

Court File No. 64757

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

BETWEEN:

THE ONTARIO FLUE-CURED TOBACCO GROWERS' MARKETING BOARD,  
ANDY J. JACKO, BRIAN BASWICK, RON KICHLER  
and ARPAD DOBRENTEY

Plaintiffs

- and -

IMPERIAL TOBACCO CANADA LIMITED

Defendant

Proceeding Under the *Class Proceedings Act, 1992*

**STATEMENT OF DEFENCE**

1. Except as expressly admitted herein, Imperial Tobacco Canada Limited (**ITCAN**) denies all of the allegations contained in the Statement of Claim.
2. ITCAN is or has been an importer and manufacturer of tobacco products. Its head office is located in Montreal, Quebec.

**The purchase and sale of Ontario-grown tobacco**

3. Between January 1, 1986 and December 31, 1996, ITCAN purchased Ontario-grown tobacco under a marketing plan administered by The Ontario Flue-Cured Tobacco Growers' Marketing Board (the **Board**). The Board is a farm marketing board established and overseen by the Ontario government through the Farm Products Marketing Commission (the **Commission**). The Board's mandate and powers are set by the Commission and subject to the Commission's sole and absolute discretion.
4. The purchase and sale of tobacco was governed by contracts or "Heads of Agreement" (the **Agreements**). The parties entered into a new Agreement each crop year following negotiations among various participants, including the Ontario Ministry of Food and Agriculture. The parties to the Agreements were the tobacco manufacturers and the Board. Individual

tobacco farmers were not parties to the Agreements. Tobacco farmers dealt with the Board, and the Board in turn transacted with the manufacturers. ITCAN had no dealings and no contractual relationship with tobacco farmers in relation to the purchase and sale of tobacco.

5. The negotiated Agreements specified two prices: (i) a guaranteed minimum price for tobacco purchased for the manufacture of tobacco products to be sold outside of Canada (duty-free & export tobacco or **DFX tobacco**), and (ii) a higher minimum guaranteed price for tobacco purchased for the manufacture of tobacco products to be sold domestically in Canada (**domestic tobacco**). Further, the Agreements specified the volume of DFX tobacco to be purchased by ITCAN and other tobacco manufacturers for each year.

6. Tobacco was purchased via auction. Each bale of tobacco would be graded by licensed graders hired by the Board and verified by government graders. A bale of tobacco would then be put up for sale. If a bale did not receive a bid higher than the minimum guaranteed price, the tobacco would become subject to a market clearing program.

7. Audit reports relating to the purchase and sale of tobacco administered by the Board were prepared annually by the accounting firm MacGillivray Partners (**MacGillivray**). MacGillivray reported to the Tobacco Advisory Committee, which included government representatives and representatives of manufacturers and tobacco exporters.

#### **Increase in taxes on tobacco products and the creation of market for contraband tobacco**

8. Starting in 1987, the federal government and some provincial governments began to increase taxes and duties on tobacco products sold in Canada which significantly increased the retail price for domestic tobacco products. However, these taxes and duties were not imposed on exported tobacco products.

9. The resulting increasing difference in price between domestic and exported tobacco products stimulated a growth in the market for contraband tobacco products. In particular, growth occurred in the market for tobacco products that had been exported from Canada to the United States and re-imported illegally back into Canada. These contraband products (**Contraband DFX Products**), which (by virtue of the illegal re-importation) could be sold in Ontario for less than domestic tobacco products, contained Ontario-grown tobacco sold at the DFX tobacco price.

**Plaintiffs' knowledge of Contraband DFX Products**

10. By at least 1990 the widespread existence of Contraband DFX Products had become common knowledge to the Canadian public. By that time, and likely much earlier, governments, the Board, tobacco farmers and MacGillivray knew or ought to have known that:

- (a) Contraband DFX Products made using tobacco sold to manufacturers (including specifically ITCAN) at DFX prices were being illegally re-imported into Canada and sold within Canada; and
- (b) Contraband DFX Products were widespread and a significant portion of the tobacco bought at DFX prices was being consumed in Canada.

Each and every year that the Agreements were entered into, all parties were aware of these facts.

11. The Agreements, including the pricing and volume of tobacco, were negotiated in the context of a known and increasing market for Contraband DFX Products containing DFX tobacco.

12. Under the Agreements, the Board, negotiating on behalf of the tobacco farmers, made an informed decision to sell increasing volumes of DFX tobacco to ITCAN and the other manufacturers, knowing that a significant portion of DFX tobacco was being used in Contraband DFX Products that were being illegally re-imported into Canada and sold within Canada.

**No breach of contract**

13. ITCAN denies that it is liable to the Plaintiffs for breach of contract, as claimed or at all.

14. ITCAN complied with all of its contractual obligations under the Agreements. It paid the Board the amounts stipulated under the Agreements for domestic tobacco and DFX tobacco. The fact that some DFX tobacco was being sold in Canada through the market for Contraband DFX Products was expressly considered and factored into the Agreements through negotiations on price and volume.

