

COURT FILE NO.: 02-CL-004605
DATE: 20070118

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:)
)
LESLIE FROHLINGER) Joel Rochon and Peter Jervis, for Plaintiff
)
Plaintiff) Kirk Baert and Murray Gold, U.S. lead
) Plaintiffs Nortel I
- and -)
)
)
NORTEL NETWORKS CORPORATION,) Peter Griffin, Steve Tenai, D. Michael
JOHN ANDREW ROTH, FRANK DUNN, F.) Brown, and Tom Donnelly, for Nortel
WILLIAM CONNER, CHAHRAM) Networks Corporation, Roth, Conner,
BOLOURI, WILLIAM R. HAWE and) Bolouri, and Hawe
DELOITTE & TOUCHE LLP)
) Thomas G. Heintzman and Junior
) Sirivar, for Frank Dunn
)
) Brian G. Morgan and Christopher P.
) Naudie, for Deloitte & Touche LLP
)
) Allan Sternberg, for Chubb Canada
Defendants)
)
) Randy Bennett, Court Appointed Monitor

Proceeding under the *Class Proceedings Act, 1992*

AND

ONTARIO
SUPERIOR COURT OF JUSTICE

COURT FILE NO.: 05-CV-285606CP

BETWEEN:)
)
PETER GALLARDI) Joel Rochon and Peter Jervis, for Plaintiff
)
Plaintiff) Barbara L. Grossman and Peter
) Cavanagh, for U.S. lead Plaintiffs Nortel II

- and -

NORTEL NETWORKS CORPORATION,
FRANK A. DUNN, DOUGLAS BEATTY,
MICHAEL GOLLOGLY, JOHN EDWARD
GLEGHORN, ROBERT ELLIS BROWN,
ROBERT ALEXANDER INGRAM,
GUYLAINE SAUCIER, SHERWOOD
HUBBARD SMITH, JR. and DELOITTE &
TOUCHE LLP

Defendants

)
)
) **Peter Griffin, Steve Tenai, D. Michael**
) **Brown, and Tom Donnelly** for Nortel
) Networks Corporation, Cleghorn, Brown,
) Ingram, Saucier & Smith
)
) **Thomas G. Helntzman and Junior**
) **Sirivar,** for Frank Dunn
)
) **Jennifer Lynch,** for Douglas Beatty
)
) **Marie-Andrée Vermette,** for Michael
) Gollogly
)
) **Randy Bennett,** Court Appointed Monitor
)
) **HEARD:** November 6, 2006

Proceeding under the *Class Proceedings Act, 1992*

Winkler R.S.J.:

[1] This is a motion seeking approval of a settlement, together with a companion motion for approval of class counsel fees, brought in two related class proceedings involving Nortel Networks Corporation. Similar approval motions have been brought in the United States District Court, Southern District of New York and in the courts in the provinces of British Columbia and Quebec. By order dated June 22, 2006, this court granted certification, on consent, under the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 for the purposes of settlement of these two class proceedings, which are styled as *Frohlinger v. Nortel Networks Corporation et al.* ("Frohlinger") and *Gallardi v. Nortel Networks Corporation et al.* ("Gallardi"). The classes for which certification issued pursuant to these Ontario proceedings were national classes except for residents of British Columbia and Quebec. The classes covered by the U.S. proceedings are world-wide. The plaintiffs in both of the actions, supported by the corporate defendant, some of the individual defendants, and plaintiffs in related proceedings in other jurisdictions, move before this court for approval of a settlement that is a proposed global resolution aimed at concluding all outstanding litigation, based on similar claims, in Canada and the United States. Although some of the individual defendants have not joined in support of the settlement for other reasons, none of those defendants are objecting to the approval of the settlement.

[2] For the reasons that follow, I approve the settlement as being “fair, reasonable and in the best interests of the class” and approve class counsel fees, as sought, in the total amount of \$5,000,000 plus disbursements and applicable taxes.

