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CANADIAN SECURITIES CLASS ACTIONS: THE CHALLENGES FOR D&O INSURERS

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April 2007

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I. INTRODUCTION

Directors and officers of publicly traded corporations have numerous duties imposed upon them by both statute and the common law. A failure to meet these duties can lead to liability being imposed on the director or officer in addition to the corporation. These duties, coupled with the increased willingness of the Courts to certify shareholder class actions, have played a significant role in the pricing of D&O insurance and its availability.

We have observed with interest the settlements in the Enron ($7 billion), Worldcom ($6 billion) and Nortel ($2 billion) investor class actions. While 2006 saw the number of U.S. securities class actions drop to its lowest number in a decade, it is uncertain whether this is a result of increased corporate vigilance and the enactment of Sarbanes-Oxley or is merely a result of a steady bull market and will reverse trends with the next market correction. Either way, the need for D&O insurance in adequate limits remains a major concern for directors and officers.

While claims against public companies and their directors and officers may have recently decreased slightly in the U.S., no similar slow down has been noted in Canada. Class action legislation is now present in all but two Canadian provinces and securities-related class proceedings appear to be on the rise. With the advent of civil liability legislation for secondary market disclosure, many predict that U.S. style securities-related class actions and other shareholder litigation will grow in Canada, a prediction likely to arouse the interest and concern of D&O insurers who must respond to and reimburse the cost of these claims.

The purpose of this paper is to discuss the emergence of securities-related class actions in Canada while providing a comprehensive overview of Canadian class action legislation and the available (and growing) causes of action against both corporations and their directors and officers.

Finally, note that parts of this paper are intended for Canadian court and class action neophytes. However, as each chapter in this paper is relatively self-contained you may choose to go straight to Chapters VII and VIII where the liability of directors and officers for securities-based class actions is addressed.

II. THE LEGISLATURE, THE JUDICIARY AND COURT PRACTICE

This chapter provides an overview of the court governing securities-related class action lawsuits in Canada. The following chapter provides an overview of Canadian Securities Commissions. Ensuing chapters delve more comprehensively into the specifics of Canadian securities law and class action procedure.

A. THE LEGISLATURE

The organization of Canada's legislative system is a function of Canada's Constitution, and in particular the *Constitution Act, 1867*. By virtue of that Act, authority over the various areas of governance in Canada is divided between the federal (national) government and the ten provincial governments. For your purposes it is sufficient to note that the provinces have constitutional authority over civil justice and property rights. Accordingly, securities law and governance is a provincial rather than a federal responsibility.

B. THE JUDICIARY

Canada has both federal and provincial courts, though they do not constitute two separate systems as in the United States. Federal courts can only decide matters pertaining to federal statutes. Provincial courts decide matters related to provincial statute law and the common law, and some matters within the federal jurisdiction such as criminal law.

There are functionally four levels of court in Canada. First, there are Provincial Courts, which handle the vast majority of legal actions. The names of the Provincial Courts are not identical in each province, but the system is essentially the same across the country. Judges at the Provincial Court level are appointed by the provincial governments. Provincial Courts deal with most criminal offences and, in some provinces, with civil cases involving small amounts of money. The Provincial Court level may also include certain specialized courts, such as youth and family courts.

Second, there are the trial divisions of the provincial Superior Courts. These Courts deal with more serious crimes, the vast majority of civil cases and also take appeals from Provincial Court judgments. Judges of the Superior Court are appointed by the federal government. Superior Courts are the highest level of trial court in a province and have the power to review Provincial Court and various Board and Tribunal decisions. Securities claims will invariably be commenced in the provincial Superior Courts.

On the same trial level as the Superior Courts, but responsible for differing types of lawsuits, are the Federal Court and the Tax Court. As mentioned above, unlike the provincial and territorial Superior Courts, the Federal Court can only deal with matters specified in federal statutes. The jurisdiction of the Federal Court of Canada includes specialized areas such as copyrights, maritime law and citizenship appeal. It also reviews decisions of various federally appointed administrative tribunals.

Third, there are the provincial Courts of Appeal and the Federal Court of Appeal, which hear appeals from decisions of the provincial Superior Courts and the Federal Court.

The fourth level of court in Canada is the Supreme Court of Canada, which serves as the final court of appeal in Canada. The Supreme Court of Canada, as the country's highest court, hears appeals from decisions of the provincial appellate courts as well as from the Federal Court of Appeal. Its judgments are final. The Supreme Court of Canada is usually called upon to decide important questions of interpretation concerning the Canadian Constitution and controversial or complicated areas of private and public law. In the context of civil cases, including securities cases, parties must ask the judges of the Supreme Court of Canada for permission, or leave, to appeal. In contrast to its counterpart in the United States, the Supreme Court of Canada functions as a *national*, and not merely *federal*, court of last resort.

In summary, securities-related matters are heard in provincial courts, mainly the province's Superior Court. Decisions of a Superior Court can be appealed to the province's Court of Appeal and, in very rare cases, securities cases could be granted a further appeal to the Supreme Court of Canada.

C. BASIC PROCEDURE IN CIVIL ACTIONS

1. Commencement of Action

The term "action", in most common law jurisdictions in Canada, is defined as a proceeding commenced by a Writ of Summons or a Statement of Claim, depending on the rules of the particular province. It is the form of proceeding to employ except when another is specifically mandated by a statute. In other words, if no statute or regulation specifies the procedure to be followed for a specific kind of grievance, the only correct form of commencing a proceeding is by issuance of a Writ of Summons or Statement of Claim.

The form of proceeding generally determines the "evidence gathering" procedures available to the parties and the mode of presenting evidence to the court. Discovery of documents, Examination for Discovery (known as depositions in the United States), discovery by interrogatories and the pre-trial conference are all procedures generally only available to parties in a proceeding commenced by a Writ or Statement of Claim.

This is in contrast to a Petition which typically proceeds before the court by way of affidavit evidence.

A completed Writ or Statement of Claim is filed with the local court registry, where it is date stamped and assigned an action number. The filed Writ or Statement of Claim must then be served on the defendants within a time limitation prescribed by the rules of court, usually one or two years.

The purpose of the Writ or Statement of Claim, similar to a complaint in most jurisdictions within the United States, is to particularize the plaintiff's claim and alleged damages suffered so as to inform the defendants, as much as the plaintiff is able at that early stage of the proceedings, of the case they will ultimately be required to meet at trial.

Service of the Writ or Statement of Claim, a critical step in the proceeding, is the method by which the court gains jurisdiction over the defendant. Once the Writ or Statement of Claim is served on the defendant that defendant is in turn required to file and serve an Appearance, Notice of Intention to Defend or Statement of Defence to the action within a time frame prescribed by the rules, usually two to four weeks. If one of the prior two documents is filed, the defendant must still file a Statement of Defence within a prescribed further length of time. The Statement of Defence particularizes each the defences to be relied upon by the defendant at trial and can include any alternative pleadings, a claim over against other defendants in the action or a set-off or counterclaim against the plaintiff.

By entering an Appearance, Notice of Intention to Defend or Statement of Defence, a party becomes a "party of record" in the action, entitling it oral and document discovery from the other parties, any notices of motion and a notice of trial.

2. Scope of Document and Oral Discovery

The Rules of Court in Canadian common law jurisdictions (the provinces other than Quebec) provide that a party may obtain discovery of documents from "any other party" in an action, and the party from whom those documents are sought need not be adverse in interest or opposite the party seeking discovery and disclosure. Also, a party may apply to the court for an order compelling a person or entity who is not a party to the action to produce any documents that are relevant or would assist the parties and the court in the determination of the issues in the action.

The definition of "documents" is broad and includes any written records, photographs, audio and videotapes, computer records and digital data or any information recorded or stored by means of any device.

The Rules of Court further provide that the party from whom document discovery is sought must produce a list of documents to the other parties within a specified time. The scope of the list of documents is typically much broader than the duty to produce the actual documents as documents which are privileged can be identified as such on the list with a corresponding refusal to produce. The duty to disclose is ongoing and the parties must ensure that their list of documents are amended and supplemented as further documentation comes to light.

An Examination for Discovery, like a deposition in the United States, is an oral examination under oath to which a party to a case can compel another party, adverse in interest, to submit. Parties being examined must answer any question asked relating to a matter in question in the action unless they are entitled to claim privilege over the information.

The purpose of an Examination for Discovery is to assist in proving the case of the examining party and to disprove the case of the party being examined through admissions. It is to enable the parties to know the case they will be called upon to meet at trial and to enable them to dispense with much of the more formal proof required at the hearing. The plaintiff may examine a defendant after the expiration of time for delivery of the Statement of Defence of that defendant as specified in the rules of court. A defendant may examine the plaintiff following the delivery of his or her Statement of Defence.

3. Written Discovery/Interrogatories

The range of matters that may be canvassed by written questions, known as Interrogatories, differs between jurisdictions. Generally, the rules specify no limit on the number of questions which may be set out in an interrogatory, no limit on the number of persons who may be required to answer and no limit on the number of times interrogatories may be served. However, in recent years the courts in various provinces have limited the scope of Interrogatories, reducing their usefulness as a tool to achieving discovery of opposing parties.

Interrogatories may be delivered to "any other party, or on a director, officer, partner, agent employee or external auditor of a party". However, the body of caselaw dealing with this area of civil procedure indicates that answers cannot be compelled from a non-party to the action.

The weaknesses of written Interrogatories as a means of obtaining evidence are well known. The answering party has the time and the opportunity to study the questions carefully and to frame the least helpful response. Also, there is no way follow up answers made in order to obtain more complete information. For these reasons, oral

Examination for Discovery is recognized as a superior means for obtaining evidence from an opposing party.

4. Summary Judgment and Summary Trials on Affidavits

If a party fails to do anything which, under the Rules or Court, he or she is obliged to do, the consequences may be that the other party will:

(1) enter judgment against the defaulting party, as of right;

(2) apply to the court for judgment;

(3) proceed with an action without further notice; or

(4) proceed against the party for contempt of court.

The Rules of Court in some provinces also provide a means for a party to proceed with a motion for summary judgment based upon affidavit evidence. The purpose of this rule is to enable the plaintiff to obtain summary judgment without trial if he can prove his claim clearly and if the defendant is unable to set up a *bona fide* defence or raise an issue against the claim that ought to be tried. The rule is intended for vexatious defences but is not intended to cast an onus on a defendant in every case of proving a good defence by affidavit. Correspondingly, a defendant can bring a motion for summary dismissal of a claim if it discloses no reasonable cause of action or if the defendant has a complete defence which leaves no triable issue for the court.

