Reflections on the Muscletech Case

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On January 18, 2006, Muscletech Research and Development Inc. ("Muscletech") and certain related companies filed[2] for protection under the *Companies' Creditors Arrangement Act*[3] (the "CCAA").

Muscletech had once been engaged in the sale of pharmaceutical products including products using ephedra. Generally speaking, ephedra is a weight loss drug. It was extremely popular for a number of years and Muscletech and the other North American companies that sold it – primarily in the United States - made a lot of money.

Unfortunately, some users of ephedra suffered various health problems (some deaths were involved) and allegations were made that their use of ephedra was the cause. Then, ephedra was banned by the government regulators – first in Canada and then the U.S. Eventually, thousands of lawsuits were commenced in the United States against the companies selling ephedra (Muscletech was the subject of approximately eighty of those lawsuits) and some of the U.S. companies filed for protection under Chapter 11 of the U.S. *Bankruptcy Code*. Three of the largest Chapter 11 proceedings involved companies called Twin Labs, (which proceeding started in New York in 2003), Metabolife, (which proceeding started in California in 2005) and N.V.E., (which proceeding started in New Jersey in 2005).

Muscletech was based in Toronto and accordingly, as noted, it commenced its proceeding under the CCAA – with an ancillary proceeding also being commenced under Chapter 15 of the U.S. *Bankruptcy Code*.

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2 *Muscletech Research & Development Inc., Re* (2006), 2006 CarswellOnt 264 (Ont. S.C.J. [Commercial List]).

3 R.S.C. 1985, c. C-36, as amended.

By the time the Muscletech group initiated its CCAA proceeding, it no longer had any active business, nor, for that matter, did the companies have any assets to speak of. Of course, the Muscletech group had discontinued the sale of ephedra products long before January, 2006 and as discussed in more detail below, prior to its CCAA filing, the key assets of Muscletech were transferred to a new company – Iovate Health Sciences Inc. ("Iovate") – and other companies, but the proceeds of those transactions were also gone. Iovate ended up playing a significant role in the *Muscletech* CCAA case.

My firm, Miller Thomson, became involved shortly after the Initial CCAA Order was made when I was contacted by U.S. insolvency counsel (Brown Rudnick of New York and Boston) who had been advising a broad ranging group of tort lawyers – acting for claimants against ephedra companies – in navigating their way through some of the existing Chapter 11 cases, including Twin Labs, Metabolife and N.V.E.

We initiated contact with Goodmans, who were counsel to Muscletech, and Davies Phillips, who were counsel to RSM Richter, the CCAA Monitor, and stressed the desirability of getting representative counsel for the tort victims recognized at an early stage – even before the establishment of the claims and mediation process (which proved to be a central feature of the case – again as discussed below). After further discussion on both sides of the border, and submissions to Justice Farley in the Canadian court, on February 8, 2006, an Order (the "Representative Counsel Order") was made in Canada in the *Muscletech* CCAA case appointing Brown Rudnick and Miller Thomson as representative counsel on behalf of an Ad Hoc Committee of tort claimants. The order was modeled on the orders made in the *Canadian Red Cross Society* CCAA case, from the 1990s, in which representative counsel for the various tainted blood victims' groups were appointed.

It was immediately apparent that the *Muscletech* case had no shortage of interesting features. They included Iovate's presence as the "DIP Lender" and the fact that the CCAA stay included protection for a host of "third parties" who had been affected by Muscletech's pre-filing business activity. Those third parties included retail stores, such as GNC, where the ephedra products were sold, as well as insurers in Canada and the United States. Among other things, those third parties were involved in the litigation which had preceded Muscletech's CCAA filing. Some of those third parties had indemnity claims or other "claims over" against the Muscletech companies.

The Muscletech companies, as well as Iovate and the "non debtor third parties" all signaled an intention to use the CCAA proceeding to reach a global resolution of all claims against those parties.

In an early decision in the *Muscletech* case, Justice Farley said that he wanted to see "lightning. . .progress"[4] in pursuing that goal and certainly the

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4 *Muscletech Research & Development Inc., Re* (2006), 19 C.B.R. (5th) 57 (Ont. S.C.J. [Commercial List]) at para. 7 (page 59).

case moved extremely quickly through final plan sanctioning in Canada (in February, 2007[5]) and the United States (in March, 2007). However, in the little more than one year duration of the case, it gave rise to a number of important decisions in Canada and the United States. In this article I will discuss briefly some of those decisions respecting:

- the Chapter 15 proceeding in the United States
- the Muscletech group's pre-filing transactions
- the status of "Class Action" claims in CCAA proceedings
- third party releases

I. The Chapter 15 Proceedings

The *Muscletech* case was the first full proceeding under what were then the relatively new provisions of Chapter 15.[6]

RSM Richter was the Monitor in the *Muscletech* CCAA case and applied for recognition of the Canadian proceedings as a "foreign main proceeding" by the U.S. District Court for the Southern District of New York (the "U.S. Court") and, in turn, recognition of the Monitor, in the capacity of a "foreign representative".[7] The Chapter 15 process that RSM Richter proposed was controversial – such that arguments were advanced that the proceeding should instead be based in the United States - for a host of reasons, including the following:

- Muscletech had sold its product in the United States and all of the litigation against Muscletech was on-going in the United States. (Indeed, prior to the initiation of the CCAA proceeding, the various litigation had been consolidated – as part of the "multi-district litigation" consolidation process used in the United States – before Judge Rakoff of the U.S. Court.)
- The important claims process which was central to the *Muscletech*

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5 Justice Ground's decision in this regard is reported at *Muscletech Research & Development Inc., Re* (2007), 30 C.B.R. (5th) 59 (Ont. S.C.J. [Commercial List]).