Background

[3] The *Frohlinger* action was commenced with a different representative plaintiff in Ontario on February 23, 2001. Following various amendments, the claim now alleges that during the period between October 24, 2000, and February 15, 2001, Nortel Networks Corporation (“Nortel”), and certain of its officers, issued a series of materially false and misleading press releases and financial statements relating to its financial performance. It is alleged that the price of Nortel securities were artificially inflated during the relevant period as a result of these statements. On February 15, 2001, Nortel issued a press release significantly lowering its next quarterly and full year financial performance guidance to investors. During the next trading day, the share price suffered a drop of approximately \$15.00 or 33% from its closing price on February 15. Shortly thereafter class actions were commenced in the United States, Ontario, British Columbia and Quebec on behalf of purchasers of Nortel securities during the relevant periods. The class actions in the United States were consolidated in the U.S. District Court for the Southern District of New York as *In re Nortel Networks Securities Litigation*. This consolidated litigation is referred to as “Nortel I”.

[4] The *Gallardi* action was commenced in relation to allegedly misleading financial reports and press releases that are claimed to have caused an artificial inflation in the Nortel securities market price during the period between April 23, 2003 and April 27, 2004. Class actions filed in the United States in relation to these claims have also been consolidated in the Southern District of New York. That consolidated litigation is referred to as “Nortel II”.

[5] While the class periods are the same in the respect of the *Frohlinger* and Nortel I actions, and in the *Gallardi* and Nortel II actions, the classes are otherwise defined differently to accord with certain distinctions in the class action jurisprudence in Canada and the United States. While these differences are discussed in greater detail below, the practical reality is that the distinctions will not have an impact on the approval of this settlement.

[6] Ontario-based pension funds acted as lead plaintiffs in each of the Nortel I and Nortel II actions in the United States, which is indicative of the fact that Nortel securities were widely held on both sides of the border. The U.S. actions advanced more quickly than the Ontario actions for various reasons, and settlement negotiations, under the supervision of Senior United States District Judge Robert W. Sweet, were initiated in September 2005 between the U.S. lead plaintiffs and the defendants. The negotiations culminated in a two-day mediation with Judge Sweet in early February 2006. A conditional agreement in principle was announced in a Nortel press release on February 8, 2006.

[7] Neither the plaintiffs nor the class counsel in the Canadian actions participated in the settlement negotiations in the United States. However, since it was intended that the settlement would represent a global resolution of all outstanding class action litigation, further discussions were necessary in order to have the Canadian classes adopt the settlement and thereby achieve the desired global resolution. The end result was a settlement agreement dated June 20, 2006, accepted by all parties to all of the outstanding class actions in both countries. That settlement has now been presented to this court for approval. Approval has also been sought from the courts in New York, British Columbia and Quebec pursuant to the terms of the settlement agreement. In order for the settlement to take effect it must be approved by all of the courts.

The Settlement

[8] Settlement is to be encouraged in litigation. In a class action context, a settlement ought to be approved by the court where it is "fair, reasonable and in the best interests of the class as a whole". In determining whether a proposed settlement meets that test, a number of factors are to be considered but these factors are guidelines rather than rigid criteria. As stated in *Kelman v. Goodyear Tire and Rubber Co.*, [2005] O.J. No. 175 (S.C.J.) at para. 12 and 13:

[para12] When considering the approval of negotiated settlements, the court ought to have regard to a number of factors, including:

- (i) Likelihood of recovery or likelihood of success;
- (ii) Amount and nature of discovery, evidence or investigation;
- (iii) Settlement terms and conditions;
- (iv) Recommendation and experience of counsel;
- (v) Future expense and likely duration of litigation and risk;
- (vi) Recommendation of neutral parties, if any;
- (vii) Number of objectors and nature of objections;
- (viii) The presence of good faith, arms length bargaining and the absence of collusion;
- (ix) The degree and nature of communications by counsel and the representative plaintiffs with class members during the litigation;
and
- (x) Information conveying to the court the dynamics of and the positions taken by the parties during the negotiation.

(See *Dabbs v. Sun Life Assurance Company of Canada* (1998), 40 O.R. (3d) 429 (Gen. Div.) at 440-44; *Parsons v. The Canadian Red Cross Society*, [1999] O.J. No. 3572 (Sup. Ct.) at paras. 71 and 72.)

[para 13] However, these factors provide a guide for analysis rather than a rigid set of criteria that must be applied to every settlement. In practice, it may well be the case that all of the factors are not applicable or, alternatively, should not be given equal weight. (See *Parsons* at para. 73.) (Emphasis added.)