Further provinces, notably British Columbia, permit summary trials by affidavit. Summary trials allow the parties to have a claim adjudicated on its merits, provided that there are no issues of credibility that then require the summary trial judge to remand the matter for a full trial.

5. Use of Expert Opinions

Typically, an expert retained by another party in anticipation of litigation or preparation for trial is exempt from any pre-trial examination. An opposing party only has a right of cross-examination at trial.

The written opinion of an expert witness is admissible at trial provided the form of the opinion is in compliance with the applicable rules, i.e. the party seeking to tender the opinion furnishes a copy to the other parties in advance of the trial and the opinion includes a statement of the expert's qualifications and facts and documents upon which the opinion is based. A party wishing to tender expert evidence at trial is entitled to have the expert attend in person to give evidence orally. The opposing parties can compel the attendance of an expert witness for cross-examination on giving proper notice.

III. THE SECURITIES COMMISSIONS

Each province has its own Securities Commission. The function of each Securities Commission is similar to that of the SEC, the U.S. Securities and Exchange Commission. The importance of Securities Commissions to this discussion is that often it is a Securities Commission investigation or proceeding for Securities Act violations that subsequently leads to a class action being commenced.

A. WHAT PROMPTS SECURITIES COMMISSION INVESTIGATIONS?

While it is impossible to draw a complete list of the sources of information that may prompt the Securities Commission to undertake an investigation of an issuer's disclosure record, the following are the most common sources relied upon.

1. Complaints

Complaints are unquestionably an important source of information relied upon to initiate investigations. While some complaints prove to be entirely unfounded the Securities Commission considers that it has a duty to review complaints that it receives.

2. Market Surveillance

Given the important resources that are allocated to the review of complaints the Securities Commission has limited resources to perform an effective monitoring of the market. Nevertheless, a significant portion of investigations originates from market surveillance activities.

3. Tips from Other Securities Regulators and the Police

The various provincial securities administrators and the U.S. securities administrators, as well as the Commercial Crime Section of the RCMP, are valuable sources of information for the Securities Commissions. Each provincial Securities Commission may disclose information to other securities administrators provided that the release of such information would not be prejudicial to the public interest. A Securities Commission may thus exchange information with its counterparts in the other provinces and in other countries.

4. Audit and Inspection

The Securities Commissions may audit issuers, brokers and advisers. Valuable information may be discovered in the course of such audits.

5. Review of Reports and Other Materials

The review of the reports filed with a Securities Commission may reveal facts that raise suspicions, which may mature into a formal investigation of an issuer's affairs.

Similarly, the contents of various promotional materials circulated to the public or advertisements placed by issuers may attract a Securities Commission's attention and form the basis of further investigation.

B. SECURITIES COMMISSION'S POWERS TO GATHER EVIDENCE

The following is a brief overview of the powers available to a Securities Commission to compel the production of evidence in the course of an investigation.

1. Powers of Superintendent/Director

A clearing agency, registrant (e.g. a broker, dealer, portfolio manager), reporting issuer or mutual fund or their respective employees, directors and officers may be compelled by the Superintendent/Director to provide information or to produce records. A person who receives a request from a Superintendent or Director to produce documents must satisfy the request notwithstanding the fact that the Superintendent/Director is proceeding against him.

2. Audits

A Securities Commission may appoint an auditor to review the affairs of any reporting issuer at the issuer's expense.

3. Nomination and Powers of Investigator

An investigator may be appointed by a Securities Commission in order to conduct an investigation that the Securities Commission considers expedient. The initiation of an investigation and the appointment of an investigator do not need to be made public by the Securities Commission.

The investigator is given broad investigative powers and may apply to the Court for an order authorizing the search of premises and the seizure of documents and records. However, the Court may not authorize the entry into a private residence.

4. Power of Investigator at Hearing

An investigator may hold a hearing and force the attendance of witnesses and compel witnesses to give evidence and produce records and things in their custody, possession or control. So far, the power to compel witnesses to appear before an investigator has been upheld by the courts.

The failure or refusal of a witness to attend an investigator's hearing makes the witness liable for contempt of court upon application by the investigator to the Court. The person summoned to appear before an investigator must give evidence notwithstanding that the person is also facing criminal charges in connection with the subject matter under investigation.

5. Appointment of Expert

The Securities Commissions are authorized to appoint experts to examine the affairs of a person under investigation.

6. Investigator's Report

After completion of an investigation the investigator must provide the Securities Commission with a report including any transcript of evidence and material in his possession.

It should be noted that an investigator has no adjudicative function to perform, which function rests entirely in the Securities Commission. Since an investigator does not perform an adjudicative capacity, those requested to provide evidence in the course of his investigation do not benefit from the protection against self-incrimination afforded by section 7 of the *Charter of Rights and Freedoms.*

7. Disclosure of Evidence

Every person who participated in an investigation is prohibited from disclosing (except to his counsel) any information or evidence obtained or the names of any witness examined in the course of an investigation unless the Securities Commission's prior consent is obtained.

C. SECURITIES COMMISSION'S POWERS AT A HEARING

The person presiding at a hearing of the Securities Commission enjoys the same powers as an investigator and may receive all relevant evidence without being bound by the rules of evidence. Witnesses may thus be compelled to attend at a hearing and to answer questions. The principles of natural justice must nevertheless be respected.

IV. THE STATUTORY CAUSE OF ACTION IN PROVINCIAL SECURITIES ACTS

Beginning in the late 1970's most provincial securities legislation was amended to expand civil liability for misrepresentation in prospectuses and other publicly filed documents.[1] The Canadian amendments were modelled on U.S. securities legislation. The dual purposes behind the statutory civil cause of action included providing greater protection to shareholders when making investments and to assist in the regulation of the securities market by promoting open and frank disclosure of materials facts that may affect the value of a company's securities. Of course, this expanded liability for misrepresentations dramatically affects an insurer's exposure under a directors' and officers' liability policy.

This chapter discusses of the statutory civil cause of action in Canada with a view to informing D&O insurers of the scope of liability that attaches to misrepresentations in prospectuses and other publicly filed documents, including who may use the statutory cause of action, who may be liable under the legislation, and the available statutory remedies for misrepresentation.

A. THE STATUTORY CAUSE OF ACTION FOR MISREPRESENTATION

The various provisions of each province's securities legislation that create the civil statutory cause of action for misrepresentation are contained in the chart attached at Appendix 1. All provinces have enacted such a statutory cause of action and the provisions are largely uniform across the provinces. [2]

1. The Cause of Action

The cause of action in Canadian securities legislation arises when a prospectus contains a misrepresentation as to a material fact. "Material fact" and "misrepresentation" are defined in British Columbia's *Securities Act* as:

> **"material fact"** means, where used in relation to securities issued or proposed to be issued, a fact that significantly affects, or could reasonably be expected to significantly affect, the market price or value of those securities;
>
> **"misrepresentation"** means

[1] Alboini, "Due Diligence and the Role of the Securities Lawyer" (1981-2) 6 C.B.L.J. 241 at 241.

[2] The securities legislation in the Yukon, Northwest Territories and Nunavut do not contain civil causes of action for misrepresentation but do permit rescission of the transaction if a prospectus contains a misrepresentation.

(a) an untrue statement of a material fact, or
(b) an omission to state a material fact that is
  (i) required to be stated, or
  (ii) necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made.

Accordingly, the cause of action can arise from an untrue statement or a material fact that is not disclosed.

While this section will generally confine itself to misrepresentations in prospectuses, D&O insurers should be aware that the various provincial securities legislation, with the exception of Prince Edward Island, also provide causes of action for misrepresentations in other publicly filed documents, including take-over bid circulars, issuer bid circulars, notices of change or variation, directors' circulars and various other disclosure documents. Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Prince Edward Island and Nova Scotia also provide a cause of action for misrepresentations in an offering memoranda and Saskatchewan provides a cause of action for misrepresentations in sales literature and for verbal misrepresentations.

2. Who Can Sue?

The statutory cause of action is available to a person who purchases securities offered by a prospectus during the period of distribution. Accordingly, two conditions must be met before a person can avail him or herself of the various provincial securities legislation:

(a) the security must have been purchased by an offer *under a prospectus*; and

(b) the security must have been purchased *during the period of distribution*.

These limiting requirements are important in that they protect potential defendants from unlimited liability to purchasers on the secondary market and to purchasers after the period of distribution closes. Potential exposure for secondary market liability will be dealt with in Chapter VII. All of the provinces with the statutory cause of action contain similar limiting provisions with the exception of Manitoba. Manitoba's securities legislation does not contain wording that limits the cause of action to those who purchased under a prospectus or to purchases made during the period of distribution. This has been recognized in one recent British Columbia Court of Appeal decision[3] as leaving open the possibility that persons to whom the Manitoba Act applies may have recourse to the statutory cause of action even if the share purchase was made in the secondary market or following the period of distribution.

3. Who Can Be Sued?

The statutory cause of action imposes liability on the following parties for misrepresentations in a prospectus:

(a) the "issuer" (i.e. the company);

(b) an underwriter who signs a certificate in the prospectus;

(c) every director of the "issuer" at the time the prospectus was filed;

(d) every person who consents to having his or her report, opinion or statement included in the prospectus; and

(e) every person who signed the prospectus, which typically includes the company's chief executive officer, chief financial officer, two members of the board of directors or a promoter.

However, Manitoba's expanded cause of action, which may afford secondary market liability, only imposes liability on the directors of the issuer for misrepresentations in a prospectus.[4]

Liability for misrepresentations in other publicly filed documents, discussed above, does not extend to the same range of parties as does liability for misrepresentations in a prospectus. If misrepresentations occur in these other documents liability is generally extended to those persons who would have had direct involvement in their preparation. However, D&O insurers should be aware that liability always extends to an issuer's directors at the time the document containing the misrepresentation was issued.

Liability pursuant to the statutory cause of action in Canadian securities legislation is joint and several.

