described this element as follows:

[paragraph]18.101.1 As the oppression remedy jurisprudence has developed, "reasonable expectation analysis" has become the standard analytical tool. It has been said that, "[t]he unifying thread of the oppression remedy is to protect such reasonable expectations" of corporate stakeholders. The analysis is highly attractive in that it develops a normative standard for conduct in the corporate context. Corporate conduct that is oppressive, unfairly prejudicial or unfairly disregards the interests of a corporate stakeholder is that corporate conduct which defeats reasonable expectations. The dynamic which creates reasonable expectations is an interaction of the written word and conduct, which each party explicitly and implicitly recognizes in their relationship with the other. (emphasis in citation)

....

Under the reasonable expectations paradigm, reasonableness is ascertained on an objective basis, and whether or not a reasonable expectation has been created is a matter of fact. Typically, the interests of the shareholders of a company are intertwined with the expectations that have been created by the company's management and/or controlling shareholders. It had been held that reasonable expectations are to be protected regardless of the intent or *bona fides* of any decision made by officers or directors of the responding corporation.”

Cholakis v. Cholakis, [2006] M.J. 151 (Q.B.) at para 16

See also *Cohen v. Jonco Holdings Ltd. et al.*, [2005] M.J. No. 126, 2005 MBCA 48

50. The Province’s close involvement in the Crocus Fund created reasonable expectations for shareholders which can be determined on an objective basis. Crocus was not just any investment. It was an investment which the Province promoted, held shares in, appointed senior bureaucrats to, and co-invested with. It is alleged that the Province had inside knowledge of serious financial difficulties at the Fund by no later

than November 27, 2000. It is further alleged that the Province not only failed to act to protect class members, but having received this information, it took steps to encourage the sale of more shares. This Honourable Court has already held that these allegations give rise to an arguable claim. The nature of the statutory claim under the *Corporations Act* is such that it can be adjudicated on a class wide basis without the need for individualized proof.

Bellan #2 SOC, para 53.1-53.10

Bellan v. Curtis, [2007] M.J. No. 325 (Q.B.) at para 106-109

51. The Province submits that the preferable procedure to a class action would be small claims court. This is plainly impractical and highlights the importance of access to justice in this case. Class member losses are individually modest. Absent certification, no one could afford to pursue a complex securities case like this.

52. The Province's submissions on Mr. Nelson's ability to serve as a representative plaintiff are no longer relevant. On January 17, 2008, Mr. Nelson withdrew his request to be appointed as a representative plaintiff due to poor health. He still hopes to benefit from a resolution of the class action, but Mr. Nelson is no longer physically able to carry out the court appointed duties of a representative plaintiff.

Affidavit of Norman Boudreau, sworn January 17, 2008

53. Mr. Nelson's experience is illustrative of the goals of access to justice embodied by the *Class Proceedings Act*. There are more barriers to our court system than just legal costs. Litigation can be stressful, intimidating and time-consuming for laypersons. This can be especially true for someone in poor health. In describing the social, psychological and other non-economic barriers to our justice system that the *Class Proceedings Act* is designed to help overcome, the Ontario Law Reform Commission wrote:

“There are a number of noneconomic barriers that may effectively prevent an injured person from seeking compensation by means of litigation. The

first such barrier may simply be ignorance of the availability of substantive legal rights, or of legal institutions that may assist in enforcing such rights...

Another barrier to effective enforcement of legal rights may exist where significant injuries occur without the victim's knowledge. Problems of this sort may arise, for example, in the securities field, where the average investor may have neither the sophistication nor the time to discover violations of securities laws, and in cases where victims suffer side effects from dangerous drugs that cannot be traced to particular medications without expert assistance. The fact that the victims do not know that these injuries exist, or that they may be attributable to a defendant's misconduct, clearly does not mean that they are unimportant, since unknown securities violations may result, in fact, in a financial loss, and the side effects of a drug may damage a person's health...

The Commission is of the view that many claims are not individually litigated, not because they are lacking in merit or unimportant to the potential claimant, but because of economic, social and psychological barriers. We believe that class actions can help to overcome such barriers and, by providing increased access to the courts, may perform an important function in society. Quite clearly, effective access to justice is a precondition to the exercise of all other legal rights."

Ontario Law Reform Commission, Report on Class Actions, 1982, pp. 127-8 and 139

54. Both Mr. Nelson and Mr. Bellan have worked diligently on behalf of the class. Their service to their fellow shareholders is commendable. This provides another reason this action should be certified. Absent a class action, many shareholders will simply not have the means, economic or otherwise, to pursue their claims individually.

PART V
CONCLUSION

55. The non-settling Defendants' arguments are unavailing. The Plaintiffs seek an order certifying these actions as against Wellington West, the Manitoba Securities Commission and the Province, and consolidating these actions.

ALL OF WHICH is respectfully submitted this 15th day of February, 2008

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