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Waiver of tort: a disturbing development in Canadian product liability law

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Canadian courts are expanding the potential exposures for defendants in product liability actions by refusing to strike out pleadings in putative class actions claiming disgorgement of profits under a controversial extension of the doctrine of 'waiver of tort'. Plaintiffs are increasingly relying on waiver of tort, as an alternative to pleading negligence and negligent misrepresentation, in order to circumvent the traditional tort law requirement that a plaintiff must be able to show loss or damage in order to sustain a claim in tort.

Waiver of tort is by no means a new concept; however, its application in Canada is unprecedented. By being able to pursue a product liability action which focuses on the defendant's gain rather than the loss allegedly sustained by class members, plaintiffs can eliminate a potentially significant individual issue that previously was a bar to certification. The novel application of waiver of tort represents a remarkable policy shift in Canadian law, displacing the primary compensatory function of tort law[1] in favour of corrective justice and extending recovery beyond the well-established Canadian tort law boundaries governing recovery of pure economic loss.[2]

The ease with which certain Ontario courts have applied the doctrine in certification motions is also extremely problematic. In certain cases, courts are assuming causation of class-wide loss rather than critically examining whether the plaintiff has provided some evidence that there is a way to prove such loss[3] and whether the amount of enrichment is truly a common issue rendering a class action the preferable procedure for resolution of the dispute.

For international observers of Canadian legal developments, the embrace of the alternative waiver of tort theory is extraordinary, as historically Canadian courts have been conservative, intent on avoiding the excesses which characterise the US tort law system. For example, punitive damages are the exception, not the rule, in Canada and are relatively modest in relation to what is routinely awarded in the US, with awards seldom exceeding C$1 million. Similarly, the Supreme Court of Canada made the policy decision in 1978 to cap general (that is, non-pecuniary) damage awards for bodily injury in tort actions at C$100,000 for the most catastrophic injuries, subject to annual indexation of that amount from the 1978 upper limit,

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after being influenced by the astronomical sums awarded in US medical malpractice actions and the impact of such awards on the availability of affordable professional liability insurance.

The waiver of tort development that we are currently witnessing in Canada therefore represents a marked departure from Canadian judicial conservatism and the prior careful delineation of the function and scope of tort, contract and unjust enrichment. The proliferation of a freestanding cause of action based on waiver of tort, if unabated, will create a highly unpredictable product liability environment in Canada and cause a significant misalignment of Canadian tort law with other common law jurisdictions.

Waiver of tort: a tort remedy or an independent cause of action?

The doctrine of waiver of tort finds its origins in the expression 'waiver of tort and suit in *assumpsit*', the latter being the historical antecedent of modern 'quasi-contract' claims for restitution. A plaintiff upon whom a tort has been committed and who brings an action for the benefits received by the tortfeasor is said to 'waive the tort', in the sense that he or she elects to sue in restitution to recover the defendant's unjust benefit rather than to sue in tort to recover damages. Under the traditional view of waiver of tort, the plaintiff in certain circumstances has alternative remedies; however, the tort itself is not extinguished. A long line of English cases has established that it is a *sine qua non* of both remedies (damages or disgorgement) that the plaintiff establish that the tort has been committed.[4] Waiver of tort was traditionally regarded as parasitic of the underlying tort claim and involved an election for a more lucrative remedy made *after* the plaintiff had established the requisite elements of the tort, including loss.[5] The types of torts which could be waived historically were conversion, trespass to land or goods, deceit and extortion. In the US, the doctrine has been extended to permit disgorgement for intentional interference with contractual relations and other intentional torts. In England, the House of Lords in an exceptional case has accepted that disgorgement is available to the victim of a breach of contract where the plaintiff has a legitimate interest in preventing the defendant's profit-making activity and in depriving him of his profit.[6]

The obvious benefit of pleading waiver of tort is that in certain circumstances, where a wrong has been committed, it may be to the plaintiff's advantage to seek recovery of an unjust enrichment from the defendant rather than tort damages. But can the doctrine be invoked where the plaintiff has sustained no loss at all? This issue has been the subject of considerable academic debate.

The alternative view of waiver of tort that has been advanced by many academics is that it is not necessary to establish all of the constituent elements of a tort, including loss or damage, in order to invoke the doctrine. Influential Canadian legal academics such as P D Maddaugh and J D McCamus argue that waiver of tort is an independent cause of action and that it is difficult to justify denying relief simply because the wrong involves tortious conduct that has caused no pecuniary damage to the plaintiff. Maddaugh and McCamus have opined that, given the Supreme Court of Canada's acceptance of the tri-partite principle of unjust enrichment espoused in *Pettkus v Becker*,[7] 'there appears to be no reason why this approach ought not to be employed to recognise waiver of tort as an independent restitutionary remedy'.[8] Leading English authorities on the law of restitution also agree that waiver of tort is an example of the general principle that an action in restitution lies to compel the defendant to disgorge an unjust enrichment gained through any type of wrongdoing and that it is not a remedy that is parasitic and dependent on the actual commission of an underlying tort.[9]

What was once an academic discussion is now a fierce judicial debate in Canada, where judges are deeply divided over the proper function of waiver of tort and the stage of the proceeding at which the significant policy issues associated with the doctrine should be determined. In the 2006 decision *Serhan Estate v Johnson*

& Johnson,[10] the Ontario Divisional Court upheld a certification decision based on an independent action for waiver of tort in the absence of any pecuniary loss or bodily injury being sustained by the plaintiff class. The majority of the Divisional Court concluded that while of questionable merit, the modern ambit of waiver of tort should be defined with the benefit of a full trial record and not at the pleadings stage. Previously, Ontario, Saskatchewan and British Columbia courts refused to recognise waiver of tort as a freestanding cause of action.[11] In June 2007, an Ontario Superior Court judge granted leave to appeal a certification decision based on waiver of tort, concluding that since the amount of the 'wrongful gain' subject to an accounting and disgorgement or a constructive trust may not be a common issue, it is open to serious debate whether a class action is the preferable procedure for a waiver of tort claim based on a negligent failure to warn the putative class.[12]

Previously, Ontario, Saskatchewan and British Columbia courts refused to recognise waiver of tort as a freestanding cause of action.

Serhan Estate v Johnson & Johnson

In *Serhan*, the plaintiffs in a proposed class action claimed damages for negligence, negligent and fraudulent misrepresentation, breach of the Canadian *Competition Act* and conspiracy relating to the defendant's manufacturing, selling and distributing in the 1990s defective meters to be used by diabetics to monitor their blood glucose levels. In 1998, as a result of user complaints, various US federal agencies began an investigation into the meters and the defendants entered into a settlement agreement in December 2000, in which they admitted that at the time they started distributing the product, they knew of its defects, they failed to remedy the defects when they received complaints and they submitted false reports to the Food and Drug Administration. The defendants ultimately paid a US$29 million fine in the US and also settled claims initiated by whistleblower employees in their Canadian division.

The plaintiffs pleaded that the meters and the strips inserted into them were dangerously defective in that, in some cases, they would fail to show the existence of high blood glucose levels. The plaintiffs alleged that the defendants were negligent in selling the devices when they knew of the defects. The plaintiffs claimed that the defendants held all revenues generated from the sale of the products in a constructive trust for the benefit of the plaintiff class and also sought a personal remedy in the form of an accounting and disgorgement of those revenues, alleging that but for the misrepresentation and conspiracy, the defendants would not have received the revenues.

Cullity J, who heard the original certification motion, refused to certify the class action based on any of the pleaded torts because no findings of liability were possible without individual trials.[13] Other than an expert's affidavit opining on the potential health consequences for a user with an undetected high blood glucose level, Cullity J found that there was virtually no evidence that either of the representative plaintiffs or any other members of the putative class suffered any injurious effects to their

health by using the meter or the strips, other than the pain involved in obtaining additional blood samples, and no diabetic shock or loss of income. There was no evidence that any member of the putative class actually paid for the meters or the strips, as they were paid for by the applicable provincial drug benefit program. Based on the binding Court of Appeal decision in *Chadha v Bayer,*[14] if no loss or damage could be established on a class-wide basis that ought to have been the end of the inquiry.

However, the plaintiffs had pleaded constructive trust as if it were a separate cause of action rather than a remedy, on the basis that the defendants had acquired property by a wrongful act as contemplated in a Supreme Court of Canada decision that potentially expanded the grounds for finding a constructive trust, *Soulos v Korkontzila.*[15] In *Soulos*, the Supreme Court of Canada identified four conditions which generally should be satisfied as a prerequisite for a constructive trust based on wrongful conduct:

- the defendant must have been under an equitable obligation — that is, an obligation of the type that courts of equity have enforced — in relation to the activities giving rise to the assets in his or her hands;
- the assets in the hands of the defendants must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his or her equitable obligation to the plaintiffs;
- the plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and
- there must be no factors which would render imposition of a constructive trust unjust in all circumstances of the case, such as the interests of intervening creditors must be protected.

With respect to the first condition, Cullity J noted that fraud had been pleaded, which was one of the traditional heads of equity jurisdiction. He did not see any difficulty in holding that a party who has obtained property of another by fraudulent misrepresentations has breached an obligation of the type courts of equity have enforced. He also noted that in cases where the 'doctrine' of waiver of tort applied, the equitable remedy of an accounting of profits will often be appropriate and has often been granted.

Notwithstanding that the plaintiffs had not pleaded waiver of tort and had 'probably inadequate' references to 'good conscience' in the statement of claim, Cullity J nevertheless believed that material facts had been alleged which, if proven, could entitle the plaintiffs to a remedy on the basis of waiver of tort, noting that claims based on waiver of tort seek restitution of benefits received by the defendants, as a consequence of their tortious conduct, rather than damages to compensate the plaintiffs for a loss. He pointed to an American decision,[16] quoted by Maddaugh and McCamus, as encapsulating the basis of the doctrine:

> The point is not whether a definite something was taken away from the plaintiff and added to the treasury of defendant. The point is whether defendant unjustly enriched itself by doing a wrong to plaintiff in such manner and in such circumstances that in equity and good conscience defendant should not be permitted to retain that by which it has been enriched.