6 Chapter 15 was introduced into law in October, 2005. It codified much jurisprudence which had developed under the predecessor provisions of the old s. 304 of the U.S. *Bankruptcy Code*.

7 See the article *Recent CCAA and Cross-Border Developments in the MuscleTech and Calpine Canada Restructurings* by J. A. Carfagnini, David B. Bish and Brendan O'Neill, in J. Sarra, ed. (2006) *Annual Review of Insolvency Law* (Carswell, 2007) and an article presented by Peter Farkas of RSM Richter (*Living with Chapter 15 – A Case Study*) at the 2006 conference of the Insolvency Institute of Canada.

case would effectively deprive American plaintiffs of jury trial rights that would have otherwise been preserved in a Chapter 11 case.

- Many of the participants (such as the important "non debtor" third party participants) were based in the United States.

However, the Monitor argued that, within the terms of Chapter 15, the Muscletech group's "centre of main interest" was in Canada.[8] The Ad Hoc Committee supported that argument and supported the proposition that the CCAA proceeding would provide an appropriate mechanism to attempt to deal with the full range of claims facing the Muscletech group of companies. Our Committee also supported the argument that the basic principles of comity between American and Canadian courts, including with specific reference to insolvency proceedings, supported recognition of the CCAA proceeding by the U.S. Court pursuant to Chapter 15. Ultimately,[9] on March 2, 2006, the Monitor was successful in obtaining full recognition by the U.S. Court of the *Muscletech* CCAA proceedings as a "foreign main proceeding" under the provisions of Chapter 15.

II. Dealing with the Debtors' Pre-Filing Transactions

As the *Muscletech* CCAA case unfolded, it was apparent that the group of companies had engaged in some significant "pre-CCAA filing transactions", as alluded to above. Without purporting to do complete justice to the complexity of the events in question or the detail in which RSM Richter reported on those

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8 In Justice Farley's first decision in the *Muscletech* case – reported at *Muscletech Research & Development Inc., Re* (2006) 19 C.B.R. (5th) 54 (Ont. S.C.J. [Commercial List]) at para. 4 (at 55) – he noted the following factors to "support a finding that each Applicants' [centre of main interest] is Ontario, Canada:
(a) each of the Applicants was incorporated in Ontario;
(b) each Applicant's mailing address is an Ontario address;
(c) the principals, directors and officers of the Applicants are residents of Ontario;
(d) all decision-making and control in respect of the Applicants, including product development, takes place at the Applicants' premises located in Ontario;
(e) the Applicants' principal banking arrangements have been conducted in Ontario through the Canadian Imperial Bank of Commerce; and
(f) all administrative functions associated with the Applicants and all of the employees that perform such functions, including general accounting, financial reporting, budgeting and cash management, are conducted and situated in Ontario".

9 After the matter had been "kept alive" earlier in the United States through the making of temporary restraining orders.

matters, the transactions and the chronological context within which they occurred included the following:

- The Muscletech group of companies began doing business in the late 1990s at a time when other companies were also marketing ephedra products. During that time period, the Muscletech companies began paying significant annual bonuses to the individual principals of the companies.
- The Muscletech group of companies sold their products through various retail outlets and Muscletech was required to maintain various indemnity arrangements with those retailers.
- Allegations about the potential adverse health effects of ephedra began in the early 1990s and in 2000 the American Food and Drug Administration advised that it had public health concerns about certain ephedra products. Health Canada issued a warning against ephedra use in 2002.
- The Muscletech companies discontinued the sale of its leading ephedra product in 2002, which was also the year that the sales and profitability of the Muscletech companies reached their highest point.
- The Muscletech group of companies continued marketing products through the 2003 fiscal year.
- Lawsuits against the Muscletech group of companies began in 2000 and by the end of 2004 there had been a total of 77 lawsuits.
- In turn, the Muscletech group held various insurance policies during its period of business operations and it was necessary for the Muscletech companies to work in conjunction with their insurer and their retailers in dealing with the lawsuits against the Muscletech group. Some funds were set aside in 2001 for the purpose of dealing with product liability issues.
- Beginning in 2001, the Muscletech group of companies was unable to secure fresh insurance coverage and began a period of self insurance. There was also litigation between the Muscletech group and its insurance company over the scope of coverage.
- In 2003, some American companies that had been selling ephedra products began filing for protection under Chapter 11 of the U.S. *Bankruptcy Code*.
- In late 2003 and early 2004 most of the assets of the Muscletech group of companies were sold to a new group of companies includ-

ing Iovate. The individual principal of the Iovate group of companies was the same as the individual principal of the Muscletech group of companies. Muscletech commissioned valuations with respect to the assets transferred.