4. Remedies

The statutory cause of action provides for two different remedies in an action for misrepresentation in a prospectus - rescission of the purchase and damages. A rescission remedy allows a shareholder to essentially "return" the shares to the company and recover the amount originally paid for them. A remedy in damages

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[3] *Pearson v. Boliden Ltd.* 2002 BCCA 624

[4] Note, however, that Manitoba's legislation extends liability for misrepresentations in an offering memorandum to the issuer and every person or company who signed the offering memorandum.

requires a plaintiff to prove the amount of his or her actual loss that resulted from the misrepresentation. Under Canadian law, damages are generally assessed by determining the difference between the actual value of the securities at the time of the distribution if the misrepresentation had been disclosed and the amount that the plaintiff paid for the securities. The rescission remedy is only available in an action against the issuer, a selling security holder or an underwriter but not a director or officer. If rescission is elected the shareholder cannot also claim damages.

The remedies for misrepresentation in a prospectus in Canada do not include the potential punitive aspects such as those contained in the U.S. *The Racketeer Influenced and Corrupt Organizations Act*[5].

The remedies under the provincial securities legislation are discussed in more detail in Chapters X and XI.

5. Advantages of the Statutory Cause of Action

The civil cause of action granted by the various provincial securities legislation has a number of advantages over the common law actions for fraudulent or negligent misrepresentation.

The first advantage is the range of potential parties liable under the statutes for misrepresentations. Since the securities legislation provides an enumerated list of potential defendants against whom a shareholder can claim, a shareholder is not required to prove that a specific party, such as an individual director who did not sign the prospectus, made a misrepresentation upon which the plaintiff relied when purchasing the securities.[6]

The greatest advantage to shareholders arising from the statutory cause of action is the "deemed reliance" provision. Canadian securities legislation provides that a purchaser is deemed to have relied upon a misrepresentation in a prospectus whether or not the purchaser received or reviewed the prospectus. In contrast, with the common law causes of action, each purchaser of a share is required to prove reliance on the misrepresentation in order to be successful in a lawsuit. The requirement to prove reliance has effectively prevented securities class actions based on common law causes of action from being certified due to the variety of different circumstances that would have to be proven for each plaintiff to establish the reliance requirement.

It is notable that the deemed reliance provision also applies to the situation where a "lock up" agreement exists in which an entity agrees to purchase a number, or "block",

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[5] 18 U.S.C.A. ss. 1961 – 1968 (1982). Cited in Chapman, "Class Proceedings for Prospectus Misrepresentations" (1994) 73 C.B.R. 492 at 496.

[6] Chapman, *supra*, at 501.

of shares prior to the issuance of a prospectus. A recent decision of the Alberta court determined that the reliance provisions in the Alberta securities legislation were conclusive and not rebuttable.[7] This makes clear the statutory remedy is available even when the investor makes his or her judgment as to the wisdom in purchasing a share before the prospectus is even issued.

The provincial securities legislation also gives shareholders the advantage of being able to claim rescission or damages as the remedy for misrepresentation. Under the common law, rescission is only available for actions based on misrepresentations if the misrepresentation was fundamental to the shareholder entering into the transaction. The election of rescission as the remedy under the statutory cause of action negates the need for the shareholder to prove damages as he or she is merely entitled to a return of the purchase price of the securities.

6. Limitation Periods

The one disadvantage to shareholders relying on the statutory cause of action for misrepresentation in a prospectus is truncated limitation periods. Under British Columbia's *Limitation Act*[8], the limitation period for an action for misrepresentation based on the common law is six years. However, under the securities legislation, most Acts provide for a limitation period of 180 days after the date of the transaction giving rise to the cause of action (i.e. purchase) if a plaintiff is seeking rescission. If the plaintiff is seeking damages, the Acts provide a limitation period of the earlier of 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action (i.e. the misrepresentation) or three years after the date of the transaction giving rise to the cause of action. These limitation periods are slightly more advantageous to defendants than those in the U.S., which provide for a limitation period in a claim for damages of the lesser of one year from the time the facts giving rise to the cause of action ought to have been discovered and three years from the date of the transaction.[9]

The only provinces with slightly different limitation periods are Saskatchewan, Prince Edward Island and Quebec. Saskatchewan and Prince Edward Island have longer limitation periods in a claim for damages, being the earlier of one year after the plaintiff first had knowledge of the facts giving rise to the cause of action or six years from the date of transaction in Saskatchewan (three years in Prince Edward Island). In an action for damages, Quebec provides a three-year limitation period for rescission from the date of the transaction and a three-year limitation period in an action for damages from the time of the filing of the prospectus with the Securities Commission.

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[7] *Ball et al. v. Merit Energy Ltd.* (February 7, 2000), (Alta. Q.B.) [unreported]
[8] R.S.B.C. 1996, c. 266
[9] Chapman, at 501.

B. DEFENCES

Despite the advantages provided by the securities legislation in a statutory action for misrepresentation in a prospectus, the various Acts also provide for a number of defences to the parties to which liability may attach.

1. The Issuer

The issuer of shares sold under a prospectus containing a misrepresentation only has two defences available to it. The first defence is the statements can be proven to be true. The second defence is that the purchaser knew the true facts. To avoid liability, the issuer must prove that the shareholder knew of the misrepresentation at the time the shares were purchased. This defence will be extremely difficult for the issuer to meet, especially in the context of a class action, given the necessity to prove the individual knowledge of each plaintiff of circumstances that are arguably within the exclusive knowledge of the issuer. An issuer's liability, once a misrepresentation in a prospectus is proven, is akin to strict liability.

2. Directors, Underwriters and Third Party Experts

Directors and underwriters have, in addition to proving that the shareholder had knowledge of the misrepresentation at the time the shares were purchased, the following additional "due diligence" defences :

(a) the prospectus was filed without the person's knowledge or consent and, upon becoming aware of its filing, the person gave reasonable general notice that it was so filed;

(b) after issue of the receipt for the prospectus and before the purchase of securities by a purchaser, on becoming aware of the misrepresentation the person withdrew the person's consent to the prospectus and gave reasonable general notice of the withdrawal and the reason for it;

(c) if the misrepresentation was contained in a part of the prospectus provided by an expert, the expert had no reasonable grounds to believe, and did not believe, that there was a misrepresentation or that part of the prospectus did not accurately represent the opinion of the expert;

(d) if the misrepresentation was a false statement from an official person or pubic official document, it was a fair representation of the statement and the person had reasonable grounds to believe it was true; and

(e) if the misrepresentation was contained in a part other than that provided by an expert, the person conducted a reasonable investigation to provide reasonable grounds for a belief that there was no misrepresentation unless the person believed that there was a misrepresentation.

If the misrepresentation is in that part of the prospectus provided by an "outside expert", such experts have the above defences and the additional defences of:

(a) the misrepresentation unfairly represented the expert's opinion and the expert, after reasonable investigation, had reasonable grounds to believe that the prospectus fairly represented the expert's opinion or, after becoming aware that the prospectus did not fairly represent the expert's opinion, the expert gave reasonable general notice of the fact that the opinion was not fairly represented and that the expert would not be responsible for that opinion; and

(b) the expert conducted reasonable investigation to provide reasonable grounds for a belief that there had been no misrepresentation unless the expert believed that that there had been a misrepresentation.

Essentially, the defences available to directors, underwriters and third party experts include giving notice that a prospectus was filed with a misrepresentation and "due diligence". Directors and underwriters are also entitled to rely on the opinions of third party experts as long as reasonable due diligence was conducted prior to relying on those opinions. The standard of "reasonableness" is that of the "reasonable person" in the circumstances of the director, underwriter or third party expert.

There is very little Canadian judicial consideration of what constitutes "reasonable due diligence" to relieve directors and underwriters from liability under the statutory cause of action. Numerous articles have been written with a view to providing recommendations as to the scope of investigation that should be undertaken in order to build a viable defence. A comprehensive review of recommended due diligence is beyond the scope of this paper, however, there is a positive requirement to take steps to conduct independent investigation into the situation of the company.[10] Such investigation should include review of the company's current and past financial situation, including the status of the company's current and contingent assets and liabilities, the company's position in the market and the company's corporate plans for

[10] Denstedt and Miller, "Due Diligence in Disclosing Environmental Information in Securities Transactions" (1995) 33 Alta. L. Rev. (No. 2) 231 at 237.

the future.[11] Any assessment by D&O insurers of the quality of the due diligence undertaken by directors should always bear in mind the requirement under the securities legislation to disclose any facts that may affect the value of the securities being offered. This is discussed in detail in Chapter VIII.

The "due diligence" defence available to directors and officers is of particular importance should the company become insolvent and an action has been commenced by shareholders under the statutory cause of action in the provincial securities legislation. A D&O policy held by the directors of an insolvent company is likely to be the only avenue of recourse for shareholders when the company is insolvent. Accordingly, D&O insurers are advised to review the due diligence undertaken by directors prior to issuing D&O coverage if a company is proposing to make a distribution of securities.

3. Limitations on Liability

The provincial securities legislation across Canada also provides for limitations on the quantum of damages that can be recovered from the various parties that have liability under the statutory cause of action.

Underwriters are only liable for the portion of the total public offering price represented by the portion of the distribution underwritten by the underwriter. Secondly, all potential defendants are only liable for damages that can be proven to represent the depreciation in value of the security resulting from the misrepresentation. In other words, if the defendants are able to prove that factors other than the misrepresentation caused a decrease in the value of the securities, a shareholder's damages claim is reduced by the amount that these other factors affected the price. Finally, the amount recoverable by a shareholder cannot exceed the price at which the securities purchased by the shareholder were offered to the public, thus ensuring that a claim for damages does not provide the same level of recovery as a claim for rescission.

V. CANADIAN CLASS ACTION LEGISLATION

The purpose of this chapter is to provide a general overview of the statutory provisions of those Canadian provinces that have introduced class action legislation and to compare such provisions with those of U.S. Federal Rule 23, with an emphasis on discovery rights. Much of the information in this chapter is discussed in greater detail in later chapters in the context of securities-related class actions. Appendix 2 provides a

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[11] Alboini, *supra*, at 264 – 267.

summary of the various provisions of the class action legislation grouped by province and in juxtaposition to Rule 23 in the United States for comparative purposes.