He then referred to the view expressed by Lord Denning in *Strand Electric & Engineering Co Ltd v Brisford Entertainment Co,*[17] that benefits are recoverable even though the plaintiff suffers no loss and noted that another Ontario Superior Court justice has accepted Lord Denning's view in *Transit Trailer Leasing Ltd v Robinson.*[18] Observing that a motions judge should be slow to strike novel causes of action or those in an area of the law that is unsettled or undergoing significant change or development, Cullity J found that the law relating to waiver of tort falls within each of these categories.

Cullity J then conceded that the application of the second condition in

Soulos to the facts of the case 'raises a question of some difficulty', as no agency relationship existed and he did not see any ground on which one could be deemed to exist. However, he mused that it was possible that the references to 'agency activities' in *Soulos* were not intended to limit the availability of the constructive trust remedy to cases of fraud, or other wrongful conduct, by agents, but only reflected the facts of that particular case. He concluded that the second condition in *Soulos* could be satisfied as:

> Equity is evidently concerned with an event rather than a relationship. The offence is the conduct which brought about the acquisition; the courts are not primarily concerned with the relationship that was thereby abused.[19]

With respect to the third and fourth condition in *Soulos*, Justice Cullity concluded that they would not be appropriately dealt with on the basis of the pleadings alone, as the third may be affected by a decision with respect to other remedies available at trial and the fourth is one on which evidence may be required. While it was not alleged that each class member had any pre-existing legal or equitable interest in the property that would be the subject matter of the trust and its existence was not premised on any payments made by class members to acquire the impugned products, he did not think these objections would necessarily be fatal to the waiver of tort claim. He did not, however, refer to or distinguish the clear direction from the Court of Appeal in *Chadha v Bayer* that there be some evidence for the certification judge to conclude that the loss or gain could demonstrably be linked to the defendant's wrongful conduct.

In concluding that the material facts alleged in the statement of claim disclosed a potential cause of action for waiver of tort, in the absence of loss or damage sustained by the plaintiff class, Cullity J acknowledged (at [46]) the radical shift that the imposition of such liability in the product liability context would represent:

> While I recognize that the introduction of waiver of tort principles – for which proprietary, as well as personal, remedies may be available — into cases of products liability may have serious, and possibly, far-reaching implications, I do not believe that the law is at present sufficiently clear to permit me to strike the claim for a constructive trust solely on the basis of the pleadings, or to find that it does not satisfy the requirement in s. 5(1)(a). If, at trial, it is found that waiver of tort principles are applicable, but that a proprietary remedy is not appropriate, this would not exclude the possibility of the personal restitutionary remedy for an accounting and disgorgement that the plaintiffs have claimed in the alternative.

In November 2004, Ground J granted leave to appeal the certification decision to the Divisional Court on the basis that Cullity J's decision was in conflict with the judicial consideration of waiver of tort in other decisions where it had been regarded as a choice of remedies after an actionable wrong had been established.[20]

The Divisional Court split 2–1 on whether a claim based on waiver of tort in the absence of loss or damage was certain to fail. The majority concluded that, while they had serious reservations about the ultimate viability of the cause of action, the plaintiffs should nevertheless be permitted to proceed with their action. In doing so, they had to distinguish a well-crafted decision by a British Columbia Supreme Court Judge discussed below.

The orthodox view of waiver of tort: Reid v Ford Motor Co

The Divisional Court in *Serhan* was referred to the British decision of Gerow J in *Reid v Ford Motor Co,* which apparently had not been cited to Cullity J. *Reid* was a class action in which the representative plaintiff claimed damages in negligence for repairing an allegedly defective ignition switch. Following the issuance of the *Serhan* decision, the plaintiff in *Reid* decided to up the ante and moved to amend the statement of claim and certification order to include a claim for waiver of tort. The plaintiff sought an order adding a claim for a restitutionary award of the benefits that accrued to Ford as a result of its negligence or failure to warn (that is, an order for

disgorgement of revenue from the sales of replacement modules). Gerow J dismissed the motion, noting (at [17] and [18]):

> In order to be successful in a claim of negligence against a defendant, the plaintiff must prove on the balance of probabilities that the defendant owed a duty of care to the plaintiff, the defendant breached its duty to the plaintiff and the plaintiff suffered loss or damage as a result of the breach. By pleading waiver of tort Ms. Reid is attempting to avoid the necessity of proving that the Class Members suffered any loss as a result of Ford's negligence or failure to warn.

This is made apparent in the pleadings by the fact that the statement of claim now pleads that in the alternative the class members have a claim for out-of-pocket expenses they have incurred as a result of their attempts to identify and repair the TFI defect. The effect of the pleading is that waiver of tort stands on its own, and that proof of causative loss as a constituent element of negligence or failure to warn is not required. In effect the proposed plead of waiver of tort introduces strict liability for an allegedly defective product.

Gerow J also noted as grounds for refusing to permit the claim for the restitutionary award the policy reasons that motivated the Supreme Court of Canada in *Winnipeg Condominium Corporation No 36 v Bird Construction Co*,[21] where the Supreme Court of Canada created an exception to the historic prohibition against recovering pure economic loss in negligence for products with defects that posed a 'substantial danger'. The policy reason for imposing liability in such circumstances was to encourage people to act quickly and responsibly to fix a defect before it causes injury to person or damage to property. Gerow J correctly noted that the Supreme Court addressed the traditional concern of liability in an indeterminate amount by limiting the liability to the reasonable cost of repairing the dangerous defect and restoring the product to a non-dangerous state.

Gerow J observed that the amount of damages the plaintiff would be entitled to in the dangerous defect exception to the prohibition against claiming for pure economic loss was confined to the reasonable cost of repairing the defect and mitigating the danger, but did not extend to pursuing the revenues earned on the sale of the replacement modules. Gerow J stated (at [23]) that:

> … as the amount the Class Members would recover would bear no relationship to any losses or damages they incurred, the proposed amendment would raise the risk of indeterminacy of damages the Supreme Court avoided by limiting the amount of liability to the reasonable cost of repair.

Turning to the law of unjust enrichment, Gerow J referred to the decision of the British Columbia Supreme Court in *Networth Industries Ltd v Cape Flattery*,[22] where Lowry J observed (at [29]) that there has never been a case of unjust enrichment grounded in negligence:

> The torts supporting a claim for unjust enrichment have been for the most part proprietary torts such as conversion or trespass to land and goods which have been described as 'anti-enrichment wrongs'. Restitutionary claims are not made in negligence and nuisance because they are in the main 'anti-harm wrongs' in relation to which it is impossible, even if they lead to an enrichment of the wrongdoer, to elevate the prevention of enrichment to the level of a primary purpose.

Gerow J also referred to the decision of the British Columbia Court of Appeal in *Capilano Fishing Ltd v Qualicum Producer*,[23] where the appellate court rejected a claim for unjust enrichment in the context of a claim for damages on the basis that actions for negligence in the operation of vessels are actions for compensation for losses caused — there was no need to complicate such actions with notions of unjust enrichment. Gerow J also observed that she was aware of no authority in which unjust enrichment had been grounded in failure to warn.

Finally, in rejecting the proposed amendment, Gerow J pointed out that the proposed pleading did not alleged any corresponding deprivation (the plaintiff was arguing that the class members would not have to show they suffered any deprivation in order for Ford to be forced to disgorge the benefits that had accrued to it by its negligence and failure to warn). Gerow J disposed of this argument by noting that any benefit to Ford from the sale of the replacement modules was indirect and only incidentally conferred on Ford. Unjust enrichment does not extend to permit such a recovery, as cases where unjust enrichment has been made out generally deal with benefits conferred directly and specifically on the defendant, such as goods or services purchased directly from the defendant or money paid to the defendant.[24]

Serhan Divisional Court majority distinguishes Reid

The majority of the Divisional Court in *Serhan* distinguished the *Reid* decision on the basis that it concerned a claim which was framed in negligence, unlike the case in *Serhan,* where fraud and conspiracy formed the foundation of the claim. They observed that Gerow J had specifically recognised fraud as one of the intentional torts where the doctrine of waiver of tort had been utilised.

The Divisional Court acknowledged the legitimate concern that Gerow J had expressed about the consequences of allowing, in products liability cases, a cause of action that eliminates the need to prove loss. Writing for the majority of the Divisional Court, Epstein J stated (at [67] and [68]):

> I share this concern, but am of the view that it should be considered and resolved on the basis of a full record … *Reid*, while distinguishable, does, however, contribute to the ongoing debate regarding the legal issues raised in this appeal. The debate taking place among legal writers and arguably in the jurisprudence demonstrates that there is room for difference of opinion as to the precise status of the doctrine and specifically whether it is an independent cause of action … the law with respect to this issue has not been authoritatively settled. Clearly, it cannot be said that an action based on waiver of tort is sure to fail. Furthermore, the resolution of the questions the defendants raise about the consequences of identifying waiver of tort as an independent cause of action in

> circumstances such as exist here, involves matters of policy that should not be determined at the pleadings stage.

The majority of the Divisional Court upheld the certification decision, even though it found that there was considerable merit to the defendants' arguments about the problems the plaintiffs have in meeting the four conditions in *Soulos* for the remedy of a constructive trust based on wrongful conduct. With respect to the personal remedy of an accounting and disgorgement, founded in waiver of tort, Epstein J noted (at [122]):

> This examination of disgorgement raises significant policy concerns with respect to the nature and scope of a remedy that possesses no link to a plaintiff's loss ... in the absence of such a loss, society arguably should not incur the cost of shifting a windfall from one party to another without good reasons.

Notwithstanding the conceptual and substantive challenges associated with permitting the class action to proceed on an independent waiver of tort theory, the majority of the Divisional Court ultimately concluded that the policy concerns, including the essential nature of the remedy of disgorgement, require clarification in Canadian jurisprudence and that such questions need to be developed on the basis of a full factual record. While it may be that applying either remedy, a constructive trust or disgorgement, to the type of situation in *Serhan* would take 'corrective justice' too far and at trial the plaintiffs may find themselves without a remedy, the majority of the Divisional Court concluded that it may well be critical that the action be allowed to proceed because (at [156]):

> Only in this way can we be sure that the common law in general, and the law of torts in particular, will continue to evolve to meet the legal challenges that arise in our modern industrial society.