15. ITCAN also made required disclosure to MacGillivray. The Agreements required ITCAN and the other manufacturers to provide proof of export to MacGillivray. ITCAN disclosed to

MacGillivray its export sales and provided them with full access to sales records disclosing customers, shipment destinations and shipment quantities.

16. Contrary to the allegations in the Statement of Claim, ITCAN had no contractual obligation to advise MacGillivray of the existence of Contraband DFX Products, which in any event was widely known to the public, to governments and to the Board and was or should have been known to MacGillivray.

17. ITCAN denies that it had any "involvement in the smuggling operations" as alleged in the Statement of Claim and denies admitting any such conduct. In 2008, ITCAN pleaded guilty to a single regulatory offence under s. 240(1)(a) of the *Excise Act*. At no time has ITCAN ever been charged with an offence related to smuggling under the *Criminal Code*.

18. The Plaintiffs are estopped from asserting a claim for breach of contract, as a result of the Board's conduct. By agreeing to and accepting the prices for domestic tobacco and DFX tobacco while having knowledge of the existence of Contraband DFX Products, the Board represented to ITCAN that it was satisfied that tobacco farmers were adequately compensated notwithstanding the existence of Contraband DFX Products. ITCAN relied on that representation.

19. Even if ITCAN did breach the Agreements (which is denied), the Board ratified such breach(es) by its conduct. The Board negotiated and accepted the prices for domestic tobacco and DFX tobacco with the knowledge that DFX tobacco was used in Contraband DFX Products.

#### **No damages**

20. ITCAN denies that the Plaintiffs have suffered any damages, as claimed or at all.

21. But for the Contraband DFX Products, Ontario-grown tobacco would have lost market share to products manufactured using foreign-grown tobacco.

#### **The claim has been released**

22. On July 31, 2008, ITCAN and the federal and provincial governments executed a comprehensive settlement agreement that resolved any liability ITCAN may have had in relation to Contraband DFX Products (the **Comprehensive Agreement**).

23. The Comprehensive Agreement contains a release provision that releases ITCAN from any and all claims related to Contraband DFX Products for the period of 1985 to 1996 (the **Release**).

24. The Board, as a part of the Ontario government, is bound by the Comprehensive Agreement and the Release.

25. In addition or in the alternative, the Board is an agent of the Crown and bound by the Comprehensive Agreement and the Release.

26. The Plaintiffs' claim is captured by the Release. ITCAN pleads and relies upon the Release as a complete defence and reply to the Plaintiffs' claim and as an estoppel to dismiss the claim.

**The claim is time-barred**

27. This action is barred by the *Limitations Act*, R.S.O. 1990, c. L.15 and/or the *Limitations Act, 2002*, S.O. 2002, c.24, Sched. B. The Plaintiffs knew, and/or a reasonable person with the abilities and in the circumstances of the Plaintiffs ought to have known:

- (a) that tobacco sold to manufacturers at DFX prices was being used in Contraband DFX Products;
- (b) that the Board negotiated the price (and quantum) of DFX tobacco knowing that a significant portion of same would be and was used in Contraband DFX Products;
- (c) that ITCAN and the other manufacturers knew of the existence of Contraband DFX Products; and
- (d) the extent of disclosure by ITCAN and the other tobacco manufacturers to MacGillivray in respect of Contraband DFX Products,

at a time that caused their claim to become statute-barred well before the commencement of this action.

28. ITCAN requests that this action be dismissed, with costs.

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**NORTON ROSE CANADA LLP**  
TD Waterhouse Tower, Suite 2300  
Toronto-Dominion Centre  
79 Wellington Street West  
Toronto, Ontario M5K 1H1

**Orestes Pasparakis LSUC#: 36851T**  
**Rahool P. Agarwal LSUC# : 54528I**  
Tel: 416-216-4000  
Fax: 416-360-8277

Lawyers for the Defendant

**TO: SUTTS, STROSBERG LLP**  
600-251 Goyeau Street  
Windsor, Ontario N9A 6V4  
CANADA

**William Sasso LSUC#: 12134I**  
Tel: (519) 561-6228  
Fax: (519) 561-6203

Lawyers for the Plaintiffs

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Proceeding commenced at London

**STATEMENT OF DEFENCE**

**NORTON ROSE CANADA LLP**  
TD Waterhouse Tower, Suite 2300  
Toronto-Dominion Centre  
79 Wellington Street West  
Toronto, Ontario M5K 1H1

**Orestes Pasparakis LSUC#: 36851T**  
**Rahool P. Agarwal LSUC# : 54528I**  
Tel: 416-216-4000  
Fax: 416-360-8277

Lawyers for the Defendant