A. BACKGROUND

In general, a class action is a civil action brought by one or more persons on behalf of a larger group having similar grievances or is a civil action brought against one or more persons defending on behalf of a larger group similarly situated. Class action legislation does not create new causes of action but rather provides the procedural tools for maintaining claims through the class action device. Canadian courts have repeatedly referred to class action legislation as *"advancing the interests of efficiency, access to justice and the modification of the behaviour of wrongdoers and potential wrongdoers."*[12]

The United States, through the 1966 enactment of Rule 23 of the Federal Rules of Civil Procedure[13], was the first jurisdiction to permit modern class proceedings. In contrast, class action legislation in Canada is a relatively recent development. The first Canadian province to enact class action legislation was Quebec in 1979[14]. Ontario[15] and British Columbia[16] followed, enacting Class Proceedings Acts in 1992 and 1995 respectively[17].

In 1996, the Uniform Law Conference of Canada adopted its *Model Class Proceedings Act*, which was largely drafted by delegates from British Columbia and which closely mirrored the B.C. Act. Saskatchewan[18], Newfoundland[19] and Manitoba[20] have more recently followed suit with legislation which, not surprisingly, is very similar to that of British Columbia. Alberta and New Brunswick also have class action legislation in place, leaving only Nova Scotia, Prince Edward Island and the Territories without Class Proceedings Acts. However, the Supreme Court of Canada in *Western Canadian Shopping Centres v. Dutton*[21] has imported the ability to prosecute a class action into the common law, thereby permitting such proceedings in every jurisdiction. There is no federal class action legislation, though the Federal Court Rules do permit a procedure akin to class actions.

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[12] C. Jones, "Foundations of Canadian Class Action Policy" (2003), p 6.
[13] Fed R Civ P Rule 23, hereafter referred to as Rule 23.
[14] *Civil Code of Procedure*
[15] *Class Proceedings Act,* 1992, S.O., 1992, c. 6
[16] *Class Proceedings Act,* R.S.B.C., 1996, c. 50
[17] The Ontario statute, which the B.C. act closely followed, was drafted in a conscious effort to avoid the weaknesses of the U.S./Quebec model.
[18] *Class Actions Act,* L.S. 2001, c. C-12.01
[19] *Class Actions Act*, S.N., 2001, c. C-18.1
[20] *Class Proceedings Act,* C.C.S.M., c. C-130
[21] *Western Canadian Shopping Centres Inc. v. Dutton*,[21] [2001] 2 S.C.R. 534

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Like the United States, certification is the central control mechanism regarding class actions in all Canadian provinces. There are, however, significant differences in the requirements for certification among the different jurisdictions. These, and other key differences, are discussed in more detail below.

B. PARTIES TO CLASS ACTIONS AND CERTIFICATION CRITERIA AND PROCESS

Like the United States the majority of Canadian class action legislation allows both plaintiffs and defendants to sue or be sued as a class. However in B.C. and Quebec only plaintiffs may participate as a class. Furthermore, in Quebec, only a natural person (as opposed to a corporate entity) may be a member of a class of plaintiffs. In contrast, in the United States and the balance of the Canadian provinces a class plaintiff can include a body corporate.

Rule 23(a) sets out the basic U.S. requirements for a lawsuit to proceed as a class action which include "*numerosity*", "*commonality*" and "*typicality*". In order to fulfil the pre-requisite of "*numerosity*", the members of the class must be "so numerous that joinder of all members is impracticable." The second prerequisite, "*commonality*", requires the existence of "questions of law or fact common to the class". The third prerequisite, "*typicality*", requires that the claims or defences of a class of representatives are "typical of the claims or defences of the class." These latter prerequisites do not mean, however, that all claims must be identical. Rule 23 also requires that class representatives "fairly and adequately protect the interests of the class."

In addition to meeting all of the Rule 23(a) criteria a U.S. class action may only proceed if it meets at least one of the criteria set forth in Rule 23(b). Under Rule 23(b)(3) a court must consider whether "central" or significant questions of law and fact common to class members "predominate over any questions affecting only individual members" and must find that the class action device is "superior to other available methods for the fair and efficient adjudication of the controversy."[22]

While the various Canadian provincial class proceedings legislation present slightly different requirements, Section 5(1) of Ontario's *Class Proceedings Act* constitutes a reasonable proxy for the balance of the legislation. The five requirements are as follows:

(1) the pleadings or the notice of application discloses a cause of action;

[22] *Supra*, at 1, p. 3

(2) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;

(3) the claims or defences of the class members raise common issues;

(4) a class proceeding would be the preferable procedure for the resolution of the common issues; and

(5) there is a representative plaintiff or defendant who would fairly and adequately represent the interests of the class, who has produced a plan that presents a workable method of advancing the proceeding and notifying class members of the proceeding, and who does not have a interest in conflict with other class members.

The Canadian legislation has been specifically designed to overcome some of the obstacles encountered under Rule 23 limiting class actions. For example, in the U.S., questions common to class members must "*predominate*" over any questions affecting individual members only. No such provision exists in the Canadian Acts. Similarly, the Canadian legislation dictates that a class proceeding must be a "*preferable*" procedure for the resolution of the common issues as opposed to the U.S. requirement that a class action be "*superior*" to other available methods.

Also, unlike the United States, where the representative party must demonstrate that the class is so numerous that joinder of all parties is impractical, the Canadian legislation only requires that there be an identifiable class of two or more persons that would be represented by the representative plaintiff. Further, the precise numbers or identities of the class members need not be known, nor is there a "numerosity" criterion such as that which exists under Rule 23.

Finally, in Canada, excluding Quebec, certification will only be granted if the claims of the class members raise "*common issues*." "*Common issues*" are defined as common but not necessarily identical issues of fact or law that arise from common but not necessarily identical facts. The legislation in B.C. is very similar to that in Ontario, with the additional provision that the common issues need not predominate over individual issues. Ontario jurisprudence has expressly rejected the predominance test used in the U.S. and both the Ontario and B.C. experience are a direct response to the perceived difficulties for plaintiffs pursuant to U.S. Rule 23(b)(3). Quebec also does not require its representative plaintiffs to meet a predominance test.[23]

[23] J.A. Campion and P.J. Martin, "Litigation – Class Actions, Recent Developments of Importance (2000)

C. CERTIFICATION CASELAW

The Canadian courts have not been as strict as their U.S. counterparts in certifying class actions. In particular, a pair of 2001 Supreme Court of Canada cases has set the stage for an increasing number of class action certifications. Since the probability of certification can dramatically shape the defendant's assessment of its litigation risk, the importance of these recent decisions cannot be overstated.

The first of the influential Supreme Court of Canada cases, *Rumley v. British Columbia*[24], was an action against the British Columbia government in relation to its operation of a residential school for the deaf. The plaintiffs filed a class action for damages arising from sexual, physical and emotional abuse of students by staff and peers over a 42-year period. The abuse had been the subject of a government investigation resulting in a report recommending that the province accept responsibility, which it did in 1995. The province then set up a three-tiered compensation program pursuant to the report's recommendations and by the time the victims filed their class action the program had already heard 49 claims.

Two questions came before the Supreme Court of Canada: whether common issues existed and whether a class action was the preferable procedure for resolving these issues. On the first question, the Court easily found commonality, noting that, on negligence and breach of fiduciary duty, no class member can prevail without showing duty and breach. Success for one victim means success for all.

On the second question, the Court considered the preferability criteria and concluded that its basic thrust was to ask whether a class proceeding would be "fair, efficient and manageable", and preferable "in the sense of preferable to other procedures". The Court thought that individual issues of injury and causation would be a relatively minor aspect of the case and thus concluded that common issues predominated over individual ones (that being a consideration, though not a bar, under B.C.'s statutory preferability test), leading to a more efficient proceeding.

The Supreme Court of Canada also concluded that the government compensation program inadequate for various reasons, including caps on recovery in each of the tiers (the top tier being capped at $60,000) and a provision barring claimants from being represented by legal counsel. The Court thus found a class action preferable and upheld the certification order.

Hollick v. Toronto (City)[25] was one of the rare cases where certification was refused. The plaintiff had filed an Ontario class action for some 30,000 people living near a municipal

[24] 2001 SCC 69

[25] 2001 SCC 68

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landfill site. He sued in nuisance, negligence, and breach of an environmental statute, complaining of methane gas, noise, and vibrations emanating from the site. The lower court ruled against certification on the basis that as nuisance claims require a showing of individual harm there was no commonality among the class members.

The Supreme Court of Canada disagreed with the lower court's commonality analysis and, interestingly, imposed a general requirement that representative plaintiffs adduce evidence to support each of the certification requirements. Such evidence, said the Court, need not meet the rigor of a preliminary merits hearing but nonetheless has to go beyond showing that the pleadings disclose a cause of action. The Court found that the nominal Plaintiff had discharged that burden by producing several hundred government complaint records about the landfill site.

However, *Hollick* failed the second requirement, namely that a class action be the preferable procedure. Unlike B.C.'s statute, Ontario's legislation lists no factors to be assessed on a preferability inquiry. But the Court found that the legislative goal was the same and that the preferability inquiry should be conducted *"through the lens of the three principal advantages of class actions—judicial economy, access to justice, and behaviour modification"*—and by looking at the common issues in the context of the particular case. One of the contextual factors was that the Ontario government, in granting the permit for the landfill site, had set up a Small Claims Trust Fund for individual claims of up to $5,000 arising out of "offsite impact". No claims had ever been made against this fund, which led the Court to think that class members' claims were "either so small as to be non-existent or so large as to provide sufficient incentive for individual action". In either case, access to justice was not an issue and, on the facts, neither was behaviour modification nor judicial economy.

These Supreme Court of Canada decisions are part of an ongoing trend – courts interpreting class action legislation broadly and in favour of plaintiffs. They also show that one of the principal battlegrounds in defending class action certification is with respect to preferability of procedure.

D. RESIDENCY AND NOTICE PROVISIONS

In the U.S., Ontario, Quebec, Alberta and Manitoba[26], any person may be a part of a class action without regard to residency. This is in contrast to B.C., Saskatchewan, New Brunswick and Newfoundland where only a resident may commence a class proceeding. However, historically non-residents of these provinces may "opt in" to the class proceedings on the condition that they form a separate subclass of plaintiffs with

[26] In Manitoba, s. 6(3) holds that a class that comprises persons resident in Manitoba and persons not resident in Manitoba may be divided into resident and non-resident sub-classes.

their own representative plaintiff (see Chapter IV for further discussion of this issue). More significantly, in relatively recent cases the Ontario courts have certified a national class involving residents from all provinces.[27] This stream of reasoning suggests that where there are class plaintiffs outside of B.C., Ontario will most likely be the jurisdiction of choice.