The Serhan dissenting judgment

In a very strong dissent, Chapnik J found that the plaintiffs had failed to plead material facts or adduce evidence to satisfy the tripartite test for unjust enrichment which underlies all restitutionary claims. The representative plaintiffs had received their equipment essentially for free and therefore suffered no deprivation corresponding to the defendants' alleged enrichment. Further, following *Boulanger v Johnson & Johnson Corp*,[25] a binding Ontario Court of Appeal decision, any benefit conferred on the defendants was indirect given the lack of any direct relationship between the parties. Chapnik J noted that 'the complete, undeniable lack of unjust enrichment in this case is a factor that militates against finding entitlement to a restitutionary remedy'.[26]

Turning to the requirements in *Soulos* for a constructive trust, Chapnik J noted that the defendants in this case did not fall into the category of a person who obtained property of another by fraudlent misrepresentation. As Cullity J had found that the nominate tort of fraudulent misrepresentation was an individual issue, and unsuitable as a cause of action in the circumstances of this class proceeding, it was difficult to see how it might ground a claim in waiver of tort. A review of the case law, including *Soulo*s, indicated that the Supreme Court of Canada did not intend for fiduciary concepts to be stretched to such an extent, so as to permit a finding of a 'trust-like' duty on the facts of this case, where there is no direct relationship between the parties akin to an agency relationship.

Finally, examining the disgorgement remedy, Chapnik J noted that it was akin to a punitive damages award which Canadian courts now recognise must be reserved only for exceptional cases. To permit disgorgement of profits would push Canadian tort law beyond the broad post-*Winnipeg Condominium* parameters already established by the Supreme Court of Canada (at [227]–[228]):

> The Supreme Court held that compensation ought to be extended to the cost of 'fixing the defect'. In effect the amount of damages a plaintiff is entitled to in the 'dangerous defect' exception to the prohibition against pure economic loss claims is confined to the reasonable cost of repairing the defect and mitigating the danger.

In the instant case, we are not dealing with a claim by plaintiffs who incurred expense in mitigating or repairing a dangerous defect. The facts suggest that even the broad post-*Winnipeg* parameters of tort law are being challenged here. In my view, there is no principled basis upon which the remedy of disgorgement might be available to the plaintiffs in their claim based on waiver of tort.

Chapnik J concluded that, from a policy perspective, what certification accomplished in *Serhan* was, in essence, to bring strict liability to Canadian law in the area of products liability which prior courts have rejected. The only goal accomplished would be the punishment of unlawful and inappropriate behaviour by the defendants. While the goal of deterrence might in another case favour a class proceeding, given the recalls and corrective action taken by the defendants, any behavioural modification goal may well be moot. Even in the US, which has witnessed a proliferation of products liability lawsuits, the fundamental precepts of tort law are observed and enforced in US litigation. Chapnik J concluded that is not desirable as a matter of policy to make a choice such as waiver of tort, which represents a significant departure from well-established tort law and unjust enrichment jurisprudence, the norm in products liability litigation in Canada.

Heward v Eli Lilly: critical examination of the certification evidence to restrict the application of Serhan

Because of the refusal of either the Court of Appeal for Ontario or the Supreme Court of Canada to hear an appeal in *Serhan*, there remains considerable uncertainty in Canada at the present time about the scope and function of waiver of tort or whether the alternative view of waiver of tort will ultimately have any traction at trial. The doctrine, when used to circumvent proof of loss on a class-wide basis, provides a unique opportunity for plaintiffs to avoid an individual issue which has historically proven to be a barrier to certification. This aspect of the *Serhan* decision was recently considered by Lederman J in *Heward v Eli Lilly,*[27] whose decision granting leave to appeal creates a glimmer of hope for defendants that certification will be granted only if there is cogent evidence of a direct causal connection between the wrongful conduct and the gains which the plaintiffs seek to disgorge.

The certification decision in *Heward*[28] was another instance of Cullity J applying waiver of tort to certify a tenuous tort claim. In the class action, the plaintiffs alleged that the defendants had been negligent in their manufacturing of an anti-psychotic drug called Zyprexa, which gave rise to an increased risk of diabetes. Notwithstanding these alleged concerns, it was uncontroverted that the Health Canada approvals for the drug had not been withdrawn and it was still marketed, distributed and prescribed across Canada and continued to be purchased by certain class members. The plaintiffs sought an order based on unjust enrichment or waiver of tort, seeking disgorgement of revenues from the sale of the drug. Cullity J expressly rejected the analysis in *Reid* to the effect that waiver of tort was not available in negligence as that tort was an 'anti-harm' not an 'anti-enrichment tort'. These labels were meaningless.

Relying on waiver of tort, Cullity J certified the class action and the common issues included Common Issue #9:

> Are the defendants liable to account, by waiver of tort, to any of the class members on a restitutionary basis for any part of the proceeds of the sales of Zyprexa? If so, in which amount and for whose benefit is such accounting to be made?

In certifying this common issue, Cullity J said (at [101]):

> The finding that a cause of action based on waiver of tort has been disclosed in the pleading is not in itself sufficient to qualify it as a common issue. *In particular, the court must be satisfied that it is possible to determine on a class-wide basis whether a sufficient causal connection existed between the wrongful conduct and the amount for which the defendants could be ordered to account.* In *Serhan*, the 'but for' test of causation would have been satisfied if a finding was made that the products involved were, as pleaded and supported evidentially, dangerously defective to the knowledge of the defendants. Similarly, in this case, a necessary causal link between the wrong and the amount claimed by way of 'restitution' or disgorgement would be established if the plaintiffs can prove their claim that the defendants were negligent in placing Zyprexa on the market, or in continuing to market it after November 2001, without a sufficient warning of its side-effects. *In the event of a finding to this effect, the defendants would not have derived any proceeds but for their breach of duty and, in this sense, the proceeds would have resulted from the wrong. In consequence, I believe the question of causation could – as in* Serhan *– be dealt with in respect of the class as a whole.* [Emphasis added.]

In considering the defendant's application for leave to appeal from Cullity J's certification decision, Lederman J observed that he was bound by *Serhan* in so far as it established that it is not plain and obvious that an independent cause of action for waiver of tort would fail in Ontario. However, he questioned whether proof of the amount to be disgorged or held in a constructive trust is a common issue. Lederman J noted that *Serhan* does not change the requirement that there be proof of a 'wrongful gain' that will be subject to disgorgement or a constructive trust. Generally speaking (at [26]):

> … a gain is a 'wrongful gain' only if it is attained through 'wrongful conduct'; i.e. the wrongful conduct must *cause* the gain. Consequently, for the amount subject to disgorgement and constructive trust to be a *common* issue in this class action, the pleadings and evidence must demonstrate a way to prove on a *class-wide basis* that the alleged wrongful conduct (i.e. 'the failure to warn') caused the gain (i.e. 'proceeds from Zyprexa sales').

Lederman J doubted the correctness of Cullity J's conclusion that such a connection had been established. Referencing the underlined portion of

Cullity J's reasons quoted above, he found that Cullity J made a significant assumption in assuming that the defendants would not have derived any proceeds but for their breach of duty. To make such an assumption, there would have to be evidence to support the inference that the class members would not have agreed to take Zyprexa if properly warned of the risks associated with the drug or that Zyprexa would not have been approved for sale if Health Canada was properly warned of the risks associated with the drug. Absent these inferences, the only way to determine the amount for which the defendants could be ordered to account in waiver of tort is to investigate whether each member of the class would not have taken Zyprexa if properly warned.

> including class members, three years after Health Canada ordered Eli Lilly to issue warnings regarding the possible risk of developing diabetes when taking Zyprexa. There is also nothing in the pleadings or the evidence to support the inference that Zyprexa would not have been approved for sale if Health Canada was properly warned of its associated risks. And since Health Canada was in fact warned about the risks of Zyprexa use in late 2003 and has not ordered the drug off the market, it is difficult to infer that Health Canada would not have approved Zyprexa in the first place if it received these same warnings in the early 1990's.

Lederman J concluded that there was good reason to doubt the correctness of Cullity J's decision to certify as a common issue the amount of the alleged wrongful gain that is subject to disgorgement and/or a constructive trust. The public importance of the issue justified granting leave to appeal (at [33]):

Lederman J concluded that there was good reason to doubt the correctness of Cullity J's decision to certify as a common issue the amount of the alleged wrongful gain that is subject to disgorgement and/or a constructive trust.

Lederman J characterised this factual inquiry as 'the antithesis of a common issue'. Citing Feldman JA in *Chadha v Bayer,* he noted that before a court certifies a common issue based on assumptions, the assumptions must be supported by sufficient evidence. Lederman J then stated (at [32]):

> In this case, and with great respect, it is not clear to me that the pleadings or the evidence support the assumption made by Cullity J that Eli Lilly's gain was caused by its wrongful conduct. While the pleadings explicitly say the primary plaintiffs would not have taken the drug if they had been informed of its alleged side-effects (see Cullity J's reasons at para. 47), neither the pleadings nor the evidence support the inference that all members of the class would have done the same. This is perhaps not surprising, given that Zyprexa continues to be prescribed and used by persons,

> In the context of a claim in waiver of tort, accounting and disgorgement and constructive trust remedies have the power to make defendants liable for truly enormous amounts of money. The ramifications of exposure to this type of liability will extend beyond the parties to affect not just the pharmaceutical industry as a whole, but also the securities market given that most pharmaceutical companies are publicly traded. It is therefore important for an appellate court to clarify the circumstances under which proof of the amount of the 'wrongful gain' associated with these remedies is truly a common issue in a class proceeding.

Conclusions

Waiver of tort will continue to vex litigants in Canada until the country's highest court ratifies or rejects the significant modification that *Serhan* makes to the fundamental policies and principles that have historically shaped Canadian tort law. The expanded doctrine of waiver of tort creates tremendous financial exposures for defendants given the extent it expands the ambit of traditional Canadian tort law recovery. A successful application of the new doctrine will result in substantial windfalls for plaintiffs that are repugnant to the limited compensatory purpose of tort law.

