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Federal Court of Appeal Clarifies Exception to the No-Costs Rule, Upholds Security for Costs in Proposed Reverse Class Action

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The Federal Court of Appeal has upheld an order of the Federal Court that required payment of security for costs in a “reverse” class action, despite the presumptive no-costs regime for class proceedings enshrined in the Federal Courts Rules.

Key Takeaways

- **The purpose of a motion for security for costs is to obtain at least a partial guarantee for the payment of costs that might eventually be awarded to a successful defendant.** In the context of a federal class proceeding, unless an exception applies, no costs will ultimately be awarded, making security for such costs unavailable.
- **In exceptional circumstances, where it would be unjust to deprive the successful defendant of costs in respect of a certification motion, a class proceeding, or an appeal arising from a class proceeding, security for costs may be ordered.** Such exceptional circumstances may include a “reverse” class proceeding brought by foreign corporations with no significant assets in Canada against potentially thousands of Canadian residents.

Summary and Background

The appellants, a group of American film distribution, financing, and production companies, initiated a proposed “reverse” class action. A “reverse” class action occurs when the plaintiff attempts to make the same case against a number of defendants. In this case, the plaintiffs’ claim is against a number of individuals who they allege have illegally downloaded their films. One such individual, Robert Salna, is the proposed representative defendant in the class action.

Mr. Salna brought a motion requiring the appellants to pay security for costs for their intended motion for certification on the basis that the appellants are based in the United States and have no assets in Canada.

The Federal Court Decision

In February 2017, the Federal Court considered the presumptive no-costs regime for class action proceedings.¹ In particular, the Court considered the general approach to costs in a class proceeding, set

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out in Rule 334.39 of the *Federal Courts Rules*, which provides a general rule that costs will not be awarded against any party to a motion for certification, unless “exceptional circumstances make it unjust to deprive the successful party of costs,” per Rule 334.39(1)(c).

However, the Court determined that Rule 334.39 was not engaged since the appellants had not yet served and filed their notice of motion for certification – and therefore that Mr. Salna was not yet a party to a motion for certification when he brought his motion for security for costs.

Having determined that Mr. Salna was not barred from seeking security for costs, the Federal Court considered whether costs should be awarded in the circumstances, where the appellants: (i) had admitted that they were not ordinarily resident in Canada, (ii) did not have any significant assets in the country, and (iii) did not provide any evidence as to their ability to satisfy a costs award or their ability to advance the proposed class proceeding to the certification stage. The Court considered these factors and the discretionary nature of a costs award, and held that an order for security for costs was appropriate, in part, “in view of the novel nature of the proposed class proceeding.”

Federal Court of Appeal Decision

The Federal Court of Appeal disagreed with the Federal Court’s decision, holding that the Federal Court’s proposed approach would allow a defendant to circumvent the intent of Rule 334.39 by bringing a security for costs motion prior to a plaintiff’s motion for certification and “drive a wedge through the presumptive no costs regime.”²

Nevertheless, the Court of Appeal dismissed the appeal and concluded that security for costs was appropriate given the “exceptional circumstances,” that would potentially entitle the proposed representative defendant to costs at a later date. Since those exceptional circumstances could entitle the proposed representative defendant to costs on the motion for certification, the Court of Appeal held that security for those costs was available. The exceptional circumstances emphasized by the Court of Appeal were (i) the nature of the proceeding, being a “reverse” class action, (ii) the fact that the proposed class of defendants could include thousands of Canadians, and (iii) the fact that the proposed class action was brought by foreign corporations with no significant assets in Canada.

The Court of Appeal also considered the policy considerations behind the *prima facie* no-costs regime. In doing so, it found that there were no access to justice concerns since the American film distribution companies appeared to have considerable resources available and had declined to file evidence regarding their ability to post security for costs. Moreover, since the proposed class would “likely face difficulty in funding representation,” the Court of Appeal found that there was no principled basis not to award security for costs in the circumstances.

The Court of Appeal declined to interfere with the quantum of security set by the Federal Court, and

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emphasized the discretionary nature of costs awards.

The Upshot

While the Federal Court and the Federal Court of Appeal employed different approaches to the matter, both ultimately allowed security for costs, in part, due to the exceptional circumstances of the proposed “reverse” class action.

These decisions provide useful guidance as to when the Federal Court will find that there are “extraordinary circumstances” that warrant a deviation from the presumptive no-costs regime for class proceedings under the *Federal Courts Rules*.

A copy of the Federal Court of Appeal’s decision can be found [here](#).

¹ 2017 FC 130.

² 2017 FCA 221.

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