- In April 2004, the Food and Drug Administration prohibited the further sale of ephedra products in the U.S.
- The annual bonus payments to the individual principals of the Muscletech group continued through the 2004 year (with some of the funds in question being reinvested in the Muscletech group of companies pursuant to a security agreement).
- Although a number of lawsuits against the Muscletech group of companies were settled – and although both the plaintiffs and the drug companies who had been selling ephedra in North America achieved some degree of success in the various pieces of litigation – by 2005, the Muscletech group of companies had essentially run out of cash.

In essence, Iovate took the position that it was willing to contribute to the funding of a CCAA proceeding by the Muscletech group of companies – involving the tort claimants as well as parties such as the retailers and the insurer who theoretically could both: (i) have claims in their own right (such as claims pursuant to indemnity arrangements between themselves and the Muscletech companies), and (ii) be potential contributors to a global settlement pool — in order to see if a consensual global resolution could be reached with all of the various claimants and parties.

As a structure began to evolve whereby such an attempt could be made – and which effort was built around the claims process, including a mediation process designed to value the various tort claims – the stakeholders needed to consider (on a "simultaneous" basis) whether and to what extent these various "pre-filing transactions" could be attacked.

This need to consider attacks on the pre-filing transactions – and which, in theory, could include attacks against directors – came at a time when, of course, the parties all needed to devote a significant amount of time, money and energy towards pursuit of a settlement. Speaking bluntly, from the perspective of the tort claimants, if those substantial efforts resulted in both:

- a "recognized" or "admitted" dollar value for their claims at an acceptable level; and
- a pool of funds to be applied to pay those admitted claims, also at an acceptable level,

then the pursuit of a series of attacks on those pre-filing transactions would become moot. The other stakeholders – such as the retailers and the insurers – obviously could look at the prospect of the CCAA process "working" in a similar basic way; that is, they could each see a scenario where a successful process would eliminate any further desire on their part to seek to attack any of the pre-filing transactions, including by way of attacks against corporate directors.

However, of course, speaking equally bluntly, the prospect existed of a scenario whereby the process could fail at some point – perhaps months "down the line" – at which time it would become necessary to re-visit, and perhaps begin an attack against, the pre-filing transactions (and, perhaps, the corporate directors). No one wanted to be met with a limitations period defence at that point.

In the circumstances, the parties focused on paragraph 8 of the Initial Order, which provided as follows:

> 8. THIS COURT ORDERS that the term of any Right, obligation, time period or limitation period relating to the Applicants, or any of them, or any of the Property that expires or terminates with the passage of time (other than the term of a lease) is extended by a period equivalent to the duration of the Stay Period; for greater certainty, if the Applicants, or any of them, become bankrupt or a receiver is appointed in respect of the Applicants within the meaning of subsection 243(2) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "BIA"), the Stay Period shall not be counted in determining the 30-day period referred to in Section 81.1 or the 15-day period referred to in Section 81.2 of the BIA, provided that this paragraph shall not be construed to extend the term of any lease that expires during the pendency of such stay of proceedings.

It was our view that the court had authority under the CCAA (as well, as under its inherent jurisdiction and s. 106 of the *Courts of Justice Act*) not only to make the specific terms of the order in paragraph 8 – and which, of course, is in accordance with the standard, approved initial CCAA order – but to go on to make a further, specific order along those same lines which was designed to apply the essential concepts in paragraph 8 more specifically to the situation in the *Muscletech* case, (although it may be noted that the *Limitations Act, 2002* (Ontario) is a relatively new piece of legislation and there is limited case law interpreting it).

Under a subsequent Order made on May 26, 2006, in the *Muscletech* case, the Ontario Superior Court of Justice ordered as follows:

> THIS COURT ORDERS that the Initial CCAA Order shall be amended *nunc pro tunc* to include a new paragraph 8A as follows:

> 8.A THIS COURT ORDERS that, for greater certainty and without limiting paragraph 8 above, all applicable limitation periods pertaining to claims and / or causes of action that any of the Applicants or any creditor of any of the Applicants has in respect of or pertaining to:
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> (i) alleged reviewable transactions involving the Applicants; or
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> (ii) alleged derivative claims or alleged oppressive conduct involving the Applicants,
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> including, without limitation, under applicable Federal or Provincial business corporations legislation, *The Bulk Sales Act* (Ontario), *The BIA* (Canada), *The Assignments and Preferences Act* (Ontario) and the *Fraudulent Conveyances Act* (Ontario), that, but for this Order, expire or terminate during the Stay Period are hereby extended to the date that is sixty (60) days following the duration of the Stay Period.