In Ontario, an increasing number of product liability actions are being certified where loss is doubtful or unrecoverable in tort or where plaintiffs seek to recover both damages and disgorgement.[29] These increased exposures place a tremendous burden on manufacturers and, until such time as the law is clarified by the Supreme Court of Canada, will undoubtedly affect their assessment of class actions and their settlement strategies. It remains to be seen if certification judges in other provinces will follow the lead of Ontario and whether the novel doctrine will be embraced by other common law jurisdictions. Given the propensity for product liability actions to be pursued on a national basis in Canada, waiver of tort will remain a controversial feature of Canadian product liability jurisprudence for the foreseeable future and there will be numerous opportunities for the debate to continue in Canadian courts as courts explore the circumstances in which gains based awards can appropriately be used. ●

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Endnotes

1. In *Cunningham v Wheeler* [1994] 1 SCR 359 (SCC), Cory J held for the majority of the Supreme Court of Canada that the principle of recovery in an action for tort is to compensate the injured party as completely as possible for the loss suffered as a result of the negligent action or inaction of the defendant. This fundamental principle was affirmed by McLachlin J (as she then was), who stated that the ideal of compensation which is at the same time full and fair is met by awarding damages for all the plaintiff's actual losses, and no more. She stated that the watchword is restoration: what is required to restore the plaintiff to his or her pre-accident position.

2. In *Winnipeg Condominium Corp No 36 v Bird Construction Co* (1995) 1 SCR 85 (SCC), LaForest J, writing for the court, created an exception to the historic prohibition against recovery of pure economic loss in tort and permitted recovery for the costs of repairs for structural defects that were not merely shoddy but substantially dangerous. LaForest J addressed the policy concerns about indeterminate liability by limiting the potential recovery to the costs of repairs and no more.

3. In *Chadha v Bayer Inc* (2003) 63 OJ (3d) 22 (CA), Feldman JA, writing for the court, concluded that the issue of liability, including proof of loss, could not be a common issue in a class action brought by home purchasers who alleged to have suffered loss from a price-fixing conspiracy which affected the cost of iron oxide pigments used to colour concrete brick and paving stones. The plaintiffs were not direct purchasers of iron oxide from the defendants and alleged that because of the price-fixing activities they overpaid for their homes. The Divisional Court had set aside the certification order because the actual losses could not be proved on a class-wide basis or on the basis of statistics. Proof of loss could only be established on an individual basis. In the Court of Appeal, Feldman JA found that the motion judge erred by relying on expert evidence which did not address the issue of what method could be used at a trial to prove that all end-purchasers overpaid for their houses as a result of the conspiracy. The expert effectively assumed that the higher costs of products containing the iron oxide pigment would have been passed on to end-users. Feldman JA noted that 'it is that assumption that is the very issue that the court must be satisfied is provable by some method on a class-wide basis before the common issue can be certified as such' (at [30]).

4. *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 (HL); *Oughton v Seppings* (1830) 1 B & Ad 241; *Turner v Cameron's Coalbrook Steam Co* (1850) 5 Ex 932; *Commercial Banking Co of Sydney v Mann* [1961] AC 1; *Chesworth v Farrer* [1967] 1 QB 407.

5. See, for example, *Zidaric v Toshiba of Canada Ltd* [2000] OJ No 4590 (Ont SCJ), where Cumming J struck out a statement of claim as disclosing no reasonable cause of action where the plaintiff claimed pure economic loss in respect of a computer which due to a defect permitted undetected data loss or the writing of wrong data. The plaintiff sought, among other things, a claim for profits made by Toshiba relying on waiver of tort; however, the court held that waiver of tort could not be established as no tort had been made out.

6. *Attorney General v Blake* [2004] 4 All ER 385 (HL), where a former British spy, in breach of the terms of his employment, revealed official and confidential information he gained as a result of his employment in a book published in the Soviet Union, where he had defected. Although the government acknowledged that it could not establish any damages had been suffered as a result of Blake's breach of contract, the House of Lords decided the Attorney General was entitled to recover the amount of the benefit derived by Blake in breach of his contract, as the normal remedies for breach of contract would be inadequate.

7. [1980] 2 SCR 834 (SCC), which held that unjust enrichment will occur when there is (1) an enrichment of the defendant; (2) a corresponding deprivation of the plaintiff; and (3) an absence of juristic reason for the enrichment.

8. Maddaugh P D and McCamus J D *The Law of Restitution* (Canada Law Book, Aurora 2005), 24-17.

9. Beatson J 'The nature of waiver of tort' in J Beatson (ed) *The Use and Abuse of Unjust Enrichment* (Clarendon Press, Oxford 1991); Friedmann D

'Restitution for wrongs: the basis of liability' in Cornish W (ed) *Restitution: Past, Present and Future* (Hart Publishing, Oxford 1998).

10. [2006] OJ No 2421. Both the Court of Appeal for Ontario and the Supreme Court of Canada have subsequently denied leave to appeal, without giving reasons: [2006] SCCA 494 (SCC).

11. *Zidaric*, above note 5; *Reid v Ford Motor Co* [2006] BCJ No 993 (BCSC). In *Ross v HVLD Systems (1997) Ltd* (1999) SJ No 68, the Saskatchewan Court of Appeal noted that a waiver of tort is a means by which a party can claim a specified amount as compensation for certain wrongful acts instead of pursuing a claim for damages; however, the claim remains grounded in tort.

12. *Heward v Eli Lilly & Company* 2007 CanLII 26607 (Ont SCJ).

13. (2004) 72 OR (3d) 296, per Cullity J.

14. Above.

15. [1997] 2 SCR 217 (SCC).

16. *Federal Sugar Refining Co v United States Equalization Board* 268 F 575 (SDNY 1920) at 582. This case involved an intentional interference with contractual relations. The American authority that applies waiver of tort appears to be limited to intentional wrongdoing, where there is evidence of loss or detriment to the plaintiff and the actual commission of a tort. See, for example, *Colorado Interstate Gas Co v Natural Gas Pipeline Co* 885 F 2d 683 (10th Cir Wyo 1989) (restitutionary damages available for tortious interference with contract); *Raven Red Ash Coal Co v Ball* 185 Va 534 (CA 1946) (intentional trespass); *Mullins v Equitable Prod Co* 2003 US Dist LEXIS 13024 (trespass); *Olwell v Nye & Nissen Co* 173 P 2d 652 (Wash 1947) (conversion); *Schwan v CNH Am LLC* 2006 US Dist LEXIS 28516 (toxic tort claim where alleged defendants used plaintiffs' property to dispose of pollutants and thereby save the expense of collecting and disposing of pollutants).

17. [1952] 1 All ER 796 (CA).

18. [2004] OJ No 1821. This case was an action for unjust enrichment and conversion of the plaintiff's trailer. The defendant was required to pay the entire benefit wrongfully gained and punitive damages. Cusinato J found that on the facts before him the unjust enrichment test had been met, including a finding of a corresponding deprivation (that is, loss) to the plaintiff. The reference to *Strand Electric* was therefore obiter in *Transit Trailer Leasing* and hardly the foundation on which to build a new freestanding doctrine of waiver of tort with no requirement of loss or deprivation to the plaintiff.

19. Quoting Waters D W M *The Constructive Trust: The Case for a New Approach in English Law* (University of London Athlone Press 1964) 55–56.

20. [2004] OJ No 4580 (Ont SCJ).

21. Above.

22. [1997] BCJ No 3174 (BCSC).

23. [2001] BCJ No 631 (BCCA).

24. Citing *Boulanger v Johnson & Johnson Corp* [2003] OJ No 2218 (Ont CA) and *Peel (Regional Municipality) v Canada; Peel (Regional Municipality) v Ontario* [1992] 3 SCR 762.

25. Above.

26. At [221].

27. 2007 CanLII 26607 (Ont SCJ).

28. [2007] OJ No 404 (Ont SCJ).

29. A recent example is the spate of class actions commenced in Canada against the manufacturer and distributors of tainted pet food products which caused renal failure and death of cats and dogs that consumed the products. In the recent carriage motion decided in *Joel v Menu Foods GenPar Ltd* [2007] BCJ No 2159 (BCSC, issued 2 October 2007), Hinkson J noted that the British Columbia representative plaintiff had recently amended their statement of claim to plead waiver of tort, seeking a disgorgement of revenues from the defendants in respect of their sale of the tainted product, in addition to damages. For that claim to survive in British Columbia, the representative plaintiffs will obviously have to satisfy the certification judge that *Reid* may not be correctly decided and that *Serhan* should be followed in British Columbia.

AUSTRALIAN
Product Liability
reporter

Corporate Manslaughter Act finally becomes law in the UK — product manufacturers in the firing line

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In 2000, the Home Office published a consultation paper and draft Bill on the introduction in the UK of a new law creating an offence of 'corporate killing'.[1] This arose out of a perception that the existing laws, based mainly on common law principles, were inadequate to punish sufficiently corporations whose activities, through serious neglect, caused deaths. Certainly, the track record of prosecutions against companies under common law manslaughter principles had amply demonstrated that those laws were not capable of leading to a conviction in cases involving large and complex corporations.

Nearly seven years later, and after a great deal of controversy and debate,[2] the *Corporate Manslaughter and Corporate Homicide Act 2007* (the Corporate Manslaughter Act) has been enacted in the UK, receiving Royal Assent on 26 July 2007.

For manufacturers whose products might give rise to risks of serious accidents causing death, there is both good news and bad. At the time the initial Home Office consultation was launched in 2000, there were well-founded concerns that laws might be introduced that would provide for the prosecution of individual directors and managers, and allow the bringing of 'private prosecutions' by individuals.

The good news for directors and managers of corporations is that the Corporate Manslaughter Act does not include any provisions by which individuals can be prosecuted under the Act (although it does contain some provisions that will be of concern to individual directors and managers, as discussed below), and the Act makes it expressly clear that there can be no offence committed by an individual of aiding and abetting an offence of corporate manslaughter. The Act also provides that a prosecution cannot be brought without the consent of the Director of Public Prosecutions.

