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Class Actions: Gambling on a Novel Cause of Action May Not Be a Winner

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In *Atlantic Lottery Corp. Inc. v Babstock, 2020* SCC 19 (*Babstock*), the Supreme Court of Canada (SCC) clarifies the contentious doctrine of "waiver of tort" and provides helpful guidance on the way courts should assess novel claims at the stage of certification of a proposed class proceeding or on a motion to strike a statement of claim.

Key Takeaways

- **"Waiver of tort" or "disgorgement for wrongdoing" as an independent cause of action.** Disgorgement for wrongdoing is a claim for all the profits made by the defendant as a result of its wrongful conduct. By finding that disgorgement for wrongdoing is not an independent cause of action, the SCC requires plaintiffs claiming a disgorgement remedy for negligence to plead that they have suffered actual loss or injury caused by the defendant.
- **Implications for novel claims asserted in class actions.** The SCC decision in *Babstock* reminds certification judges that legal disputes should be resolved promptly, in a manner that promotes judicial economy, which is one of the principal goals of class actions. Unless a novel cause of action pleaded by a class action plaintiff is an incremental development in the law that would have a reasonable prospect of success, it should be struck at the certification stage, not "kicked down the road" to a full trial on the merits.
- **Disgorgement as a remedy for breach of contract.** The majority of the SCC in *Babstock* holds that disgorgement is available as a remedy for breach of contract only if no other available remedies are adequate.
- ***Criminal Code* prohibitions should be interpreted narrowly.** The SCC unanimously dismissed a claim that video lottery terminals are an unlawful form of "three-card monte," which is prohibited under the *Criminal Code*.

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Background

Atlantic Lottery Corporation conducts and manages lottery schemes on behalf of the governments of the four Atlantic provinces. The plaintiffs applied for certification of a class action against ALC, on behalf of all Newfoundland-resident players of video lottery terminal games (VLTs) in the six years preceding the class action. The plaintiffs claimed that VLTs were inherently dangerous and deceptive. Recognizing that they would be unlikely to establish on a class-wide basis that class members had suffered actual losses, the plaintiffs sought a gain-based remedy, quantified by the profit ALC earned from the operation of the VLTs. The plaintiffs were successful before the Newfoundland and Labrador Court of Appeal.

The central issue in this appeal was whether the plaintiffs' claim disclosed a reasonable cause of action. In addition to pleading conventional claims for breach of contract and unjust enrichment, the plaintiffs relied on a cause of action, frequently called "waiver of tort" (a term the SCC rejected in favour of "disgorgement for wrongdoing"), and argued that such a claim should be available for negligent wrongdoing, even where the plaintiffs chose not to plead actual harm resulting from the defendants' negligent conduct.

Decision

In a 5–4 split decision, Justice Brown's majority decision allowed the defendants' appeal, set aside the certification order and struck all of the plaintiffs' claims against ALC. The dissent agreed with the majority's dismissal of the claim of disgorgement for wrongdoing as an independent cause of action, but would have allowed a claim for breach of contract to proceed to trial.

The SCC's decision has significant implications for class actions and the law of restitution in Canada.

Implications for Novel Claims Asserted in Class Actions

In class actions, cases pleading novel causes of action have assumed outsized prominence because of courts' reluctance to dismiss such claims at the stage of class certification. For 16 years since *Serhan (Estate Trustee) v Johnson & Johnson*,[1] claims for disgorgement of profits from negligent wrongdoing, without proof of damage to the plaintiffs, have commonly been certified, and the issue of whether such a claim exists under Canadian law left for trial. Certification of such claims puts significant pressure on defendants to settle even unmeritorious claims because of the existential risk posed by an award of damages at trial in large class actions.

The SCC's decision in *Babstock* reminds certification judges that in appropriate circumstances, legal disputes should be resolved promptly, instead of giving the plaintiffs the benefit of any doubt and deferring issues to a trial on the merits. A class action should not be certified simply because it asserts a novel claim. As stated by Justice Brown writing for the majority, "It is beneficial, and indeed critical to the viability of civil justice and public access thereto that claims, including novel claims, which are doomed to fail be disposed of at an early stage in the proceedings."

The *Babstock* decision means that pleading novel causes of action, such as waiver of tort or disgorgement for wrongdoing, will be less effective for class action plaintiffs as a path to certification and inducing defendants to settle. If a novel cause of action is pleaded, it must be an incremental development in the law and will not proceed if there is no reasonable prospect that it will succeed.