In dealing with notice of certification requirements, Rule 23(c)(2) requires that members of a class maintained under Rule 23(b)(3) receive "the best notice practicable" under the circumstances, including individual notice to all members who can be identified through reasonable effort. In addition, Rule 23(e) requires notice to members of the class, regardless of whether it is maintained under Rule 23(b)(1), (2) or (3), before the action is dismissed or compromised.

In Canada, notice requirements with respect to certification vary little from province to province. In general, the legislation requires that the notice:

(1) describe the proceeding including the names and addresses of the representative parties and the relief sought;

(2) state the manner by which and time within which class members may opt out of the proceeding;

(3) describe the possible financial consequences of the proceeding;

(4) summarize any agreements between parties and their solicitors respecting fees and disbursements;

(5) describe any counterclaim being asserted by or against the class, including the relief sought in the counterclaim;

(6) state that the judgment, whether favourable or not, will bind all class members who do not opt out of the proceeding;

(7) describe the right of any class members to participate in the proceeding;

(8) give an address to which class members may direct enquiries about the proceeding; and

(9) give any other information the court considers appropriate.

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[27] See *Carom et al. v. Bre-X Minerals Ltd. et al* (1999), 44 O.R. (3d) 173 (S.C.J.); *Nantais. Telectronics Propriety (Canada) Ltd.* (1995), 25 O.R. (3d) 331 (Gen. Div.); and *Webb v. K-Mart Canada Ltd.* (1999), 45 O.R. (3d) 389 (Gen. Div.)

In addition, with the exception of Ontario and Quebec, notice of a determination of common issues is mandatory in most Canadian provinces.

E. OPTING OUT OF CLASS ACTIONS

In both Canada and the United States class members are given the option of "opting out" of the proceeding in the manner and within the time specified in the certification order. In Quebec, a class member has the right to request his or her "exclusion" from the group. In all jurisdictions, a member who has "opted out" or requested "exclusion" will not be bound by judgment on any common issues.

F. POWERS OF THE COURT

In the United States, Rule 23(d)(1),(3),(4) and (5) provide the court with the power to prevent undue repetition or complication within the proceeding. In all provinces with class action legislation, the court, on the motion of a party or class member, is given wide powers to make any order it considers appropriate in relation to the proceeding to ensure its fair and expeditious determination. In addition, the court, on its own initiative, may stay any proceeding related to the class proceeding on any terms it considers appropriate. The court is also able to, at its discretion, allow for the participation of individual class members if such participation is necessary to ensure the "fair and adequate representation of the interests of the class or any subclass or for any other appropriate reason."

G. DOCUMENT DISCOVERY

The represented parties are required, as in conventional litigation, to disclose to the opposite parties all of the documents in their possession or control that related to the common issues in the action. In class proceedings, this may place an onerous burden on defendants to disclose documents that are relevant to the common issues. Although the exchange of documents usually occurs following certification of the action, defendants should gather, organize and analyze all relevant documents in the early stages of the proceeding in order to completely understand the facts at hand and what is at stake in the proceeding.

As discussed below, discovery (both documents and oral) of non-representative class members is generally restricted until after determination of the common issues.

H. EXAMINATION FOR DISCOVERY

The rules of civil procedure in the United States generally permit for wide ranging rights of deposition in commercial cases. By contrast, in Canada, in the context of a corporate entity, a plaintiff has the right to examine only one corporate officer and merely a procedural opportunity to obtain rights of second examination as granted by the court. Many similarly situated plaintiffs do not have multiple discovery rights if it concerns the same defendants. For example, if there are 50 plaintiffs in a representative action each Plaintiff does not have a right to examine 50 differing corporate officers of a corporate defendant.

In the context of class actions United States Rule 23 is silent with respect to the rights and procedure pertaining to discovery. In Canada, however, the legislation across the country expressly provides that parties to a class proceeding have the same rights of discovery under the Rules of Court against one another as they would have in any other proceeding, though as discussed as follows issues arise with regards to who can be examined and when in the proceed examinations can take place.

I. WHO CAN BE EXAMINED?

In *Western Canadian Shopping Centres Inc. v. Dutton*,[28] Chief Justice McLachlin of the Supreme Court of Canada stated:

> "*One of the benefits of a class action is that discovery of the class representatives will usually suffice and make unnecessary discovery of each individual class member…Cases where individual discovery is required of all class members are the exception rather than the rule. Indeed, the necessity of individual discovery may be a factor weighing against allowing the action to proceed in representative form…I would allow the defendants to examine the representative plaintiffs as of right. Thereafter, examination of other class members should be available only by order of the court, upon the defendants showing reasonable necessity.*"[29]

Discovery in representative proceedings in Canada is therefore *prima facie* limited to the named parties, i.e. the defendant is given only the right to discover the class representative and not the other individual class members. After discovery of the class representative, the defendant may request leave from the court for discovery of other individual class members.

In any event, the utility of examining class members other than the class representative is limited. In ***Bower v. Cominco Ltd.*** it was stated:

> "*I accept that the discovery evidence of persons named as representatives in a representative proceeding is admissible against all members of the represented class, if the named representatives are examined in their representative capacity…However, I am not satisfied that Rule 40(27) is sufficiently broad to make the discovery evidence of one or*

[28] *Western Canadian Shopping Centres Inc. v. Dutton*,[28] [2001] 2 S.C.R. 534
[29] *supra* at p. 562

more members of the represented class, who are not named as representatives in the style of cause, admissible against all the other members."[30]

However, there is one stage in the proceeding when examination of multiple class members may well become appropriate and helpful. The Ontario and British Columbia class action legislation, in particular, specifically contemplates that after determination of the common issues further discovery on individual issues may be necessary. British Columbia's *Class Proceedings Act* states:

> *17(2) After discovery of the representative plaintiff or, in a proceeding referred to in section 6, one or more of the representative plaintiffs, a defendant may, with leave of the court, discover other class members.*
>
> *(3) In deciding whether to grant a defendant leave to discover other class members, the court must consider the following:*
>
> > *(a) the stage of the class proceeding and the issues to be determined at that stage;*
> >
> > *(b) the presence of subclasses;*
> >
> > *(c) whether the discovery is necessary in view of the defences of the party seeking leave;*
> >
> > *(d) the approximate monetary value of individual claims, if any;*
> >
> > *(e) whether discovery would result in oppression or in undue annoyance, burden or expense for the class members sought to be discovered;*
> >
> > *(f) any other matter the court considers relevant*.[31]

While of limited utility in most cases, as noted above, the Ontario and British Columbia Acts also permit defendants to seek leave to examine other class members prior to a determination of the common issues, again referencing the criteria set out above.

In Quebec, the parties may discover both the representative and each class member who has obtained the right to intervene in the action. As in British Columbia and Ontario, the defendant may apply for discovery of other class members and other parties. In ***Villeneuve c. Québec (Procureur general)***[32]**, the Quebec Superior Court allowed a representative plaintiff's motion to examine third party medical practitioners in a class action licensing dispute with the provincial government as the court**

[30] ***Bower v. Cominco Ltd.*** [1998] B.C.J. No. 977, at p. 5

[31] *Class Proceedings Act*, R.S.B.C. 1996, Ch. 50, s. 17

[32] ***Villeneuve c. Québec (Procureur general,[32])*** [2001] C.C.S. No. 6780

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determined that the evidence would be pertinent and fell within the ambit of the issues addressed by both parties and would simplify the evidence and issues in dispute at trial.

There is limited case law that addresses the circumstance in which additional discovery of absent class members will be permitted. The focus thus far has been on the need to balance judicial efficiency and the burden that discovery would place on the persons sought to be discovered against the need to achieve a just determination as between the parties. Where a defendant is able to demonstrate that additional discovery is necessary for the legitimate preparation of its case such discovery will be ordered.

A case that informs this matter, though it is not directly on point, was *Lloyd v. Imperial Oil Ltd.*[33] **where Alberta Court of Queen's Bench** concluded that the identification of 19 employees as representative plaintiffs did not necessarily entitle the defendant to examine each one of them. The Court considered that full compliance with the discovery provisions of the Alberta's *Rules of Court* would result in burden and expense to the 19 employees that would be grossly disproportionate to the likely benefit to the corporate defendant. The employees' interest in obtaining relief at minimal cost and inconvenience was to be balanced against the corporate defendant's interest in obtaining information necessary for the effective preparation and conduct of its case.

Accordingly, the corporate defendant was entitled to conduct Examinations for Discovery of two of the representative Plaintiffs on the basis that any part of their examinations might be admissible as evidence on issues common to the represented class against all members of the represented class. Finally, a case management meeting was ordered to identify common and individual issues and at which the class members were to produce a litigation plan.

Peppiatt v. Royal Bank of Canada[34] also demonstrates the courts' flexibility and motivation to seek a balanced yet efficient result. In *Peppiatt* the defendant sought an order creating subclasses. The court held that the class should be divided into subclasses; however, the defendant should not be entitled to examine all class members but rather a representative of each subclass.

J. DISCOVERY PRIOR TO CERTIFICATION

In Ontario, discovery is theoretically available prior to certification, subject always to the power of the court to order otherwise or limit the scope of the discovery. In British Columbia, where a proposed class proceeding is an ordinary action until it is certified, the parties enjoy the same rights of discovery prior to certification as they would in an

[33] *Lloyd v. Imperial Oil Ltd.*, [2003] A.J. No. 647

[34] *Peppiatt v. Royal Bank of Canada, (1996), 27 O.R. (3d) 462 (Gen. Div.)*

ordinary action although, in practice, these rights have rarely been invoked. Unlike the situation in the United States, however, where limited pre-certification discovery is widely utilized, in Canada discovery ordinarily takes place following the certification motion.

In Ontario, prior to certification, a defendant may cross-examine the proposed representative plaintiff on any affidavit that is tendered in support of certification, although the scope of such a cross-examination is limited. If no such affidavit evidence is tendered, the defendant may wish to examine the representative plaintiff under the rule permitting the examination of a witness on pending motions. In determining whether to grant leave the court will be guided by the same factors that govern the decision to grant leave to discover absent class members, as discussed above.

In Canada, as in the United States, pre-certification examinations are meant to focus on matters that are relevant to the requirements for certification as opposed to the merits of the plaintiff's claims. However, in practice, in order to determine whether certain certification requirements are satisfied (for example, the existence of common questions) some inquiry into the substantive nature of the claims may be necessary.