The bad news for product manufacturers is that the way in which the offence of corporate manslaughter has been framed in the final form of the Act makes it clear that its intended scope very much includes manufacturers whose products cause a person's death. Product manufacturers in the UK are now faced with the real risk that, if a death is caused through some failure to manage the quality and safety of the products they market, a criminal prosecution for corporate manslaughter will follow.

The offence of corporate manslaughter

An organisation is guilty of an offence under the Corporate Manslaughter Act if

> … the way in which its activities are managed or organised —
> (a) causes a person's death, and
> (b) amounts to a gross breach of a relevant duty of care owed by the organisation to the deceased.[3]

The Act goes on to specify that an organisation will be guilty of the offence only if 'the way in which its activities are managed or organised *by its senior management* is a substantial element in the breach' (emphasis added). (Interestingly, there is no explanation of what amounts to a 'substantial element in the breach', and this question will therefore fall to be determined by the jury).

There was much debate as the Bill passed through Parliament over whether the offence should be defined in relation to the role of senior managers. The text of the original draft Bill provided that an organisation would be guilty of the offence if the way in which its activities were managed or organised by its senior managers caused a person's death, and amounted to a gross breach of a relevant duty of care owed by the organisation to the deceased. The Select Committee criticised this 'senior manager' test and suggested that a new test was needed that 'better captures the essence of corporate culpability'. The Committee's concern was that the test would be a return to the old common law 'identification principle', which required that a senior individual within the organisation be found personally guilty of gross negligence before the company could be convicted. Using a 'senior manager' test, it would still be necessary to determine who the senior managers were in the organisation, and what role their management or organisation of the company's activities had in a person's death.

Although the government indicated that it would consider how the test could be improved, it is not clear to what extent (if at all) the new reference in the Act to 'senior management' offers a materially different test.

Who is the senior management?

The Corporate Manslaughter Act defines the senior management as:

> … the persons who play significant roles in —
> (i) the making of decisions about how the whole or a substantial part of [the organisation's] activities are to be managed or organised, or
> (ii) the actual managing or organising of the whole or a substantial part of those activities.[4]

It will, therefore, still be necessary to determine what individuals make up the senior management within an organisation, and to ask whether the way in which they have organised or managed its activities has caused a person's death and amounts to a gross breach of a relevant duty of care.

While there may therefore be no power under the Act to find individual managers liable for the offence of corporate manslaughter, or for aiding and abetting the offence committed by the organisation, it can be expected that senior managers will nevertheless come under scrutiny. It should also be borne in mind that individuals can face liability for other offences, such as the existing common law offence of gross negligence manslaughter or health and safety offences.

While there may therefore be no power under the Act to find individual managers liable for the offence of corporate manslaughter, or for aiding and abetting the offence committed by the organisation, it can be expected that senior managers will nevertheless come under scrutiny.

A 'gross breach of a relevant duty of care'

The offence of corporate manslaughter will be committed only if the way in which the organisation's activities are managed or organised amounts to a 'gross breach of a relevant duty of care'.

Despite suggestions to the contrary from the Select Committee, the concept of a 'relevant duty of care' remains linked to the specific duties that are listed in the Act and owed under the law of negligence. As such, a relevant duty of care includes 'a duty owed in connection with the supply by the organisation of goods or services (whether for consideration or not)' and 'the carrying out by the organisation of any other activity on a commercial basis'.[5] It therefore specifically captures product manufacturers and suppliers.

What amounts to a 'gross breach' of a relevant duty of care remains the same as that contained in the Bill when it was introduced to Parliament. As such, a breach is 'gross' if the conduct 'falls far below what can reasonably be expected in the circumstances'.[6] In deciding whether there has been a gross breach, the jury must consider whether the evidence shows that the organisation failed to comply with any health and safety legislation that relates to the alleged breach and, if so, how serious the failure was and how great a risk of death it posed.[7]

Following the Select Committee's suggestion, juries are also given express permission to 'consider the extent to which the evidence shows that there were attitudes, policies, systems or accepted practices within the organisation that were likely to have encouraged [the failure to comply with health and safety legislation], or to have produced tolerance of it' and to 'have regard to any health and safety guidance that relates to the alleged breach'.[8] This does not detract from the juries' ability to '[have] regard to any other matters they consider relevant'.[9]

Sanctions

Organisations found guilty of the offence of corporate manslaughter under the Act are liable upon conviction on indictment to an unlimited fine. In addition, upon an application by the prosecution,[10] courts may issue 'remedial orders' requiring that the organisation take specific steps to remedy the breach, to remedy any matter that appears to have resulted from the breach and to have been a cause of the death, or to remedy any deficiency in relation to health and safety matters in the organisation's policies, systems or practices.[11] An organisation that fails to comply with a remedial order is liable upon conviction on indictment to an unlimited fine.

Additionally, courts may make 'publicity orders' requiring that an organisation publicise its conviction, including particulars of the offence, the amount of the fine imposed and the terms of any remedial order made.[12] In deciding the terms of a publicity order, the court is required to seek the views of any appropriate enforcement authority, and to have regard to any representations made by the prosecution and by the organisation.

Comment

The Corporate Manslaughter Act is a significant piece of legislation for product manufacturers in the UK. Until now, the sanctions available to be levied against manufacturers whose products cause death have effectively been limited to the modest sanctions available under product safety regulations. The fact that specific legislation now exists that creates a criminal offence and expressly targets product manufacturers (among others) means that there is a real risk of criminal prosecution for companies that put unacceptably dangerous products on the market.

While it is good news that the legislation does not specifically target individual officers, directors or managers, there remains a concern arising from the fact that the formulation of the offence focuses on 'the way in which [the organisation's] activities are managed or organised by its senior management'. This means that an investigation into a possible offence will need to focus on the activities of the senior managers of the organisation, whoever they may be. Furthermore, in order to prove the offence, the prosecuting authorities will have to adduce evidence of the failures of the senior management as a cause of the death. Therefore, while the individual managers will not be exposed to criminal sanctions under the new Act, their activities will inevitably be scrutinised, possibly under the glare of the public eye, during the course of any investigation and subsequent prosecution.

This legislation has been in the pipeline for many years, and it should be expected that there will be a great deal of pressure on the prosecuting authorities to make full use of it in the case of an accident or other incident in which members of the public are killed. It is intended that sanctions imposed under the new Corporate Manslaughter Act will be greater than those imposed for breaches of health and safety legislation. With fines against companies under health and safety legislation in the UK recently reaching £15 million,[13] it should be expected that a conviction under the Corporate Manslaughter Act will have very serious consequences for the company involved. ●

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Endnotes

1. See Freeman R 'Corporate killing laws loom over UK product manufacturers and suppliers' (2000) 1 *European Product Liability Review* 12.

2. See the following articles by Freeman R: 'Corporate killing laws now imminent in the United Kingdom' (2003) 11 *European Product Liability Review* 17; 'Corporate killing — laws move a step closer' (2004) 17 *European Product Liability Review* 20; and 'Product manufacturers targeted in proposed corporate manslaughter laws' (2005) 19 *European Product Liability Review* 18; and by Taylor C: 'Corporate manslaughter: response to the UK Government's latest draft Bill' (2005) 21 *European Product Liability Review* 14; 'Corporate manslaughter: changes to latest draft Bill expected in light of Select Committee report' (2006) 22 *European Product Liability Review* 16; 'Corporate manslaughter — another step closer' (2006) 23 *European Product Liability Review* 17; and 'Corporate Manslaughter Bill introduced to Parliament' (2006) 24 *European Product Liability Review* 16.

3. Section 1(1).

4. Section 1(4)(c).

5. Section 2(1)(c).

6. Section 1(4)(b).

7. Section 8(2).

8. Section 8(3). Health and safety guidance is defined to mean 'any code, guidance, manual or similar publication that is concerned with health and safety matters and is made or issued (under a statutory provision or otherwise) by an authority responsible for the enforcement of any health and safety legislation' (s 8(5)).

9. Section 8(4).

10. Before making such an application, the prosecution must consult with such enforcement authority(ies) as it considers appropriate: s 9(3).

11. Section 9(1).

12. Section 10(1).

13. In *R v Balfour Beatty Infrastructure Ltd* [2006] EWCA 1586, Balfour Beatty was fined £7.5 million for breaches of the *Health and Safety at Work Act 1974* (UK) in connection with the Hatfield train crash (such sum having been reduced by the Court of Appeal from the £10 million fine originally imposed). In August 2005, the Scottish High Court imposed a fine of £15 million on Transco for breach of health and safety legislation leading to a gas explosion that killed a family of four.

AUSTRALIAN
Product Liability reporter

The fetal anti-convulsant litigation: will Legal Services Commission funding limitations lead to the collapse of yet another pharmaceutical group action?

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In the case of *Multiple Claimants v Sanofi-Synthelabo* [2007] EWHC 1860 (QB)[1] (commonly known as the fetal anti-convulsant (FAC) litigation), the claimants failed in their application for an order for the trial of certain dispositive preliminary issues on the basis of assumed facts. With Legal Services Commission (LSC) funding having been granted on the basis that the matter would proceed by way of a trial on the 'preliminary issue on defect', it now remains to be seen whether this litigation will join the rollcall of high-profile pharmaceutical product liability actions which have met an early demise due to the cessation of public funding.

Background

The claimants are children whose mothers had, during their pregnancy, taken an anti-epileptic drug called sodium valproate, manufactured by the defendants and marketed under the name Epilim. The claimants allege that Epilim is a defective product within the meaning of the *Consumer Protection Act 1987* (UK) (CPA). This provides that liability will attach if the safety of a product is not such as persons are generally entitled to expect. The claimants brought their actions pursuant to the *Congenital Disabilities (Civil Liability) Act 1976* (UK) (CDCLA), which governs claims for pre-natal injuries. The claimants' contention is that they were born disabled as a result of an 'occurrence' within the meaning of s 1(2)(b) of the CDCLA and s 6(3) of the CPA (which deals with how the CDCLA is to be given effect in relation to liability for defective products). The occurrence was said to be 'the transplacental spread of sodium valproate or its metabolites to the embryo/fetus, which then affected the embryonic and fetal development and organogenesis'.