Implications for Waiver of Tort and Disgorgement for Negligence

The SCC unanimously laid to rest the term "waiver of tort," declaring that it is apt to generate confusion for both judges and litigants. Instead, the SCC adopted the term "disgorgement for wrongdoing" as the proper term for referring to this type of claim.

The SCC also unanimously decided that disgorgement should be viewed as an alternative remedy for certain forms of wrongful conduct, not an independent cause of action. Therefore, in order to make a claim for disgorgement, a plaintiff in a negligence claim must plead facts, that if taken to be true, would satisfy all the essential elements of the tort. This would require pleading that a loss or injury occurred and was caused by the defendants' negligence. As the plaintiffs in *Babstock* failed to plead facts that would establish actual damages and causation, their claim for negligence was doomed to fail.

Disgorgement continues to be available for some forms of wrongdoing that do not require proof of damage, such as breach of fiduciary duty, breach of confidence or trespass. The availability of disgorgement as an alternative remedy to damages for negligence where a loss has occurred remains an unsettled issue that has yet to be decided in the appropriate case.

Implications for Disgorgement as a Remedy for Breach of Contract

The SCC was divided on whether the plaintiffs' claim for breach of contract had a reasonable prospect of success that would justify its certification as a class action.

Breach of contract, unlike the tort of negligence, does not require proof of loss as an element of the cause of action. However, the majority SCC judgment found that whether the plaintiffs' breach of contract claim disclosed a *reasonable* cause of action should be considered in light of the remedies the plaintiffs were actually seeking. As the plaintiffs in *Babstock* were seeking only non-compensatory remedies for breach of contract – namely, disgorgement and punitive damages, the majority framed the issue as whether these exceptional remedies would be available to the plaintiffs, assuming the truth of their pleadings.

Courts have accepted that disgorgement may be available for breach of contract in exceptional circumstances. In the leading English case of *Attorney General v Blake*,[2] the defendant Blake was a former MI-6 agent convicted of spying for the Soviet Union, who subsequently entered into a contract to publish his memoirs in contravention of the confidentiality undertaking in his employment agreement with MI-6. As the information in his memoirs was no longer confidential and was not damaging to the public interest, the plaintiff suffered no damages as a result of the publication. Instead the plaintiff sought disgorgement for the profits that Blake made through the breach of contract. The House of Lords held that disgorgement for breach of contract may be appropriate in exceptional circumstances, but only where, at a minimum, the remedies of damages, specific performance and injunction were inadequate. As to those circumstances, courts should in particular consider whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity. Some Canadian courts have adopted the reasoning from *Blake* in appropriate cases.

In *Babstock*, the SCC majority judgment adopted the "exceptional circumstances" standard from Blake and held that disgorgement awards are not generally available for breach of contract. Furthermore, a gain-based remedy was not appropriate in this case, as the plaintiffs' gambling losses were readily quantifiable and could have been remedied through an award of compensatory damages. It followed that the plaintiffs' claim for a disgorgement remedy for breach of contract had no reasonable chance of success and therefore should not be certified as a class action.

The dissenting SCC judges would have held that the plaintiffs' claim for breach of contract should proceed. In their opinion, declaratory relief, nominal damages, disgorgement and punitive damages were all potential remedies for breach of contract. Justice Karakatsanis writing for the dissent, stated "In my view, there is a basis for an action for breach of contract and a basis to obtain remedies against ALC even in the absence of pleadings of specific personal loss."

Implications for the Legality of VLTs

The plaintiffs in *Babstock* alleged that VLTs were so inherently deceptive that they should be considered a game "similar to" three-card monte within the meaning of section 206 of the *Criminal Code* and therefore inherently unlawful (the relevance of this was to support the plaintiffs' claims that ALC had breached the standard of care in negligence and had also breached an implied contractual term to provide safe and lawful games). The case therefore had important implications for provincial lottery corporations across Canada, many of which offer VLTs or slot machines with similar features to those offered by ALC (the VLT suppliers were also defendants in *Babstock*).

The Court dismissed the plaintiffs' arguments and confirmed that VLTs could not be considered "similar to" three-card monte under the *Criminal Code*. Courts ought to interpret the *Criminal Code* narrowly, so as to avoid broadening the scope of the criminal law on a discretionary basis and potentially creating common law crimes. Applying this approach, the Court concluded that the prohibition on three-card monte or "similar" games applied only to games that involved, at a minimum, "a player betting on the location of an object after a series of manipulations." A mere allegation that a game was deceptive or misleading could not suffice.

[1](2004), 72 OR (3d) 296 (Sup. Ct.).
[2][2001] 1 AC 268 (HL) [*Blake*].

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