In British Columbia the case law suggests that courts should take a pragmatic view and balance the plaintiff's right to compel the defendant to comply with its obligations under the Rules and the potential burden of pre-certification discovery on the defendant. In *Endean v. Canadian Red Cross Society*[35], the court granted an Order that the defendant need not deliver a list of relevant documents until after the certification motion. The courts have also permitted a defendant to postpone production of its documents until it's motion regarding a point of law was resolved (see *Edmonds v. Action Super-Save Gas Stations Ltd.*[36]).

In the United States, the Manual for Complex Litigation[37] suggests that with regard to pre-certification discovery procedures, whether in relation to certification issues or the merits, appropriate limits should be placed on the form and the extent of the discovery. Discovery should be structured to allow an early decision on certification and permit discovery on the merits to be conducted efficiently and economically.

K. AGGREGATE ASSESSMENTS OF MONETARY RELIEF

In the United States, Rule 23 is also silent with respect to the availability of aggregate relief. As a result, one must look to the common law for guidance in this area. In

[35] *Endean v. Canadian Red Cross Society,* [1997] B.C. J. No. 295 (S.C.).
[36] *Edmonds v. Action Super-Save Gas Stations Ltd.* (1996), 5 C.P.C. (4th) 105 (B.C.S.C.)
[37] Manual for Complex Litigation, 2d (New York: Clark Boardman Company Ltd., 1986) paras 30.12 and 30.233

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Canada, the provisions which address the ability of courts to award aggregate assessments are detailed and virtually identical from province to province.

Generally, the court may determine the aggregate or part of a defendant's liability to class members and give judgment accordingly, as long as:

(1) monetary relief is claimed on behalf of some or all class members;

(2) no questions of fact or law other than those relating to the assessment of monetary relief remain to be determined; and

(3) the aggregate or a part of the defendant's liability to some or all class members can reasonably be determined without proof by individual class members.

In addition, the Canadian legislation allows for the award to be applied so that some or all individual class members share in the award on an average or proportional basis. For the purposes of determining issues relating to the amount or distribution of a monetary award, the court is also allowed to admit statistical information as evidence, including information derived from sampling.

L. DETERMINATION OF INDIVIDUAL ISSUES AND ASSESSMENTS

In the United States, Rule 23 does not contain any statutory provisions that provide the court with the power to make individual assessments. Rather, it allows class actions to be brought only with respect to particular issues. This is not the case in Canada, where the court may order the determination of individual issues or assessments of liability after granting judgment on common issues.

M. AWARD DISTRIBUTION

Rule 23 is silent regarding how awards made in the context of class action proceedings are to be distributed. As a result, methods of distribution in the United States vary from jurisdiction to jurisdiction. It is worth noting that some United States jurisdictions are willing to approve non-traditional methods of distributing awards.

Not surprisingly, in Canada the various legislative provisions which deal with method of award distribution are numerous and detailed. Generally, the court may direct any means of distribution of amounts awarded that it considers appropriate. Such direction may include an order that the defendant distribute the award directly to class members or that the defendant pay the award into court. Direction can also be given for distribution by abatement or credit. In addition, the court may make an order that the award be paid in a lump sum or in instalments.

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With respect to unclaimed amounts, the Ontario legislation mandates that any award that remains unclaimed or otherwise undistributed after a time set by the court must be returned to the party against whom the order was made. In the balance of the legislation, "unclaimed" or "undistributed" awards may be returned to the defendant or may be applied in "any manner that may reasonably be expected to benefit class or subclass members." Such amounts may also be applied to the cost of the proceeding or forfeited to the government.

N. SETTLEMENT, DISCONTINUANCE, ABANDONMENT AND DISMISSAL

In the United States, a class proceeding may not be settled, discontinued or abandoned without approval of the court and proper notification to class members. The same can be said for Canada, although the Canadian legislation allows the court the discretion to determine whether it deems such notice to class members to be necessary.[38]

O. APPEALS

In the United States, Rule 23 does not contain a provision which deals with the parties' right to appeal. However, the common law holds that a defendant has no right of appeal against a certification order and a plaintiff may not immediately appeal a denial of certification, except with leave of the court.

In all Canadian jurisdictions with class proceedings legislation, a plaintiff may appeal a denial of certification or a decertification order. In Quebec, the defendant has no right of appeal against a certification order, while in Ontario leave to appeal is required to appeal an order granting certification. The balance of the legislation allows for any party to appeal to the Court of Appeal from (i) an order certifying or refusing to certify a proceeding as a class proceeding, (ii) an order decertifying a class proceeding, or (iii) a judgment on common issues. Most of the Canadian legislation also allows for a member of a class or subclass to apply to the Court of Appeal for leave to act as the representative plaintiff where the representative plaintiff chooses not to appeal or fails to appeal on a timely basis.

P. COSTS, FEES AND DISBURSEMENTS

Rule 23 itself does not provide for the awarding of costs or disbursements. The general rule, however, is that each side must bear its own costs regardless of its success or failure at trial or on appeal. As such, in the United States a representative plaintiff may

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[38] This is not the case in Quebec where notice of settlement, discontinuance, abandonment and dismissal is mandatory. Also, in Quebec court approval of settlement is not required where settlement is for the full amount claimed.

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bring an action without fear of a large cost award against the plaintiff if the action is unsuccessful.

In Canada, curiously, only Ontario and Quebec's legislation allows for costs to be awarded to the successful party. In the balance of the provinces each party must bear its own costs "in any event of the cause", though the court retains a discretion to award costs if either party has acted in a vexatious manner, has taken improper or unnecessary steps, abused the process of the court or if exceptional circumstances make it "unjust" to deprive the successful party of costs. This stream of legislation also holds that class members, other than the person appointed as representative plaintiff for the class, are not liable for costs except with respect to the determination of their own individual claims.

As in the United States, class actions in Canada can be undertaken on a contingency fee basis. However, agreements respecting legal fees must be in writing and approved by the court to be enforceable. Further, any amounts owing under such agreements are a first charge on any settlement funds or monetary award.

Q. CONCLUSION

Class Action litigation continues to evolve in Canada. Historically, neither the common law nor the various provincial Rules of Court that allowed for representative proceedings prompted substantial multi-party claims to the degree seen in the United States. However, the relatively quick growth in Canada of class action procedural law, together with wider securities statutory liability regimes, will likely support the prediction that the amount of U.S. style securities class actions and other shareholder litigation will rise in Canada. As a result, more than ever directors and officers who avoid their duties to their company and their shareholders do so at their (or their D&O insurers') peril.

VI. EXTRA-PROVINCIAL AND TRANS-NATIONAL CLASS ACTIONS

This chapter discusses whether a Canadian provincial superior court can certify a class action in cases where members of the class do not reside in that province. In the face of class actions that attempt to address the complaints of individuals who reside in other provinces – and in some cases other countries – Canada's courts have been forced to grapple with the important issue of jurisdiction and authority.

As discussed in the previous chapter, in the context of securities class actions two broad categories of class actions exist. First, provincial securities legislation provides a statutory cause of action for misrepresentation against prescribed individuals involved in a "distribution" of shares, including the directors of the issuing company, the underwriter and the signatories to the prospectus.[39] Second, shareholders can rely on common law remedies of fraudulent or negligent misrepresentation if they cannot avail of the statutory cause of action. As discussed below it is the second class of lawsuits, available to shareholders in both initial and secondary markets, which has the potential for a greatly expanded class of potential plaintiffs.

A. THE STATUTORY CAUSE OF ACTION

A British Columbia Court of Appeal decision appears to have definitively decided that Canadian shareholders must bring their claim for a statutory remedy in the province in which their original purchase of the securities in question took place. [40] This decision will be highly persuasive though not binding on the courts of other provinces.

In this case the representative shareholder brought class action proceedings against Boliden Ltd. ("Boliden") under the British Columbia *Securities Act* for misrepresentation. Boliden was a resource company that owned a mine in Spain. In August of 1998 a tailing dam constructed to contain toxic chemical by-products from the mine collapsed resulting in an environmental disaster with cost repercussions of over $300 million in remediating the spill and for lost revenue.

In July, 1997 Boliden conducted a share offering and represented in its prospectus that it was in compliance with all environmental regulations and had taken appropriate steps to ensure continuing compliance, even though one of its former engineers had informed a Spanish environmental authority that the tailing dam was inadequately constructed and posed a serious risk. As a result of the dam collapse the Boliden share price fell from $16.00 to roughly $5.00.

In *Boliden* the Court addressed three jurisdictional issues relating to different proposed class members:

(1) The Alberta *Securities Act* has a shorter limitation period than its Provincial counterparts in other provinces. The action was filed after this limitation period had expired. Were those class members who had purchased their shares pursuant to a "distribution" in Alberta entitled to rely upon s. 131 of the British Columbia *Securities Act* which had a longer limitation period?

(2) The New Brunswick *Securities Act* does not contain a provision which is analogous to s. 131 of the British Columbia Act. Neither of

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[39] S. 131(1) British Columbia Securities Act, R.S.B.C. 1996, c. 418.
[40] *Pearson* v. *Boliden Ltd.*, 2002 BCCA 624.

Canada's two Territories have securities legislation. Were class members who purchased their shares pursuant to a trade in New Brunswick, the Territories, or outside Canada able to rely upon s. 131 of the British Columbia Act?

(3) Were U.S. shareholders who purchased shares pursuant to U.S. securities regulations able to avail themselves of provincial misrepresentation statutes?

The Court's analysis of these problems commenced with a review of how provincial securities legislation purports to exercise jurisdiction over securities transactions. Most provincial Securities Acts provide that a person shall not "distribute" a security unless a prospectus has been filed with the provincial securities authority. A "distribution" of a security is defined as "a trade in a security of an issuer that has not been previously issued".[41] The definition of "trade" specifically excludes the *purchase* of securities.