The claimants allege that the defect that caused the occurrence was the teratogenic capacity of sodium valproate. Their primary case is that the information supplied with Epilim to a user is not a relevant circumstance when assessing the legitimate expectation of safety of persons generally for the purposes of the CPA. They also submit that the information provided by the defendants was inadequate.

> … the claimants failed in their application for an order for the trial of certain dispositive preliminary issues on the basis of assumed facts.

The defendants say that the current state of scientific knowledge does not permit any of the anti-epileptic drugs currently on the market to be deemed free of teratogenic potential. They deny that a product such as Epilim is defective within the meaning of the CPA where, by its very nature, its use carries a potential risk of adverse events and those risks are generally known to treating practitioners and/or specifically warned about by the marketing authorisation holder. They also argue that the claimants' case is bad in law, as the CPA cannot be construed to require a court to disregard the essential factual context of the guidance or warnings provided as to adverse events or harmful characteristics of the product.

The funding of the case

The claimants had originally been granted funding by the LSC to pursue to trial their cases as to liability and generic causation, subject to an annual affordability review. In August 2006, the LSC notified the claimants of a decision that effectively brought the funding to an end. Judicial review proceedings were subsequently instituted and the LSC's decision to withdraw the funding was quashed. The LSC then agreed to provide some limited funding.

A witness statement of the director of the LSC's Special Cases Unit (which is responsible for managing funding for complex or high-cost civil cases) was put before Mr Justice Smith at the

hearing of the claimants' application. In the statement, his Honour referred to some of the matters identified at Rule 1.1(2) of the Civil Procedure Rules as aspects of dealing with a case justly. He stated:

> Ensuring that high cost civil cases are subject to appropriate financial controls requires case managers to ensure funded cases comply with the spirit of the Woolf reforms, in particular the overriding objectives of saving expense and dealing with the case in ways which are proportionate given the amount of money involved, the importance of the case and the complexity of the issues.

It is stated at the outset of the *Civil Procedure Rules* (UK) that they have the 'overriding objective of enabling the court to deal with cases justly'. Mr Justice Smith noted that the director made no mention in his statement of the other matters referred to in CPR 1.1(2), such as ensuring that the parties are on an equal footing (CPR 1.1(2)(a)), dealing with the case in ways which are proportionate to the financial position of each party (CPR 1.1(2)(c)(iv)) and ensuring that the case is dealt with expeditiously and fairly (CPR 1.1(2)(d)). According to the director's statement, the LSC appeared to have elevated some of the various elements that the CPR identify as contributing to the overriding objective into distinct overriding objectives in their own right. Mr Justice Smith said he did not consider this to be helpful, as the court has to seek to give effect to the overriding objective as a whole.

The director explained that following the decision in the judicial review proceedings, the LSC's Funding Review Committee (FRC) concluded that the case:

> ... had sufficient merits to meet the merits test contained within the Funding Code as long as the case proceeded on the basis that the preliminary issue on defect, which was alone capable of derailing the litigation, was decided first ...

If the case could not proceed by way of a trial on a preliminary issue, then the case would be sent back to the FRC for review.

The court's findings

The claimants therefore applied to have certain preliminary issues determined first. At the hearing, the claimants' counsel expressed the opinion that, unless the court acceded to the views of the LSC as to how this litigation should proceed, it was likely that funding would be discontinued. However, Mr Justice Smith thought this submission went further than the director's evidence.

Assumptions

Mr Justice Smith first considered the assumptions upon which the claimants proposed that the preliminary issues be tried. He noted that, particularly in complex cases, it was necessary that the assumptions be precise and unambiguous, as much of the purpose of having preliminary issues would be lost if the assumptions had to be expanded and explained by complicated scientific and pharmacological evidence.

His Honour found that the assumptions in the instant case did not, and however drafted could not, provide a clear and precise factual basis for the determination of the issues. For example, one of the claimants' assumptions was that Epilim 'is unsafe for all pregnant women whose fetuses are exposed to it'. Yet, it was unclear what the description of 'unsafe' meant. Nor was it clear what was the degree of risk and what potential damage and/or disabilities would be sufficient for the drug to be described this way. While his Honour accepted that it may be necessary to supplement assumptions with some limited evidence, the more that is required, the less attractive the proposal for preliminary issues becomes.

Preliminary issues

Mr Justice Smith then considered the preliminary issues that the claimants proposed and found these also to be problematic. For example, one of the issues assumed there had been an 'occurrence' when this was still in dispute. Another issue could not be satisfactorily decided without a firm factual and evidential basis. Mr Justice Smith therefore rejected the claimants' application for an order for the trial of the questions as preliminary issues.

Comment

It remains to be seen whether the LSC will now pull the plug on the funding of the FAC litigation — an outcome that the claimants' counsel clearly thought was likely. Without public funding, this litigation will inevitably become the latest in a long list of group actions doomed to failure in recent years. The LSC currently funds major group actions out of a budget of £3 million per annum, which potentially limits the scope of major new group litigation. Funding for group actions is under far greater control than ever before through the LSC's Special Cases Unit. In a recent article, Colin Stutt, the head of funding policy at the LSC, noted that pharmaceutical actions remain 'very problematic'.[2]

However, there may be some light at the end of the tunnel for claimants hoping to pursue pharmaceutical group actions in the future. In June this year, a series of recommendations was made by the Civil Justice Council to the Lord Chancellor to improve access to justice through the development of improved funding structures.[3] One of the recommendations was for the introduction of properly regulated contingency fees in multi-party cases where no other form of funding is available. It may well be that contingency fees will become the mainstream funding alternative for pharmaceutical group actions in future, given the continued tightening of the LSC's purse strings for such cases. However, the introduction of any such reforms is likely to come too late for the claimants in the FAC litigation. ●

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Endnotes

1. The defendant is incorrectly described as Sanifo-Synthelabo in the official judgment heading.
2. Stutt C 'Who ate all the PI's?' (2007) JPIL 81 at 82.
3. Civil Justice Council *The Future Funding of Litigation — Alternative Funding Structures* June 2007.

AUSTRALIAN
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No such thing as a free product recall

Professor Dr Thomas Klindt
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The Landgericht (District Court) Frankfurt am Main´s refusal last year to grant a manufacturer reimbursement of recall costs from a supplier, because a warning by the manufacturer to its customers would, in the opinion of the judges, have sufficed, passed almost unnoticed by businesses and lawyers alike. However, this initially disregarded development has recently been confirmed by an appeal judgment and now looks set to rewrite the rules on who bears the cost of product recalls — with potentially huge financial implications, given the many millions, sometimes billions, that can be involved in such a recall.

Customary law: free replacements of recalled products

The Oberlandesgericht (Appellate Court) Hamm decided on 16 May 2006 (File No 8 U 4/06) that, in the case of product defects which result in safety shortcomings, the manufacturer must provide replacement free of charge only during the warranty period. Historically under German law, requirements for manufacturers are based mainly on court judgments, not statutes, and this is also the case with the obligation to conduct a recall. There is, therefore, no obligation on companies specified by statute to recall defective products, notwithstanding that since 2004, for the first time, a statutory possibility was provided to public authorities to order a recall. In practice, recalls are based on, first, criminal law judgments which require that recalls are conducted if responsible managers learn of a product safety risk in the field and, second, on the development by the civil courts based on the public duty of care, of permanent monitoring and — in the event that safety deficits in goods supplied a long time earlier arise — of a duty to prevent danger. This line of German judgments goes back many decades and has not been affected by the European Product Liability Directive 85/347/EEC. Somewhat stealthily, the view has become established in Germany that in such recalls an exchange of 'new for old' free of charge is to be expected.

New judgments: a clear warning is enough

This is where one confronts the core of the new judgments. It remains legally clear that measures to prevent danger must be taken. However, whether this obligation is not already satisfied by the manufacturer issuing a clear warning about its own product, without at the same time offering replacement free of charge, is a longstanding legal dispute which has now flared up again — with the Oberlandesgericht Hamm speaking clearly in an appeal concerning reimbursement of recall costs. If one looks in the legal literature of recent years, passing reference is often made — mostly without real theoretical discussion — to the duty of the manufacturer, naturally at its own expense, to provide the user in a recall situation with a safe product. Industry very often acted accordingly in practice in Germany, conducting product recalls free of charge. Newer judgments, which of course are only at first instance and therefore receive considerably less notice, have subjected this position to legal examination. They refer to the question of whether a product is to be improved or exchanged free of charge as being primarily a question of sales law and the claims being warranty claims. If the user is still within the warranty period under his or her purchase agreement, the user has the right to make a warranty claim under the agreement. It is also the case that this right no longer exists if the warranty period has

expired — the user must restore a safe situation at his or her own expense.

Distinguishing fault-related liability from questions of cost

In Germany, judgments on duty of care to the public and associated measures to prevent danger have their source not in sales law, but in tort — that is, a purely statutory fault-related liability. Their purpose is not the establishment of contract compliance, but the vindication of certain personal safety interests. So, if the question of how a preventative measure should look is discussed in this context, the issue of who bears the cost has, prima facie, no relevance to the measure's efficacy or comprehensiveness — and herein lies the basis for the new judgments.

When a manufacturer issues a product warning which leaves no room for doubt that the item supplied is subject to a safety problem, it thereby provides the user with knowledge of the potential risk and places the user in a position to protect himself or herself. The prevention of danger intended by the duty of care to the public is thus ensured, and whether the user also receive a safe repaired product was not considered a concern — in other words, the new judgments saw no logical connection between questions of cost and successful prevention of danger.

Consequences for suppliers and vendors

The implications of this case law for companies both within Germany and further afield are several. First, companies are well advised, if they wish to maintain the former system unchanged, to include from the outset binding clauses in their contracts on the liability for costs throughout the supply chain. Second, in a recall situation, businesses have a choice: either they reduce the financial burden by not waiving a charge for the repair, or a free recall can be conducted in the spirit of first-rate customer service and goodwill.