In due course, Muscletech *was* able to put together a reorganizational plan which – from the viewpoint of the tort claimants who we represented – met the basic standards referred to above: namely, that it funded their claims at amounts which they had accepted pursuant to the mediation process. In the circumstances, the plan also included releases in favour of directors which were framed in compliance with the CCAA.

The basic approach used in the *Muscletech* case has been used in other CCAA cases. For example, Miller Thomson acted for the Applicant in an Ontario CCAA case known as "Cu-Connect" (Ontario Superior Court File No. 06-CL-6746) which involved a company which had been in the business of providing connection services to the Interac and other financial services networks, so as to allow credit unions to offer shared cash dispensing services at automated teller machines and point-of-sale direct payment services to their customers. Cu-Connect had "branched out" into other lines of business - including a vault cash service program – and when the company filed for CCAA protection, serious irregularities in its financial affairs had been identified in relation to its vault cash program (which involved stocking automatic teller machines with cash). In our view, at the outset of the *Cu-Connect* CCAA proceeding, the emphasis properly needed to be on maximizing the value of the existing business which could not be maintained indefinitely. In other words, "Job 1" was not to go back and attack the pre-filing reviewable transactions; the time and attention of the Chief Restructuring Officer was needed more urgently elsewhere. In the circumstances, a paragraph was included in the Initial Order in the *Cu-Connect* case which was along the lines of the "stay" included in the *Muscletech* order with respect to limitation periods for attacking pre-

filing transactions.[10]

In short, in those circumstances, if the debtor is able to satisfy the court that it is proceeding in good faith in a meaningful attempt to maximize recovery for the creditors, it seems to be appropriate for the Court to use its jurisdiction under the CCAA to suspend the limitation period for attacks against the transactions in question while the parties make an effort to see if the CCAA process can be successful (effectively rendering those attacks – with all of the expense, uncertainty and delay associated with such attacks – moot). That is not to say that at the end of the day, the releases built into the CCAA plan must not conform to the CCAA, and which prohibits releases of certain types of conduct, including oppressive conduct. [11] However, again, where the process successfully results in full satisfaction of a creditor's claim at an agreed upon, mediated level (all as part of an "overall. . .resolution"[12] as Justice Farley put it in an early *Muscletech* decision) the issue of pursuing the oppression claim becomes moot.

III. The Muscletech Claims Process

As noted, one of the central features of the *Muscletech* case was the claims process.

In that regard, the Muscletech companies sought approval of a very broadly worded claims order which was made on March 3, 2006 (the "Call for Claims Order"). The Call for Claims Order called on all claimants to file claims within the Canadian proceeding prior to a bar date of May 8, 2006. In particular, the Call for Claims Order required the filing of all "Claims" (broadly defined to include claims in respect of the Muscletech applicants and their officers and directors) and "Product Liability Claims," which were defined to include claims against the Muscletech group and the "non-debtor third parties" (such as the retailers and the insurers) related to alleged physical damages suffered from using Muscletech's ephedra products.

The Call for Claims Order was followed by a Mediation Order of April 13, 2006 – which provided for mediation of ephedra-related Product Liability Claims – and a Claims Resolution Order of June 8, 2006, which set out a method

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10 Reference may also be made to the Ontario CCAA case of *Fireco Inc., Re* ((2005), 2005 CarswellOnt 179 (Ont. S.C.J. [Commercial List])) where such a provision was also included in the Orders made during the CCAA proceeding, which eventually became a bankruptcy case. The *Cu-Connect* case also eventually became a bankruptcy case.

11 See the discussion of pursuing claims against directors and other parties (including through use of the oppression remedy) in: Jeffrey Carhart *Corporate Governance and Insolvency and Restructuring Professionals* (2003) The Comparative Law Yearbook of International Business (Kluwer Law International) 39

12 *Muscletech Research & Development Inc., Re* (2006), 19 C.B.R. (5th) 54 (Ont. S.C.J. [Commercial List]) at para. 3.

for the Monitor to review claims and to either accept or reject them, with a claims resolution process for resolving disputed claims.

Our Ad Hoc Committee participated in the drafting of the Call for Claims Order, the Mediation Order and the Claims Resolution Order and therefore was in a position to support the seeking of those Orders. Importantly, as discussed below, the seeking of these Orders was not opposed by any party.[13]

The Call for Claims Order was, in turn, recognized by the U.S. Court and the Call for Claims Order process was also advertised in three newspapers: the *Globe and Mail*, the *Wall Street Journal* and *USA Today*. In addition, of course, the Call for Claims Order required the Monitor to send a claims package to all known creditors of Muscletech and other steps were taken to publicize the claims process, including advertising it extensively on the Internet.

When the Call for Claims Order was first sought, there were two categories of 'stakeholders' in the United States who had engaged Canadian counsel and who had been added to the service list in the *Muscletech* CCAA case.