[9] The settlement contains terms relating to direct compensation to class members as well as indirect benefits through the adoption of certain corporate governance changes. In respect of direct compensation, the settlement is divided into two pools, one for each of the Nortel I (*Frohlinger*) and Nortel II (*Gallardi*) actions. Compensation is in the form of cash and shares of Nortel in each pool. In the Nortel I action, class members will share in a pool of U.S. \$438.6 million in cash and 314,333,875 Nortel common shares. In the Nortel II action, the pool of compensation to be shared among class members will consist of U.S. \$370.1 million in cash and 314,333,875 Nortel common shares. I note that the court was advised at the hearing that Nortel may move to consolidate its shares and in the event such consolidation occurs before distribution of the settlement, the actual number of shares issued to the classes will reflect the consolidation.

[10] Estimates of what each class member will actually receive vary, as they must in a settlement of this nature, because of the uncertainties wrought by the yet to be calculated valuation of individual claims, the unknown number of class members who will actually file a claim and the normal fluctuations in share prices on a going forward basis.

[11] The global amount of the settlement was negotiated based on the underlying principle of Nortel's ability to pay while still remaining a viable going concern. This is similar to the approach undertaken in *Kelman*, as set out at para. 16-17:

[16] ...it is clear that the overriding concern was the ability of the defendants to pay a larger amount by way of settlement without putting their solvency at risk....

[17] In consideration of the limits on funds available for settlement, and the other risk factors inherent in litigation, I am satisfied that the plaintiffs achieved through the negotiation the maximum available amount for satisfaction of the claims in total, short of trial...Further, there is some evidence that had the matter proceeded to trial, although a judgment for a larger amount may have been obtained, the actual recovery by the class may have been significantly less because of the solvency issues of the defendants (Internal citation omitted.)

[12] Based on the evidence before this court from the plaintiffs and the experts retained to analyze Nortel's ability to pay by the lead plaintiffs in the U.S. actions, I am satisfied that, as in *Kelman*, the settlement provides "the maximum available amount for satisfaction of the claims in total, short of trial". Moreover, the manner in which this settlement was achieved, with the supervision of Judge Sweet, satisfies a number of the criteria set out in *Kelman* and the cases referred to therein for settlement approval. Although the settlement discussions largely took place in the context of the U.S. actions, they were conducted by experienced counsel, who had undertaken extensive investigation into the claims, under the supervision of an experienced judge as a neutral third party. There can be no doubt that the result was achieved through arms length hard bargaining. The further steps required to obtain adoption of the bargained settlement in the Canadian class actions, with the concomitant due diligence conducted by Canadian class counsel, provides additional comfort to the court that the settlement represents a fair compromise.

[13] The fact that an action is certified on consent for settlement purposes does not obviate the requirement that the action as framed must meet the certification criteria under s. 5(1) of the CPA. (See: *Baxter v. Canada (Attorney General)*, [2006] O.J. No. 4968 (S.C.J.) at paras. 24 and 25). That includes the requirement that there be an "identifiable class" which must be defined objectively without resort to merits-based identifiers. (See: *Western Canadian Shopping Centres Inc. v Dutton*, [2001] 2 S.C.R. 534 at para. 38.)

[14] In the *Frohlinger* Action the class has been defined as:

All persons and entities, except Excluded Persons and members of the British Columbia Class and the Quebec Class, who, while resident in Canada at the time, purchased Nortel common stock or call options on Nortel common stock, or wrote (sold) put options on Nortel common stock during the [period between October 24, 2000 through February 15, 2001, inclusive].

[15] In the *Gallardi* Action the class has been defined as:

All persons and entities, except Excluded Persons and members of the Quebec Class, who, while resident in Canada at the time, purchased Nortel common stock or call options on Nortel common stock, or wrote (sold) put options on Nortel common stock during the [period between April 24, 2003, and April 27, 2004, inclusive].

The Ontario classes are defined as national classes so as to include all Canadian residents except those resident in British Columbia and Quebec. The relevant British Columbia and Quebec actions have similar class definitions, save for the obvious inclusion of different residential requirements and the omission of reference to jurisdictional exclusions. The classes for purposes of the U.S. proceedings are world-wide classes which include persons wherever located.