One additional point should not be overlooked: German businesses are very successful exporters, so any product safety risks affect not only the domestic market. If an international recall becomes necessary, the question of whether there is a legal obligation to conduct such a recall free of charge has to be answered separately for each state or jurisdiction — so any reduction of the obligation to prevent danger based on the judgments does not change the need for German companies to find an overall commercial strategy for costs liability in the case of an international recall. Recall insurance, which many companies now have, should also be taken into account.

Likewise, foreign enterprises should review if and to what extent their agreements with German companies provide for liability for recall costs and adjust their insurance cover accordingly. If they sell products on the German market directly, they will be relieved at the easing of liability. However, they should consider the consequences for their company's image if, contrary to the practice so far, it refuses to replace defective parts of potentially dangerous products free of charge. This is particularly relevant in the business-to-consumer arena. Whoever first tests the ice may be first to fall. ●

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Funding group actions: a brave new world?

Michael Goldberg and **Simon Pearl**
DAVIES ARNOLD COOPER

The report by the Civil Justice Council (CJC) on the future of litigation funding[1] arrived to little media fanfare in June this year, notwithstanding that it included recommendations that could pave the way for more group actions in England and Wales.

In addition, there has been much speculation about US-style class-action litigation being about to arrive on these and other EU shores — albeit much of it generated by lawyers keen to talk up a possible upsurge in claims

The CJC's examination of the viability of introducing contingency fees as a means of funding group (or multi-party) actions comes at a time when several EU initiatives geared towards improving consumer redress are gathering pace. The recent global credit crunch, sparked by the crisis in the US sub-prime mortgage market, has added a greater sense of urgency to the issue.

EU initiatives to improve consumer redress

Moves initiated by the EU Commission in March this year opened up a wide-ranging consultation process aimed at developing effective consumer redress mechanisms. The EU Consumer Affairs Commissioner, Meglena Kuneva, has committed the Commission to taking action to improve the availability of collective redress mechanisms to consumers who fall victim to breaches of consumer protection legislation and also infringements of competition law.

In April, the European Parliament approved Commission recommendations geared towards enabling victims of anti-competitive behaviour to bring collective actions.

Meanwhile, other EU member states, most notably France and Germany,

have introduced fresh legislation designed to give consumers more rights, with Italy currently having draft Bills under consideration. Spain formally introduced a class actions regime in 2000.

The CJC's findings

The CJC report was prepared based on two key assumptions:

- that there will be no new government money to fund the recommendations; and
- that the concept of 'no win, no fee' is now ingrained in the funding system.

Alternative funding schemes

The CJC considered how alternative funding schemes operate in Hong Kong, Australia and Canada. The review included public funding schemes utilising what is known as a Contingency Legal Aid Fund (CLAF). CLAFs operate as freestanding, commercially run (although not necessarily for profit) funds which are made viable by a levy, usually derived from damages recovered from previous cases. Supplementary Legal Aid Schemes (SLASs), in contrast, are essentially a bolt-on facility to existing legal aid funding.

The principal argument against introducing CLAF schemes in England and Wales is that they would require initial funding from the public purse and would be competing in an already active market for insurance-based Conditional Fee Agreements (CFAs). CFAs have been available for all civil cases since July 1998. In most cases, CLAF schemes provide no protection against having to pay the other side's costs. An SLAS, on the other hand, has the advantage over a CLAF in not requiring any initial funding — also known as 'seed funding'.

The CJC particularly favoured the idea of calculating the SLAS levy for seed funding purposes by reference to damages, but also contemplated the possibility of seeking direct recovery from opponents in group actions.

Third-party funding

Third-party funding, while hardly a new or innovative mode of funding litigation, is becoming increasingly viewed as a potent weapon in the litigant's funding armoury in light of recent court decisions.

In October 2006, a decision reached in the High Court of Australia held that contingency fee arrangements were neither contrary to public policy nor unlawful, thereby encouraging the already burgeoning market for companies which are prepared to step in to fund large or complex litigation on a contingency basis.

Following a Court of Appeal decision, English courts have relaxed their rules on champerty and maintenance which rendered third-party funding agreements an altogether more risky affair if they came before the courts. In *Arkin v Borchard Lines* [2005] EWCA Civ 655, it was decided that third-party funding was acceptable in terms of public policy in cases where the claimant had no other means of funding his claim. Previously, these rules had served as an effective brake on the independent funding of litigation by third parties.

No doubt influenced by the Court of Appeal's finding in *Arkin*, the CJC report recognised that third-party funding is acceptable and in the interests of justice, especially where a prospective claimant is unable to fund his or her claim by any other means. The CJC concluded that such funding should be encouraged, subject to certain controls limiting the extent of liability of the third-party funder.

The key point is that there is now one less obstacle preventing investors who are bold enough to take a calculated risk by stepping in to fund a group action. In the wake of *Arkin,* however, they must weigh up the risk of losing everything they have put into a claim — and potentially more if the courts start endorsing the liability of funders to pay adverse costs orders in such claims.

Contingency fees in multi-party claims

The CJC took note of the growing interest in encouraging consumer rights in multi-party claims. Having considered the current funding and procedural obstacles to bringing such claims and their adverse impact on protecting consumer rights, the CJC accepted that it is 'prudent' for the

government to examine alternative methods of funding multi-party actions in view of the instability of the CFA insurance marketplace.

The CJC also supported the findings of the government's Better Regulation Task Force, whose report, *Better Routes to Redress*,[2] considered the potential impact and effectiveness of using contingency fees to fund group actions. The report states:

> The introduction of properly regulated contingency fees would simplify the funding system reducing satellite litigation and the role of costs intermediaries. This would save costs for those who ultimately pay for the litigation and for the lawyers involved in the litigation. There would also be a saving in the disproportionate amounts of time, cost and Government resource spent on the Courts role in resolving costs disputes. Transparency and simplicity for the consumer clients would be a significant benefit under a contingency fee regime.

The CJC states that it intends to publish a further paper once it has completed further study of the American and Canadian contingency fee systems.

Comment

It is all too easy to preach doom and gloom about the CJC proposals as being the harbinger of a deluge of consumer class actions. The reality is not that simple.

The process of widening funding availability ought to be regarded as the result of an overdue market correction. A void exists within the litigation funding insurance marketplace, which has so far failed to produce sufficiently sophisticated funding products capable of supporting complex and expensive group litigation.

Also, the renewed interest in third party funding suggests that a new generation of litigation-savvy financial backers may view some group actions as a reasonably safe investment, provided the merits are heavily on their side. However, the downside of ploughing money into an action which may not lead to any return for years, plus the possibility of having to pay the other side's costs and even face adverse costs orders, will dissuade all but the bravest of hedge fund managers.

However, with initiatives on consumer redress squarely on the EU legislative agenda, the CJC recommendations potentially pave the way for removing the funding difficulties that for so many years have acted as a brake on their exponential expansion. ●

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Endnotes

1. Civil Justice Council *Improved Access to Justice — Funding Options & Proportionate Costs* (June 2007), available at <www.civiljusticecouncil.gov.uk/files/future_funding_litigation_paper_v117_final.pdf>.

2. Better Regulation Task Force *Better Routes to Redress* (May 2004), available at <www.brc.gov.uk/upload/assets/www.brc.gov.uk/betterroutes.pdf>.

Casenote

English House of Lords slams door on 'worried well' claims

ROTHWELL v CHEMICAL INSULATING CO

[2007] UKHL39

In a long-awaited decision, the English House of Lords has unanimously dismissed the Pleural Plaques Litigation appeals. In so doing, it confirmed the Court of Appeal's view that pleural plaques do not constitute a compensable injury, nor does psychiatric injury caused as a result of asbestos exposure. The decision will come as a huge relief for employers who historically used asbestos in their business or had it in the fabric of their buildings — and even moreso for the insurance industry, which stood to lose in excess of £1 billion in the event of the House of Lords ruling the other way. The verdict also firmly shuts the door on the possibility of 'worried well' claims appearing in English courts.

Background and judgment

Pleural plaques are a scarring of the lung membrane caused by exposure to asbestos. They are almost always symptom free, but they are evidence of asbestos fibres in the lungs and pleura, which themselves give rise to an increased risk of the development of more serious asbestos-related conditions such as asbestosis, lung cancer and mesothelioma. Plaques typically develop 20 or more years after exposure to asbestos.

The question before the House of Lords was whether the presence of this symptom-free internal scarring, in combination with an increased risk of future serious disease, and consequent anxiety on the part of the claimants, could give rise to a right to claim damages. In *Patterson v Ministry of Defence* [1987] CLY 1194, the High Court held that it could, and on that basis plaques claims had regularly been settled until the insurance industry decided to challenge the position in this case two years ago. Although at first instance the High Court held that the earlier authority was correct, the Court of Appeal last year, with some difficulty, decided that it was not.

In a robust judgment, the House of

Lords dismissed the claimants' appeal. The lords had no difficulty in unanimously holding that symptomless plaques do not in themselves constitute an actionable injury: Lord Hoffman pointed out that 'proof of damage is an essential element in a claim in negligence and in my opinion the symptomless plaques are not compensatable damage', and Lord Hope said that there must be 'real damage, as distinct from damage which is purely minimal … Where that element is lacking, as it plainly is in the case of pleural plaques, the physical change which they represent is not in itself actionable'. The House of Lords also pointed out that it was well established that neither an increased risk of future illness, nor anxiety caused by this, could alone form the basis of a claim.

The claimants' case that a cause of action could be made out by the aggregation of the plaques, the future risks and the anxiety was also given short shrift. Lord Scott of Foscote noted that neither plaques, risks nor anxiety in this context could sustain a tort action, and therefore their aggregation could not succeed in creating one because 'nought plus nought plus nought equals nought'. Lord Rodger of Earlsferry gave a further reason for rejecting the aggregation theory — namely, that the anxiety and the risks are not actually associated with the plaques themselves: 'the plaques alert the claimants to a heightened risk … but they would not be a cause of the illnees if it did develop.'