- First, there were four uncertified class action claims or – as they came to be called by Justice Mesbur - "Representative Plaintiff" claims. One of the claims had been commenced in Florida (under the name Hannon), one had been commenced in California (under the name Guzman) and two had been commenced in New York State (under the names Hochberg and Rodriguez). Generally speaking, these claims raised an allegation that the product failed to produce the type of muscle mass they expected (essentially a "false advertising" type of claim) or that it contained anabolic steroids, a controlled substance (i.e. a complaint that the "claimants" in question had been sold a controlled substance). The proceedings had been moved to the U.S. Court as part of the MDL procedure before Judge Rakoff, although, again, the claims had *not* been certified as class action claims at the date of the initiation of the Muscletech CCAA case.
- Second, there was another group of claimants — called the "California Consumers" by Justice Mesbur– who filed a false advertising claim that sought restitution, as opposed to damages from personal injury. That claim was under the name of a Ms. Osborne, who sought to file the claim on her behalf and other similarly situated

13 Justice Farley's endorsement with respect to the unopposed Claims Order is reported at *Muscletech Research & Development Inc., Re* (2006), 2006 CarswellOnt 1517 (Ont. S.C.J. [Commercial List]). I note that he prophetically referred to it as "an integral part of the CCAA. . .process". Certainly, as discussed ahead, it was indeed viewed as very important by Justice Mesbur and Justice Ground. Justice Ground's approval of the Claims Resolution Order is reported at *Muscletech Research & Development Inc., Re* (2006), 2006 CarswellOnt 3632 (Ont. S.C.J.).

> California consumers. However, that claim was also uncertified as a valid class claim at the date of the initiation of the Muscletech CCAA proceedings.

Our Ad Hoc Committee duly filed specific "individual" claims for each member of the Committee pursuant to the Call for Claims Order and then proceeded with the claims mediation process designed to reach a specific dollar figure for each claim for the purposes of the Muscletech CCAA Plan. That claim and mediation process was conditional on the successful implementation (including approval and funding) of the CCAA Plan.

IV. Class Action Claims

The Representative Plaintiffs filed a claim (right on the May 8th deadline date), stated to be on their own behalf, and on behalf of all other similarly situated persons.[14] Again, the claim was in a "purported class representative capacity".[15] A claim was also filed with respect to the Osborne Claim which, it may be noted, sought an "estimated amount of U.S. $100 million".[16]

The Muscletech group refused to recognize either the Representative Plaintiffs ("at least to the extent that they purport to advance claims for other than Hannon, Hochberg, Rodriguez and Guzman personally"[17]) or the California Consumers as having valid claims in the *Muscletech* CCAA proceeding, and in both cases motions to consider those positions taken by Muscletech were heard. Interestingly, although there were obvious similarities between these two categories of claimants, their matters were heard separately by two different judges.

The motion by the Representative Plaintiffs was heard first, by Justice Mesbur.

Our Ad Hoc Committee supported the position put forward by the Muscletech companies and the Monitor to the effect that "representative claims" should not be recognized in this case and that, instead, individual tort claimants had to submit claims for injuries or other damages which they actually suffered either in their own name or through their own properly authorized representative. That is, we agreed with the Muscletech Companies and the Monitor that the Call for Claims Order did not allow broad categories of potential, unknown,

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14 *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 218 (Ont. S.C.J. [Commercial List]) at para. 16 (page 222), additional reasons at (2006), 2006 CarswellOnt 5884 (Ont. S.C.J. [Commercial List]).

15 *Muscletech Research & Development Inc., Re* (2006), 2006 CarswellOnt 7877 (Ont. S.C.J.) at para. 2.

16 *Ibid.*, at para. 2.

17 *Muscletech Research & Development Inc.*, *supra*, note 14.

unidentified claimants to simply rely on a generic filing by some kind of 'class representative.' In our view the Call for Claims order had been very clear in stipulating that that type of filing just 'wasn't good enough' in this case and would, in fact, bring it to a halt because it would be impossible for Iovate and the other third parties interested in contributing to a settlement to know what claims they were facing – at least on any kind of timely basis. That is, generally speaking, we supported the proposition that, among other things, the Call for Claims Order had clearly contemplated that individual persons / entities would submit claims, either under their own signature or through properly identified and authorized representatives.[18]

As Justice Mesbur said in her decision:

> The Ad Hoc Committee of Tort Claimants supports the applicants. . . The Committee takes the position that even before the [C]all for [C]laims [O]rder was made, it was able to obtain an order allowing it to participate as a Committee in the CCAA process and obtain what is called representative status in the proceedings. It says that if the Ad Hoc Committee was able to do so within the CCAA process, these other proposed claimants could, and should have done the same. Since the other proposed claimants did not, and took no steps to appeal the [C]all for [C]laims [O]rder and indeed, declined to participate in the motion in which its terms were set, they should be barred from doing so at this late date.[19]

In considering whether a claim on behalf of an uncertified class action group could be provable in the *Muscletech* claims process, Justice Mesbur held "the CCAA neither expressly permits nor forbids representative claims".[20]

In that regard, Justice Mesbur went on to hold that:

> . . .while it is possible at least to have a limited representation order in CCAA proceedings, it is by no means clear that representation orders have been extended to permit a "representative" proof of claim to be filed. Canadian courts have not yet permitted a filing of a proof of claim by a plaintiff in an uncertified class proceeding on behalf of itself and other members of the class. At best, our courts have at least once lifted a stay to permit the filing of certification materials. . .[21]

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18 In addition, we submitted to the court that, at the time of that hearing, ephedra had been off the market for a significant time period and there was, therefore, no real need to "find" groups of victims through class action type proceedings.