[16] In the U.S. proceedings on the other hand, the Nortel I class has been defined as:

All persons and entities, wherever located, who bought Nortel common stock or call options on Nortel common stock during the period October 24, 2000 through February 15, 2001, inclusive, and suffered damages thereby, including, but not limited to, those persons or entities who traded in Nortel Securities on the New York Stock Exchange and/or the Toronto Stock Exchange. (Emphasis added.)

Save for the differing class period, the Nortel II class is similarly defined.

[17] As can be seen, the class definitions in the U.S. proceedings and those in the Canadian actions are not precisely the same. In the U.S. actions, the classes are defined by reference to "damages" suffered. Under Canadian law, this would be an unacceptable merits-based definition. However, under the settlement and the plan of administration in this case, it is a distinction without a difference for the practical purposes of claims adjudication and compensation distribution to class members. Accordingly, it is not necessary to undertake a comparative analysis of Canadian and American jurisprudence in this area but, in my view, the rationale underlying the Canadian jurisprudence bears further comment in light of the class definitions in the Canadian actions.

[18] Although courts in Canada have rejected merits-based class definitions, the courts also recognize that over-inclusive class definitions must also be avoided. In *Ragoonanan v. Imperial Tobacco Canada Ltd.* (2005), 78 O.R. (3d) 98 (S.C.J.), Cullity J. undertook an extensive review and analysis of the current Canadian case law with respect to class definitions. In his view there was an "inevitable tension between rejecting a merits-based test and requiring that a class must not be over-inclusive". However, in *Ragoonanan*, after a probing review of the relevant case law, Cullity J. ultimately determined that the plaintiff could not define a class that was not over-inclusive without resort to merit-based limits and, accordingly, denied certification.

[19] As noted by Cullity J., the "inevitable tension" regarding class definitions stems largely from subsequent interpretations of the Supreme Court of Canada decision in *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158 which states, in part, at paras. 19-21:

19 ...[t]he difficult question, however, is whether each of the putative class members does indeed have a claim -- or at least what might be termed a "colourable claim" -- against the respondent. To put it another way, the issue is whether there is a rational connection between the class as defined and the asserted common issues...

20 The respondent is of course correct to state that implicit in the "identifiable class" requirement is the requirement that there be some rational relationship between the class and common issues. Little has been said about this requirement because, in the usual case, the relationship is clear from the facts. In a single-incident mass tort case (for example, an

airplane crash), the scope of the appropriate class is not usually in dispute. The same is true in product liability actions (where the class is usually composed of those who purchased the product), or securities fraud actions (where the class is usually composed of those who owned the stock). In a case such as this, however, the appropriate scope of the class is not so obvious. It falls to the putative representative to show that the class is defined sufficiently narrowly.

21 The requirement is not an onerous one. The representative need not show that everyone in the class shares the same interest in the resolution of the asserted common issue. There must be some showing, however, that the class is not unnecessarily broad -- that is, that the class could not be defined more narrowly without arbitrarily excluding some people who share the same interest in the resolution of the common issue. Where the class could be defined more narrowly, the court should either disallow certification or allow certification on condition that the definition of the class be amended. . . (Internal citations omitted.)

[20] In reviewing this passage in his Reasons in *Ragoonanan*, Cullity J. stated at para. 23:

23 In practical -- as well as logical -- terms, the problem created by the supposed over-inclusive rule and the prohibition on merits-based class definitions is that they operate in opposition to each other. While the former insists that only those with valid -- or, in the words of the Chief Justice, "colourable" -- claims are included in the class, the latter restricts the possibility of achieving this end. If they are applied strictly, their combined application will tend to exclude the possibility of any acceptable class definition.

[21] The underlying reason for each of these prohibitions is readily apparent. Merits-based class definitions require a determination of each class member's claim as a precondition of ascertaining class membership. Carrying that concept to its logical conclusion, it would mean that at the conclusion of a class proceeding, only those individuals who were successful in their claims would be members of the class and, therefore, bound by the result. Theoretically, unsuccessful claimants would not be "class members" and would be free to commence further litigation because s. 27(3) of the *CPA*, which states in part:

A judgment on common issues of a class or subclass binds every class member who has not opted out of the class proceeding. . . ,

would not bind them or bar them from commencing further actions

[22] The rationale for avoiding over-inclusiveness, on the other hand, is to ensure that litigation is confined to the parties joined by the claims and the common issues which arise.