The House of Lords also dismissed the appeal of Mr Grieves, a claimant who had developed a recognised psychiatric illness as a result of anxiety caused by the plaques. Lord Hoffmann, with whom the other lords agreed, said that applying traditional principles, the psychiatric illness was not a reasonably foreseeable consequence of the creation of a risk of an asbestos-related disease. He also rejected the *Page v Smith* [1996] AC 155 approach — namely, that if physical injury is a foreseeable consequence of a breach of duty, then it is also possible to recover for psychiatric injury, on the basis that no physical injury had occurred in Mr Grieves's case and to allow recovery for psychiatric injury in these circumstances would extend the *Page v Smith* doctrine.

Significance

Plaques is the most common condition of those exposed to significant quantities of asbestos and, had these appeals been allowed, the likelihood is that courts would have been flooded with plaques claims. While this judgment was very much grounded in legal principles rather than based on policy reasons, there is no doubt that difficult issues would have arisen had the appeals been allowed. Claimants would effectively have been put into a position where, once aware that they had plaques, they would have had to bring proceedings to ensure that any more serious condition they might subsequently contract would not be time-barred. This would have been a clear encouragement to increased litigation, and would have likely also seen an increase in claimant-recruiting, through means such as 'scan vans' — mobile X-ray units paraded around shopping centres by claims management companies and lawyers. A judgment for claimants on this issue might also have led to the beginning of 'worried well' claims, even beyond the field of asbestos litigation, in which claimants who are not injured but have an increased risk of future injury are able to recover damages for their anxiety and the cost of medical monitoring.

English courts have struggled in recent years to deal with the difficult and unique issues raised by asbestos claims, in particular the challenges posed by the long time lapse between exposure to asbestos and the development of any symptoms. In this context, a judgment based on traditional English principles is to be welcomed, particularly as it will prevent courts being clogged up by cases involving claimants without physical injuries.

If this judgment is considered to be unfair by some who feel that those who have been exposed to asbestos ought to be compensated even if no noticeable injury has occurred, that does not point to the judgment of the lords being incorrect or unjust. It simply demonstrates that the litigation system is not the proper place for dealing with the unique problems of compensation raised by the asbestos tragedy.

It is important to remember that this is not a case about whether people who have been injured by asbestos can recover damages. Quite the contrary. It is about whether people who have been exposed to asbestos, but who have suffered no physical impairment, and may never do so, should be able to sue now. The lords, relying on long-established legal principles, have confirmed that the right to sue arises when, and only when, physical impairment occurs.

This is an important judgment that has significant implications for product manufacturers in all industries and their insurers. ●

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A version of this article was previously published in the Lovells European Product Liability Review.

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US round-up

SHOOK, HARDY & BACON LLP

Ohio Supreme Court upholds state filing requirements for asbestos claims

The Ohio Supreme Court has determined that a state law requiring plaintiffs to show physical injury caused by asbestos exposure in order to maintain a tort action alleging an asbestos claim is not preempted by federal law: *Norfolk S Ry Co v Bogle* No 86339 (Ohio, decided 10 October 2007). The court agreed with the defendant that the medical criteria and administrative dismissal process were procedural and did not affect or place undue burdens on substantive federal rights under the *Federal Employees' Liability Act* (US) (FELA) or the *Locomotive Boiler Inspection Act* (US) (LBIA). Because the Ohio law allows potential plaintiffs to re-file their claims when proof of injury becomes available, the court was able to distinguish cases finding preemption in other jurisdictions that require dismissal with prejudice where the plaintiff is unable to meet a threshold standard of proof. The two dissenting justices agreed with the intermediate appellate court, reversed by the majority, that the state requirement 'would "gnaw" at the FELA/LBIA claimants' substantive rights to assert a cause of action under federal law in state court'.

US Supreme Court faces punitive damages issues in two 'cert' petitions

The US Supreme Court will consider whether to hear appeals in two cases involving claims that the punitive damages awarded are excessive. On the court's conference docket for 26 October 2007 are *Exxon v Baker* No 07-219 ('Whether a $2.5 billion punitive damages award for economic harm to fishermen and private parties resulting from the Exxon Valdez oil spill is permitted under federal maritime law or the Due Process Clause'), and *Continental Carbon Co v Action Marine* No 07-257 ('Whether a $17.5 million punitive damages award for property damage on top of $1.9 million in compensatory damages violates the Due Process Clause').

In other Supreme Court news, medical-device trade groups have reportedly filed an amicus brief in a case the court will hear in December 2007, involving the federal preemption of state-law claims for personal injury allegedly caused by medical devices approved by the Food and Drug Administration. *Riegel v Medtronic Inc* No 06-179 (US, cert granted 25 June 2007). Amici argue that the federal agency should have exclusive jurisdiction over medical devices in this country. According to a spokesperson for the Advanced Medical Technology Associations, which joined the amicus brief: 'Encouraging states to insert state court liability suits into the process would undermine the science-based approach to approvals currently in place and would likely result in inconsistencies in standards and delayed access to products.'

Federal court imposes sanctions on lawyers representing plaintiffs with baseless claims

A federal court in California has imposed sanctions on public-interest lawyers who filed suit against Texaco Inc on behalf of plaintiffs in Ecuador who allegedly contracted cancer from exposure to water sources purportedly polluted by the company's drilling operations in that country. *Gonzales v Texaco Inc* No 06-02820 (US Dist Ct ND Calif, decided 16 October 2007). According to the court, three of the nine named plaintiffs did not have cancer, and their counsel either knew or should have known before the lawsuit was filed that they did not have the disease. Defendants filed a motion to dismiss the plaintiffs' claims after they were deposed in Ecuador and testified that they did not have cancer and did not know that lawyers in the US planned to sue Texaco on their behalf.

Finding that sanctions were justified under Rule 11 of the Federal Rules of Civil Procedure, the court chastised the plaintiffs' attorneys for failing to:

- 'follow up on pre-suit warning flags that spelled trouble';
- 'personally interview or counsel any of the three plaintiffs before filing the lawsuit; or
- gather the evidence they knew they needed to pursue the claims.

'Counsel were obligated to investigate *first* and sue *second*, not the other way around', the court stated. While defense counsel incurred US$80,000 in costs, primarily to depose the three plaintiffs in Ecuador, the court decided to impose US$45,000 in sanctions, '[t]aking into account the public interest nature of the lawyers involved and their limited pocketbooks'.

Litigation trends survey shows fewer filings against US companies but plenty of pending action

An annual litigation survey of US businesses reportedly shows that the number of new lawsuits and regulatory actions filed against them has dropped, yet one-third of corporate law departments count more than 25 pending suits at any one time and 18 per cent are handling at least 100 in US courtrooms. The survey also apparently shows that nearly one-fifth spend more than US$5 million annually in litigation. Among the types of lawsuits that remain of most concern to the companies are personal injury and toxic tort. According to a news source, the survey also revealed that retailers in the last year faced more product liability lawsuits than manufacturers. The survey, performed during May and June 2007, involved 253 US companies and 50 from the UK. ●

These items originally appeared in the October 2007 issue of Shook, Hardy & Bacon's Product Liability Litigation Report.

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Product liability news

No reforms needed for long-tail liability, says CSA

According to Chartered Secretaries Australia (CSA), the existing law is well-equipped to protect individuals who may have future personal injury claims against companies such as James Hardie. CSA is one of nine organisations to have submitted responses to CAMAC's discussion paper titled *Long-tail Liabilities: The Treatment of Unascertained Future Personal Injury Claims*.

The group maintains that CAMAC's review of the need to recognise long-tail liabilities in cases of unidentified future claimants was launched when legal proceedings against James Hardie were still unfolding. Tim Sheehy, chief executive of CSA, says that the victim compensation issue has subsequently been largely resolved to the satisfaction of the victims, state and federal governments and James Hardie shareholders: 'This result has clarified that the law is robust enough to protect the interests of future claimants and, as such, there is no pressing case for heavy-handed reform.'

CSA argues that if future personal injury claims are to be legally acknowledged, they should be limited to extreme cases involving products that the government has identified by regulation to be dangerous, and that any legal reforms should not apply to claims that could not have been foreseen by the company.

'Companies cannot be expected to sensibly provide for unidentified future claims when they are by their nature impossible to estimate because they are about claims that do not yet exist and claimants who may not yet be injured,' says Mr Sheehy. 'Requiring companies to account for such imprecise risks could damage the interests of creditors and shareholders and even undermine Australia's business environment if companies are unreasonably restricted in their normal capital management activities.'

CAMAC has also received submissions from the Australian Conservation Foundation, the Institute of Actuaries of Australia, the Business Council of Australia, the Insolvency Practititioners Association of Australia, the Australian Lawyers Alliance, the Insurance Council of Australia, the Institute of Chartered Accountants in Australia and the Australian Institute of Company Directors. Copies of the submissions are available at <www.camac.gov.au/CAMAC/camac.nsf/print/Long-tail+Liability?opendocument>. The CAMAC discussion paper is available at <www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers/$file/Long_tail_DP_Jun07.pdf>.

Sources: <www.camac.gov.au>; CSA MR/2007/16

Another toxic toy recalled

Bindeez Beads, the Australian 2007 Toy of the Year, has been banned in all Australian states and territories. At least three children in NSW and Queensland were hospitalised after swallowing the product, which is manufactured in China.

The toy contains hundreds of small coloured beads. Tests showed that these beads were coated with the industrial chemical 1,4-butanediol. When ingested, the chemical metabolises into the toxic illegal drug gamma hydroxy butyrate (GHB), also known as 'fantasy' and the 'date rape' drug. GHB can induce drowsiness, seizures or a coma.

The Melbourne company Moose Enterprises distributed Bindeez, which was manufactured in China. The Chinese government has suspended export of the toy. Bindeez was also sold in the US, where it was marketed as Aqua Dots. At least nine US children became ill after ingesting the beads. The toy has now been banned in the US, Britain, Singapore and Malaysia, among other countries. Recall information is available at <www.bindeezrecall.com>. ●

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