19 *Muscletech Research & Development Inc.*, *supra*, note 14 at para. 22.

20 *Ibid.*, at para. 27.

21 *Ibid.*, at para. 36. The case that Justice Mesbur referred to in which leave was granted to permit the filing of certification materials was the *Air Canada* case Court File # 03-CL-4932 (Endorsement of Justice Farley, 24 September 2003); however, as she noted, in that case the certification motion would occur in Canada. In *Muscletech*, it would have occurred in the U.S.

Justice Mesbur went on to hold that the process in the *Muscletech* case "adequately protected the interests of these potential claimants, had they availed themselves of the process as other claimants did".[22]

In that regard, she noted that the Ad Hoc Committee "obtained a representation order, and participates on that basis, although its members filed individual proofs of claim".[23] In contrast, she noted, no one in the position of Hannon, Hochberg, Rodriguez and Guzman (i.e. a "similarly situated" person) filed a claim although "[t]hey easily could have".[24]

She concluded that the process, therefore, was not "unfair or flawed" and "adequately protected the interests of these potential claimants [who] . . . simply chose not to utilize that process".[25]

In these circumstances, she reached the conclusion that this was not a proper case to exercise the court's discretion to allow the Representative Plaintiff claims as they were or to lift the stay to permit certification motions to proceed. Instead, she recognized that in the *Muscletech* case "a structure was established by [the Call for Claims] Order, on notice to the very parties who now wish to alter the process fundamentally, after all stakeholders have relied on the structure that was established".[26]

An appeal from Justice Mesbur's decision was dismissed by the Ontario Court of Appeal in October of 2006.[27] Among other things, the Court of Appeal noted that Justice Mesbur's decision was an "exercise of her discretion"[28] in dealing with a "very fact-specific. . .motion".[29] The Court of Appeal affirmed the importance placed by Justice Mesbur on the prospect of the class certification motions taking place in the United States and not in Canada. They described that factor as "relevant. . .in the broader assessment of the nature and extent to which the ongoing CCAA proceedings [in the *Muscletech* case] could be delayed or lengthened were the applicants/appellants allowed leave to file a representative claim on behalf of the as yet uncertified classes".[30] The Court of Appeal held, importantly, that "the impact of the requested order on the CCAA proceedings is clearly a relevant consideration"[31] [in considering whether to allow these types of claims]. Finally, the Court of Appeal held that Justice Mesbur had quite correctly stressed the importance of the claims bar procedure

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22 *Ibid.*, at para 38.
23 *Ibid.*, at para. 39.
24 *Ibid.*, at para. 39.
25 *Ibid.*, at para. 39.
26 *Ibid.*, at para. 42.
27 *Muscletech Research & Development Inc., Re* (October 24, 2006), Docket: M34242-C46020, [2006] O.J. No. 4583 (Ont. C.A.).
28 *Ibid.*, at para. 5.
29 *Ibid.*, at para. 5.
30 *Ibid.*, at para 6.
31 *Ibid.*, at para 6.

and the fact that these claimants had had notice of the seeking of the order establishing that procedure and had neither opposed it at the time that the claims bar order was made nor sought to appeal that order. In plain terms, they had "left it too late".[32]

Undaunted by Justice Mesbur's decision with respect to the Representative Plaintiff Claims, the California Consumers also sought to appeal the disallowance of the Osborne proof of claim. Their motion was heard by Justice Ground in November of 2006. Again, the Muscletech group took the position, before Justice Ground, "that the Osborne Proof of Claim is invalid as a nullity to the extent that it purports to advance a representative claim on behalf of other persons".[33]

Justice Ground felt that it was legitimate to consider whether the pursuit of a better "certification" process would be beneficial to the overall *Muscletech* CCAA process; in that regard, he noted the decision of Justice Blair in the *Canadian Red Cross Society* CCAA case in which Justice Blair held that permitting a particular class action to proceed in that case "would disrupt the CCAA proceedings with only marginal benefit to [the] . . . claimants [in question]".[34]

Justice Ground did not feel that Ms. Osborne really had proper authority to file the 'Osborne Claim' in the manner in which it had been filed. He held that:

> Although under the law of California Osborne may owe certain duties to members of the putative class having purported to institute a proceeding on their behalf, I am of the view that the law of Ontario must be applied to determine whether Osborne is a legal personal representative for purposes of orders of this court, such that she has authority to file a proof of claim on behalf of such persons in the CCAA proceeding before this court.[35]

Justice Ground found that Ms. Osborne had not been designated or conferred authority by way of a power of attorney, proxy, court order or some other document. He also held that in light of the "factual circumstances of the case

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32 The Representative Plaintiffs also sought to oppose the granting of the sanctioning order in Canada with respect to the Muscletech CCAA plan, which was heard on February 15, 2007. In a decision reported at *Muscletech Research & Development Inc., Re* (2007), 30 C.B.R. (5th) 59 (Ont. S.C.J. [Commercial List]), Justice Ground dismissed their arguments, including their suggestion that the Muscletech CCAA plan was not fair and reasonable.