[23] Merits-based definitions are self-evident. Over-inclusive class definitions on the other hand are more elusive. It cannot be the case, as is evident here from the fact that approximately 150,000 claims had been filed as of the date of the hearing, that a class is over-inclusive simply by reason of its numerical size. Similarly, a proper class definition does not include only those persons whose claims will be successful. Rather, as the Chief Justice states in *Hollick*, the essence of a proper class definition goes to the "rational connection between the class as defined and the asserted common issues". It is neither express nor implied in that statement that a class member's "colourable" claim must be one that will ultimately be successful. Indeed, it is the purpose of a class action to resolve claims through the utilization of a common issue phase and an individual issue determination, if necessary.

[24] Although the individual issues that exist obviously have an impact on the certification of a class proceeding, the class definition must be connected to the common issues raised by the cause or causes of action asserted. It is this element of commonality, which must be assessed on a case by case basis, that determines the viability of a particular class definition. Hence, where, as here, the allegations are that misstatements led to an artificially inflated share price during certain periods of time, it follows logically that anyone purchasing those shares in a relevant period has a potential claim giving rise to common issues shared with every other purchaser in the same period. As noted in *Hollick*, the relationships between the classes and the common issues asserted in these actions are "clear from the facts". Therefore, in my view, it is not over-inclusive to frame the classes in the manner set out in *Frohlinger* and *Gallardi*. The fact that any person so described may not ultimately be successful in advancing a claim for damages does not preclude their inclusion in the class. As stated by the Chief Justice in *Western Canadian Shopping Centres* at para. 38:

38 ... the class must be capable of clear definition. ... The definition should state objective criteria by which members of the class can be identified. While the criteria should bear a rational relationship to the common issues asserted by all class members, the criteria should not depend on the outcome of the litigation. (Emphasis added.)

[25] Over-inclusive class definitions can be avoided without resort to merits-based identifiers by adherence to the concept that the core of a class proceeding is the element of commonality. It is implicit in that concept that the cause of action, the scope of the class and the common issues are inextricably inter-related. Indeed, the first three criteria for certification as a class proceeding under s. 5(1) of the *CPA* may be stated in a single sentence as follows: There must be a cause of action, shared by an identifiable class, from which common issues arise.

[26] With respect to defining a certifiable common issue, the Chief Justice stated in *Hollick* at para. 18:

...an issue will be common "only where its resolution is necessary to the resolution of each class member's claim". Further, an issue will not be "common" in the requisite sense unless the issue is a "substantial ...ingredient" of each of the class members' claims.

Given this interpretation of "common issue", it can be seen that a class definition will depend in large part on how the cause or causes of action are framed and how the common issues are drawn. However, by necessary extension, a class definition is not over-inclusive if it describes a class of persons who share a claim and whose members share an interest in the resolution of a common issue that is, in turn, a "substantial ingredient" of each of their claims.

[27] Moreover, it would be a mistake in the context of a class definition analysis to interpret the terms "colourable" or "valid" claims as only those capable of success. The probability of success of a particular class member's claim cannot be a factor in determining whether a class is properly defined, either as a basis for inclusion or exclusion. To the contrary, a viable cause of action for the purpose of certification is one that is not "certain to fail" because of a "radical defect". (See: *Hunt v. Carey Canada*, [1990] 2 S.C.R. 959; *Hollick*). It would be contrary to the goals of the *CPA* to require each individual class member's claim to pass a higher threshold. If the terms "valid" or "colourable" are taken to mean a claim which will succeed, it will have the effect of imparting a *de facto* merits-based analysis into the certification test.

[28] It must be remembered that the *CPA* is a procedural statute meant to provide a mechanism for the resolution of mass claims. As such, certification is a procedural step in the litigation and not a substantive determination. The statute must be interpreted liberally and a rigid approach to class definition based on concerns about over-inclusiveness may well defeat its purposes.