The intent of the provincial securities legislation is to govern the conduct of the issuers of securities and their intermediaries – brokers and the like. As such, the jurisdiction of provincial securities legislation *does not rely upon the location of the purchaser. Rather, it relies upon the location of the vendor that the legislation was intended to govern.* In *Boliden* the Court stated:

> *"For purposes of this appeal, it is important to note that most of the Acts state that "distribution" is each case requires a "trade" or "transaction", and that "trade" includes the receipt by a registrant of an order to buy or sell security. Equally important in this case, most of the Acts expressly exclude the purchase of a security from the definition of "trade"…The defendants also emphasize that...it is not their position that purchaser's place of residence determines the applicability of a Securities Act. This distinction will in fact be insignificant in most cases: the typical investor will be solicited in the province of his or her residence or place of business and will place his or her order to buy or sell with a dealer or broker in the same province. But this will not always be the case. As noted earlier, the Acts generally state that a "trade" (the first component of a "distribution") does not include a purchase of securities; hence, while the broker's receipt of the buy order is a trade and a distribution must therefore occur where the receipt takes place, the investor's placing of the order to buy is itself not a "trade". **Thus a distribution does not, without more, occur where the investor resides or happens to be when he or she places the order."***

In *Boliden* the shareholder wanted to maintain its claim in respect of class members who purchased shares resulting from a distribution in Alberta, New Brunswick, the Territories and outside of Canada. The Defendant urged the court to dismiss the action against these extra-provincial class members asserting that the provincial legislation did

[41] s. 1(1) British Columbia *Securities Act* R.S.B.C. 1996 c. 418.

not provide protection to those shareholders who had purchased shares pursuant to distributions outside British Columbia.

The Court of Appeal sided with the Defendant. Because provincial securities legislation is enacted to govern the conduct of trades within a given province the Court ruled that no provincial legislature has authority to govern the conduct of securities vendors in other provinces. As a result, prospective class members who did not acquire shares by means of a "distribution" that took place in British Columbia could not avail themselves of the statutory remedies of the British Columbia Act.

Accordingly, the Court pared down the prospective class. Class members who acquired shares through a distribution in Alberta were excluded because the action had been commenced after the expiry of the prescribed limitation date in the Alberta Act. Similarly, class members who acquired shares pursuant to a distribution in New Brunswick or in the Territories were excluded. The Court opined that it was outside provincial jurisdiction to apply its securities legislation to the conduct of individuals which took place in other jurisdictions. The Court stated:

> *"I also take from the foregoing cases that the lex loci delicti choice of law rule is not directly applicable to the question of which provincial Act or Acts may found a statutory cause of action for misrepresentation in a prospectus. As La Forest J. observed in Tolofson, courts are limited in exercising their powers (as to choice of law issues) to the same extent as the provincial legislatures. Thus, with all due respect to Mr. Klein's argument,* ***I do not agree that it is open to a plaintiff, or a court of law, to choose to apply the Act of one province that will provide a cause of action in misrepresentation for a plaintiff who was solicited in and purchased his or her shares pursuant to a distribution in another province. Once the Act of a province applies to regulate (by means of prospectus requirements) the "distribution" of securities taking place within the province's boundaries, the same Act must surely be looked to for any statutory cause of action for misrepresentation contained in the document.*** *Its form, contents and filing are all mandated by the Act; the creation of a right to civil damages for infringing the Act must also be found in that Act."*

In practical terms, the *Boliden* decision means that class members who have acquired shares in Canadian jurisdictions that don't have statutory causes of action for misrepresentation (the Territories, New Brunswick) will be unable to mount or be involved in a statutory securities claim commenced in another province.

Further, and perhaps more significantly, the *Boliden* decision means that class plaintiffs relying upon statutory misrepresentation provisions will have to commence an action in the province which regulates the transaction in question. Ultimately this decision restricts the ability of one provincial Superior Court to preside over class actions arising in other jurisdictions.

The impact on D&O insurers of this component of the decision is obvious; instead of retaining counsel to defend one national class action, multiple class actions may arise out of a single cause of action – one in each province with class action legislation. While one single national counsel could still conceivably be appointed the additional court and paperwork cost is certain to be significant. However, on the flip side, the inability for plaintiffs to band together in a national class may discourage the commencement of class actions, particularly in the less populous provinces.

Finally, the *Boliden* decision prevents a potentially large class of shareholders from relying upon a provincial misrepresentation provision – classes of shareholders who purchased shares under an offering which was governed by the securities regulations of another country. In *Boliden,* the Court stated that potential class members in the United States who purchased Boliden shares under the auspices of the American legislative regime could not avail themselves of the statutory cause of action in Canadian provincial statutes because the provinces do not have the legislative jurisdiction to regulate U.S. transactions. This reasoning applies to shareholders in all foreign countries.

B. COMMON LAW CAUSES OF ACTION – EXTRA-PROVINCIAL CLASSES

The *Boliden* case can safely be restricted to the consideration of class actions that depend on statutory causes of action. In fact, an emerging body of case law in Canada supports the view that provincial Superior Courts can certify national classes where the shareholders are not relying upon statutory causes of action which are jurisdictionally limited to each province. The courts have been willing to extend the doctrine of "comity" to permit these larger, national classes where a common law cause of action is plead. The common law is, of course, common to all Canadian provinces and territories with the exception of Quebec, which relies on a Civil Code.

Of particular interest in the securities context is a class action that was certified by an Ontario superior court in *Carom v. Bre-X Minerals Ltd.* Infamous in Canada, Bre-X was a resource company that reported significant gold findings at a site in Indonesia. This finding was made public and caused significant upward movement in the price of Bre-X common shares. However, some time later it was discovered that the company had "salted" the ore samples and the share value plummeted, resulting in a lawsuit against the directors and officers of Bre-X for, among other things, fraudulent misrepresentation.

Bre-X argued on the certification application that the Ontario Court did not have the jurisdiction to certify a class that contained extra-provincial members. Since the Ontario *Class Proceedings Act* was a provincial statute Bre-X argued that the Court could not apply its provisions to members in other jurisdictions. The court disagreed citing the following:

I. The *Class Proceedings Act* does not restrict the definition of class members to Ontario residents;

II. The Supreme Court of Canada has recognized the principle of comity as between different provinces – a principle of private international law and of constitutional law that states that one state (or in this case province) should give "full faith and credit" to judgments from other jurisdictions; and

III. The action had a "real and substantial" connection to Ontario that brought it within the jurisdiction of the Ontario Courts.

The Court's first observation emerges from a literal reading of the Ontario *Class Proceedings Act* (the "OCPA"), which does not specifically exclude extra-provincial class members. The Court observed, *"the absence of a provision limiting its application to Ontario residents permits the inclusion of any person with a right of action, regardless of the location of his or her residence, in the class, subject to the constitutional considerations dealt with below."*

The constitutional defence that Bre-X advanced was that the province did not have the jurisdiction to rule on matters that affected the civil rights of residents of other provinces[42]. However, the Court disagreed, referencing earlier Supreme Court of Canada decisions discussing the principle of territoriality (the notion that each jurisdiction should be responsible for enforcing its own judgments) [43], which had stated:

> *"The world has changed since [those] rules were developed in 19th century England. Modern means of travel and communications have made many of these 19th century concerns appear parochial. The business community operates in a world economy and we correctly speak of a world community even in the face of decentralised political and legal power. Under these circumstances, our approach to the recognition and enforcement of foreign judgments would appear ripe for reappraisal…As I see it, the courts in one province should give full faith and credit, to use the language of the United States Constitution, to the judgments given by a court in another province or territory, so long as that court has properly, or appropriately, exercised jurisdiction in the action."*

[42] "civil rights" in this context is not equivalent to the commonly understood meaning of "civil rights" in the United States. The Canadian *Constitution Act* confers the power of presiding over "civil rights" to the provinces – which refers to the right to legislate in the area of civil law, which encompasses human rights legislation but extends to all areas of civil law including securities law and class action legislation.
[43] *Hunt v. T & N plc,* [1993] 4 S.C.R. 289; *Morguard Investments Ltd. v. De Savoye,* [1990] 3 S.C.R. 1077.

From this principle the Court moved on to the next analytical step – namely, does the class action in question have a "real and substantial connection" to the jurisdiction? When analyzing this question, the Court looked at several factors, including:

(1) The corporate defendants in the case were either Ontario corporations, their subsidiary companies operated in Ontario or their company shares were listed on the Toronto Stock Exchange;

(2) The brokerage firm research department was located in Toronto. The research analysts, implicated in the "finding" of gold in the Bre-X ore samples, were in Toronto; and

(3) Many of the plaintiffs resided in Ontario.

It is worth noting that, in the Canadian context of securities class actions involving established public companies, most actions will have a "real and substantial connection" with Ontario. This is because the Toronto Stock Exchange is the benchmark Canadian exchange where preferred companies list their securities. The fact that a company lists with the TSE in and of itself likely creates a "real and substantial connection" with Ontario, given the ongoing reporting obligations mandated by both the Ontario Securities Commission and the Toronto Stock Exchange itself.

A review of other Canadian cases reveals that provincial Superior Courts favour national classes as they permit a single jurisdiction to decide issues that are common to class members. How strong the connection with a matter must be to reach the "real and substantial" threshold is uncertain. Several Ontario cases have considered this matter and have unanimously ruled in favour of certifying national classes.[44] The reasoning in these decisions centres on the principle of comity between the provinces, and the desire to effect an efficient and just resolution of claims common to a disparate group of individuals. Particularly telling was Justice Cumming's observation in *Wilson v. Servier Canada Inc.*[45] where he stated:

> *"Ontario has an interest in adjudicating claims brought by its residents and in facilitating the resolution of the claims of other Canadian residents in a manner that meets the underlying policy objectives of the CPA…This approach is efficacious in extending the policy objectives underlining the CPA for the benefit of non-residents. If there are common issues for all Canadian claimants, this approach facilitates access to justice and judicial efficiency, and tends to inhibit potentially wrongful behaviour. This is to the advantage of all Canadians and to Canada as a federal state."*

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[44] *Nantais v. Telectronics Properitary (Canada) Ltd.* (1995), 25 O.R. (3d) 331; *Robertson v. Thomson Corp.* (1999), 43 O.R. (3d) 161; *Webb v. K-Mart Canada Ltd.* (1999), 45 O.R. (3d) 389; *Wilson v. Servier Canada Inc.* (2000), 50 O.R. (3d) 219.

[45] Ibid.

In practical terms, provincial Superior Courts have evidenced a strong desire to preside over pan-Canadian classes provided that the action does not rely upon jurisdictionally confined statutory mechanisms – as in the *Boliden* case.