33 *Muscletech Research & Development Inc., Re* (2006), 2006 CarswellOnt 7877 (Ont. S.C.J.) at para. 15. Muscletech also took the position that the Osborne Claim could not succeed on its merits with respect to the allegations of false or misleading advertising: (2006), 2006 CarswellOnt 7877 at para. 11.

34 *Ibid.*, at para. 20.

35 *Ibid.*, at para. 28.

and the equities between the parties"[36] the claim should not be allowed. He noted that the CCAA proceeding "was commenced for the purpose of achieving a global resolution of all product liability and other law suits commenced in the United States against Muscletech and others, including the Nonapplicant Defendants, relating to products formerly sold by MuscleTech"[37] and that after a lot of hard work, tremendous progress had been made in that regard.

Justice Ground concluded that the court should not exercise its jurisdiction to permit the filing of the Osborne Proof of Claim and, accordingly, he held that the Osborne Proof of Claim was invalid and a nullity "to the intent that it purports to advance a representative claim on behalf of other persons".[38]

V. Third Party Releases

At the February 6, 2006 hearing before Justice Farley, when the Representative Counsel Order was made, U.S. counsel for one particular tort claimant (the Jaramillos) appeared (along with Canadian counsel) before Justice Farley and expressed grave concerns about the Muscletech group of companies and the extent to which her clients' rights would be protected in the CCAA proceeding. In his typically succinct and clear terms, Justice Farley made clear that he would not allow the proceeding to bog down or anyone's rights to be improperly curtailed; having said that, however, he also made clear that he was going to allow the proceeding to move forward and that he anticipated cooperation from the U.S. Court.[39]

The Jaramillos claimants did thereafter participate in the Ad Hoc Committee of Tort Claimants and, indeed, filed a claim in the Muscletech CCAA proceeding as such. However, unlike the other members of the Committee, they, along with two other claimants, did not elect to be represented by the Ad Hoc Committee in the mediation process which was contemplated by the orders in the *Muscletech* case and, instead, mediated their claims individually. As it turned out, they were not able to reach an agreement on the monetary value of their claim through the mediation process.

Accordingly, in the circumstances, those three (3) tort claimants (Jaramillo, Ishman and McLaughlin) engaged separate Canadian counsel – Bennett Jones[40] – and sought to amend the claims resolution process retroactively by

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36 *Ibid.*, at para. 33.

37 *Ibid.*, at para. 34.

38 *Ibid.*, at para. 36.

39 *Muscletech Research & Development Inc., Re* (2006), 19 C.B.R. (5th) 57 (Ont. S.C.J. [Commercial List]).

40 Bennett Jones was not the same Canadian counsel who appeared with American counsel for the Jaramillos at the February 6, 2006 hearing before Justice Farley referred to above.

eliminating the relief, in the form of releases, that that process provided for "third party non-debtors" under the CCAA proceeding.

This motion came before Justice Ground in late September of 2006. Justice Ground held that the CCAA court had jurisdiction to make an order affecting claims against third parties who were not applicants in the proceeding. Once again, it was noted that the viability of the *Muscletech* CCAA proceeding was based on the objective of a "global resolution of the litigation commenced in the United States".[41] In that regard, Justice Ground rejected the suggestion that the Canadian court "lack[ed] jurisdiction to make any order affecting claims against third parties who are not applicants in a CCAA proceeding"[42] and noted that the CCAA has been used to allow plans to include settlement of claims against third parties.

Justice Ground noted – as Justice Farley and Justice Mesbur had also noted – that the "global resolution" nature and objective of the *Muscletech* proceeding had been clear and apparent to all stakeholders from the very beginning and that, indeed, these three (3) plaintiffs had both participated in that process previously and had also neither objected to, nor sought an appeal of, any of the fundamental, bedrock orders associated with that objective – such as the Claims Resolution Order. In the circumstances, Justice Ground characterized the motion as "an attack upon the substance of the [C]laims [R]esolution [O]rder and of the whole structure of this CCAA proceeding".[43] Suffice to say that he did not find that that extreme relief was warranted.

The moving parties also suggested that the objections to the claims had not sufficiently "covered" the third parties such that, they argued, their claims had been "accepted" by those non-applicant third parties. [44] Justice Ground commented that he had "difficulty with this submission"[45] and again went back to the nitty-gritty terms of the Claims Resolution Order to the effect that the applicants, with the assistance of the Monitor, could dispute claims for all purposes. Justice Ground stated that he "fail[ed] to understand how anyone could read the Notices of Objection as not applying to Product Liability Claims against Third Parties as set out in the Proof of Claim".[46] Justice Ground also

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41 *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 231 (Ont. S.C.J.) at para. 7 (page 234).