[29] While the class definitions set out in the *Frohlinger* and *Gallardi* actions are necessary to comport with the jurisprudence binding on this court, the reality is that any practical difference between those classes and those defined in the U.S. actions are, as stated above, more apparent than real in the context of the administration of this settlement. In broad terms, the compensation under the settlement will be based on a netting of gains and losses suffered by class members during the relevant class period. Those who make claims under the settlement in the U.S. action will be bound by the judgment even if in the end result it is determined that they are not entitled to compensation because of the netting calculation. Thus, class members whether in Canada or the U.S. will receive identical treatment in respect of their claims, regardless of class definition.

[30] The differences in the jurisprudence between the two countries highlights some of the potential difficulties that may arise in cross-border litigation, particularly in respect of

class actions. Courts in both countries have thus far been adept and adaptable in developing *ad hoc* procedures to deal with these types of issues. Given the increasing trends toward globalization, it is likely that cross-border litigation will increase. The instant case is an example of this. Here the settlement is global in scope crossing provincial and international boundaries and the jurisdictions in which the underlying proceedings have been commenced include two countries and several provinces. It would be useful if more formal protocols were developed to facilitate the courts and the parties in dealing with these types of cases

Counsel Fees

[31] I turn then to the fee request of class counsel. I am mindful that the fees sought in Ontario are but a fraction of the total fees that will be sought in applications before the various courts and that any fees approved in other jurisdictions will, as with the Ontario counsel fees, be drawn from the settlement funds. In my view, where both the class compensation and counsel fees are to be drawn from a single settlement fund, any court from which approval is sought as part of a global settlement has jurisdiction to review and assess the reasonableness of the counsel fees being sought in the aggregate. However, the approach taken to this review must also be tempered by the principle of comity in order to ensure that global settlements in multi-jurisdictional litigation, and their attendant benefits for class members, are not unduly impeded.

[32] In a global settlement of multi-jurisdictional class action litigation, the total amount that will be available to class members in the form of compensation is an overriding concern. To state the obvious, where compensation and counsel fees are to be drawn from a single fund, the total fees that may be awarded to counsel will reduce the amount available for distribution to class members. Therefore, when more than one court is involved in the approval process, each court must be in a position to assess the total compensation available to class members, and must accordingly be advised of the maximum amount of counsel fees that will be sought in each other jurisdiction involved. This is so in the present case. However, advertent to the principle of comity, the decision of a particular court charged with approving specific counsel fees in its jurisdiction should be respected by each other court.

[33] Here, the notices approved by the courts in respect of class certification and proposed settlement included a provision detailing the maximum amount of fees that might be sought by counsel in each jurisdiction. Provided that the amounts sought by counsel in each jurisdiction do not exceed those set out in the notice, I will defer to the decisions of those other courts regarding the specific counsel fees awarded in their respective jurisdictions.

[34] The fees sought by Ontario class counsel come before this court for approval. As stated, counsel seek approval of a fee for both actions in a total amount of \$5 million dollars (CDN) plus disbursements and applicable taxes. Although the court was made aware of some individual objections to the global fees for counsel in all of the actions in all jurisdictions, no objectors appeared before this court and no objections were advanced

by any party to the proceeding or by the plaintiffs in the other actions. I have reviewed the materials provided in support of the fee request of class counsel and find that the fee is reasonable given the work performed, the risk undertaken and the result achieved. In my view, the amount sought in respect of the Ontario actions is appropriately reflective of the effort expended by Ontario class counsel. Accordingly, the fee requested is approved.

[35] I am prepared to meet with counsel on short notice to fix the terms of the orders, if necessary.

A handwritten signature in black ink, appearing to read 'Winkler R.S.J.', written over a horizontal line.

WINKLER R.S.J.

Released: January 18, 2007

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ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

LESLIE FROHLINGER

Plaintiff

- and -

NORTEL NETWORKS CORPORATION, JOHN ANDREW
ROTH, FRANK DUNN, F. WILLIAM CONNER, CHAHRAM
BOLOURI, WILLIAM R. HAWE and DELOITTE & TOUCHE LLP

Defendants

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ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

PETER GALLARDI

Plaintiff

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ALEXANDER INGRAM, GUYLAINE SAUCIER, SHERWOOD
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Defendants

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REASONS

W K. WINKLER, R.S.J.

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