42 *Ibid.*, at para. 7.

43 *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 231 (Ont. S.C.J.) at para. 10 (page 235).

44 This motion also claimed a variety of other relief. For example, the Jaramillos used this motion to seek an order establishing an insolvency protocol in the proceeding and to appoint an investigator to be funded to review the books and records relied upon by the Monitor in preparing its report on the pre-filing transactions involving the debtors. None of the relief requested was granted.

45 *Muscletech Research & Development Inc., Re* (2006), 25 C.B.R. (5th) 231 (Ont. S.C.J.) at para. 13 (page 236).

46 *Ibid.*, at para. 13.

held that the Notice of Objection had contained sufficient detail as to the grounds of the objection. (He also noted that the pleadings in the litigation in the United States had been well advanced before the CCAA proceedings began – such that, of course, the claimants knew exactly what all the various objections and defences were with respect to their claims.)

Bennett Jones initiated an appeal from this order but the appeal was abandoned when they were able to reach an agreement with the Muscletech companies on a valuation for the Jaramillo, Ishman and McLaughlin claims.[47]

VI. Conclusion

The *Muscletech* case proves that the Canadian insolvency system continues to work well. In particular, as noted above, the *Muscletech* case took little more than a year, yet extraordinary results were obtained, along with the generation of a significant amount of jurisprudence.

Of course, *Muscletech* is an example of the treatment of a particular type of unfortunate situation of insolvency – involving a "mass tort" problem like the one encountered in the *Red Cross* case. Some people have suggested that the treatment of some of the issues in the *Muscletech* case is either wrong or at most particularly apposite to those particular types of cases.[48] While that suggestion is certainly debatable, it clearly seems true that with cases moving as quickly as they do in Canada, there is an extreme importance placed on the formulation and implementation of the claims process.

What *Muscletech* points out is the need for counsel to be vigilant in protecting their clients as those claims processes are designed and put into effect. In this article, I have referred to a number of aspects of that claims process in the *Muscletech* case, as it impacted on different categories of participants, including the particular stakeholders who I helped to represent as co-counsel for the Ad Hoc Committee of Tort Claimants. As Justices Farley, Mesbur and Ground pointed out at various stages of the proceeding, the entire nature and scope of the proceeding and the claims procedure clearly signaled an unmistakable intent from the earliest stages that this process be used to resolve *all* claims relating to the business which the Muscletech group had carried on prior to its CCAA filing, including – equally unmistakably – the claims that might otherwise have been available against third parties such as

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47 Justin Fogarty and D. Fraser Hughes of Bennett Jones published an article about this decision: *Re MuscleTech's Extension of Third Party Releases: Precedent or Anomaly?* (2007), Nat. Insol. Review 9 in which, as the title of the article suggests, they questioned the scope of Justice Ground's decision.

48 In addition to the article by Justin Fogarty and D. Fraser Hughes, reference may be made to Lawrence Crozier's article on the *Muscletech* case questioning Justice Mesbur's decision, found at (2007) 19 Comm. Insol. R. 29.

the retailers and the insurance companies (and which parties could be contributors to a settlement pool). In such circumstances, one of the key lessons of the *Muscletech* case is that if counsel want to attack the details of such a structure – for whatever reason[49] — it behooves them to do so at the earliest possible opportunity and with the greatest possible force. Otherwise, in my view, the CCAA process can be used to address those claims in a comprehensive, exhaustive manner.

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49 In that regard, it may be that a particular claimant will feel that a "global treatment" of all claims against all defendants is inappropriate for a particular reason or other. For example, the claimant might feel that it has a particularly strong case against one of the defendants who, hypothetically speaking, might have had more incriminating knowledge than other defendants at a particular time. That claimant might feel that that particular defendant is "getting off too easily" in participating in a global settlement. As such, the claimant needs to "speak up" and argue as to why the claims procedure provides inadequately for treatment of that situation. However, reverting to the most basic first principals, it also would seem to be the case that, at the end of the day, such a claimant is really interested in getting a particular dollar value level of recovery for his or her claim and it does not matter who funds that level of recovery. Therefore, perhaps even a claimant of that nature would want to work with a CCAA process geared towards a global resolution? These are not easy matters to deal with because the CCAA structure does, of course, provide for the fact that dissenting claimants can be "outvoted" at a certain level. However, as the *Muscletech* case shows, the CCAA (and, in particular, a CCAA claims process which includes protection and conditional releases for third parties) can be used to allow a group of insolvent debtors, working in conjunction with other "co-defendants," to attempt to resolve a series of claims against both the insolvent debtors and all of those co-defendants and, again, it seems clear that claimants who would want to contest that approach need to do so at the earliest stages of the proceeding before time, energy and money is spent by various people, including "fellow claimants," in reliance on a claims process clearly designed to achieve that result. The *Muscletech* case indicates that a "late" attack on such a CCAA process will probably be unsuccessful.