C. COMMON LAW CAUSES OF ACTION – TRANS-NATIONAL CLASSES

With respect to the inclusion of class plaintiffs residing outside of Canada it is clear that when the action arises pursuant to a statutory scheme – as in the *Boliden* case - the class members will be restricted to the forum of the provincial court in question. However, in common law actions against a Canadian resident defendant the answer is less certain.

The basic principle of public international law that applies to jurisdiction is the location of the defendant. If the defendant resides in a Canadian province then that provincial court has jurisdiction over the action even if some of the plaintiffs reside outside the province.

However, problems which arise with respect to international plaintiffs is whether those plaintiffs will be bound by the judgment of a Canadian court and precluded from advancing a separate claim in their own jurisdiction. In *Robertson v. Thomas Corporation*[46] the defendants argued that the class could not be certified because it contained extra-national members. The defendants argued that this would "taint" the class because the Court had no jurisdiction over the foreign plaintiffs and a decision in the Ontario court may bind the foreign class members. The implication of this argument is that a provincial court should not accept foreign class members for fear of creating a binding judgment which may not be favourable to the foreign plaintiff, preventing that plaintiff from pursuing a remedy in that foreign jurisdiction.

The Court, however, rejected this assertion. The Court observed that it could not consider whether its decision would be binding upon those members – only courts in the foreign jurisdiction could. According, it is unlikely that defendants in future actions will be able to avoid the certification of an action because there are foreign members in the class. There is no principled reason why a class of plaintiffs cannot join a class action if the defendant resides in the province in question so long as the foreign plaintiffs are not attempting to attract the protection of a Canadian statute. However, whether Canadian decisions in favour of defendants will be upheld in foreign courts – should foreign plaintiffs attempt to bring a new action in their jurisdiction – remains to be seen.

[46] (1999), 171 D.L.R. (4th) 171 (Gen. Div.)

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To date there have been no securities class actions certified in any of the common law provinces in Canada (Quebec is not a common law province) which contain foreign class members. However, in *Beaudoin c. Avantage Link Inc.* [47] the Quebec Superior Court certified a worldwide class action against a publicly traded corporation premised upon the "fraud on the market" theory adopted by some U.S. jurisdictions.[48] While it remains to be seen how the remainder of Canadian Courts will view this case, it is worth noting that the Quebec Civil Code differs from other Canadian class action legislation in that it permits virtually automatic certification. When a class representative makes a *prima facie* case that two or more people who have identical claims and whose claims raise similar issues of fact or law the Court is Quebec is compelled to certify the class.

Although it remains to be seen how the *Beaudoin* case will be decided on its merits, some commentators have suggested that the Quebec Civil Code in combination with a possible receptiveness to the "fraud on the market" cases may signal an oncoming spate of securities actions against public companies located in Quebec, many of which will contain foreign class members.[49] However, as yet no such flood of Quebec actions has been noted.

D. CONCLUSION

In summary, the following points emerge from this portion of the paper:

(1) Provincial superior courts will certify pan-Canadian classes for securities class actions *providing that the actions are based in the common law*, such as the *Bre-X* case.

(2) Provincial superior courts will *not* certify national classes when the lawsuits are premised on provincial statutory provisions providing a right of action for misrepresentation. The same principle applies to foreign class members, who will be unable to rely upon provincial securities statutes.

(3) Foreign class members may be able to join national classes in which the defendant is resident in a province with class action legislation (British Columbia, Ontario, Quebec) and the securities class action

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[47] [2002] J.Q. No 4575.

[48] The "fraud on the market" theory asserts that a company is responsible to all shareholders when it fails to make proper disclosure, or makes false statements. The theory, premised on the "efficient markets" hypothesis, is that share price accurately reflects the available information about the company. As a result, shareholders are deemed to have relied upon misrepresentations that, when discovered, cause the value of the shares to decrease.

[49] D. McGowan, The Lawyers Weekly, Vol. 22, No. 37, Feb. 7, 2003; Quebec may become the forum of choice for securities class actions".

is commenced pursuant to a common law remedy – such as negligent misrepresentation. The *Bre-X* case is an example of just such a situation, although foreign shareholders were not named as proposed class members.

VII. CERTIFICATION OF MISREPRESENTATION CLASS ACTIONS

A purchaser of shares who has suffered a loss as a result of misrepresentation by the company and its directors and officers may pursue a cause of action pursuant to the provincial Securities Acts or the common law of fraudulent or negligent misrepresentation. There are challenges to a shareholder seeking to certify such claims as a class proceeding.

The first major hurdle, from a shareholder's point of view, is whether a common issue can be fashioned out of what will often be a wide array of representations made by various corporate officials and their agents over an extended period of time and the varied circumstances of the proposed class members. The second major issue is whether a class proceeding is the preferable procedure, given the complexities of the litigation and the number of individual variables and issues involved.

These concerns are particularly acute in the context of an action based on fraudulent or negligent misrepresentation where the claims of the proposed class members are often disparate and individual issues such as reliance and causation will often figure prominently. The extent to which these issues will militate against certification of a securities class action will depend upon the unique legal and factual matrix of a particular case in the context of the policy objectives of class proceedings legislation.

The following is a review of judicial decisions that provide guidance as to when certification of securities class actions will be granted and when it will be refused.

A. STATUTORY CLAIMS

As discussed in previous chapters the securities legislation of most Canadian provinces contain provisions allowing purchasers of securities to claim against the issuer and its directors and officers, among others, for misrepresentations in prospectuses and other documents relating to an offering. Though the precise terms of each province's legislation will vary, they are broadly similar and the central features make such claims more amenable to certification as a class proceeding than common law misrepresentation claims.

1. Advantages of the Statutory Cause of Action

The following features common to the civil liability provisions contained in most of the provincial Securities Acts are important factors in determining the suitability of such claims for certification as a class proceeding:

(1) They are typically restricted to misrepresentations contained in a limited number of defined documents;

(2) They are typically restricted to purchasers who invest pursuant to a prospectus, during the offering period, such that the price and the time period of purchase are standard among the proposed class members; and

(3) They typically provide for "deemed reliance" by a purchaser on any misrepresentations.

The first two features, though severely limiting the availability and scope of the statutory cause of action, significantly enhance the amenability of such actions to certification as a class proceeding. Such claims are generally more suitable for certification than common law claims because of the greater commonality between the claims of the proposed class members, the lower likelihood of conflicts in the interests of class members, and fewer individual issues. At the same time, the fact that individual reliance need not be proved reduces the number of individual issues, further tilting the balance in favour of certification.

2. Cases Considering Certification

There are still relatively few decisions involving certification of statutory securities misrepresentation claims in Canada. Plaintiffs' counsel appear to prefer common law causes of action. However, this is likely to change, as the liability provisions in Canadian securities legislation expand and as plaintiffs counsel become increasingly aware of the comparative ease with which statute-based claims are certified.

In *Maxwell v. MLG Ventures Ltd.*[50] the proposed class was made up of former shareholders who sold shares to the defendant pursuant to an offering memorandum. The plaintiffs alleged the defendant had made misrepresentations relating to the true value of the shares. In granting certification the Court noted the proposed class members received the same offering memorandum containing the same information. Individual issues concerning the actual knowledge of each proposed class member and the application of the statutory limitation period could ultimately be dealt with by requiring each class member to file affidavit material.

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[50] (1995), 7 C.C.L.S. 155 (Ont. Gen. Div.)

A similar result occurred in *Kerr v. Danier Leather Inc.*,[51] where the defendants did not dispute that there were issues common to the class given the common representations made to all class members. The plaintiffs had purchased shares of the corporate defendant pursuant to a prospectus prepared in support of an initial public offering. They alleged that the prospectus contained misrepresentations relating to revenue and profit forecasts. The Court concluded that a class proceeding was the preferable procedure for the resolution of the common issues and the claim was certified.

The Court in *Kerr* noted that resolution of the common issues would either end the litigation – if decided in favour of the defendants – or advance it – if decided in the plaintiffs' favour – though the issue of damages may need to be dealt with individually. The issue of misrepresentation was largely a matter for expert evidence. Furthermore, the objectives of the *Class Proceedings Act* were advanced by certification – in particular, access to justice was enhanced given the relatively small value of many of the claims.

In *Pearson v. Boliden Ltd.*,[52] the shareholders sought certification of a national class action against the company and its directors in relation to alleged misrepresentations in the prospectus for an initial distribution of shares. The defendants conceded that the requirements for certification were met. Differences between the various provincial statutes were dealt with by providing for sub-classes to deal with issues unique to residents of certain provinces – including the scope of the statutory cause of action and the application of differing limitation periods.

B. COMMON LAW CLAIMS

The advantages of the statutory cause of action, in the context of certification as a class proceeding, illustrate the weaknesses of common law claims based on negligent or fraudulent misrepresentation. The most common difficulties in certifying such claims arise from the diversity of representations made by the defendants, the variety of circumstances of the various class members, and the need to prove individual reliance on the defendants' misrepresentations.

Each of these issues manifests itself differently in a given case. The particular facts of the case will determine whether a problem exists and, if so, how acute it is. Additionally, the challenges posed by these and other concerns will be weighed against the extent to which certification as a class proceeding would meet the policy objectives of the Act: access to justice, judicial economy and behaviour modification.[53]

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[51] (2001), 14 C.P.C. (5th) 292 (Ont. S.C.J.)
[52] 2002 BCCA 624, leave to appeal to Supreme Court of Canada denied, [2003] S.C.C.A. No. 29
[53] *Hollick v. Toronto (City)*, [2001] 3 S.C.R. 158 at para. 27

The cases discussed below provide some guidance as to how Canadian courts will address these issues in determining whether to certify common law misrepresentation claims.

1. Variety of Representations

The first common stumbling block to the certification of common law misrepresentation claims is the identification of issues common to each class member. A common issue must be one that will move the litigation forward in a meaningful way. In circumstances where the misrepresentations complained of are numerous, varied and spread over time, a court may have difficulty in finding any commonality.

The difficulty with claims based on a wide array of representations is that there may be little commonality between members of the proposed class in that each will have seen different representations within different contexts. This will often be the case in claims involving representations in corporate advertising, brochures and other marketing materials. In such cases, the liability analysis may be dominated by individual inquiries and will require evidence particular to each class member.[54]

In *Shaw v. BCE Inc.*,[55] the Court denied certification and dismissed a claim by minority shareholders for oppression and negligent misrepresentation. There were a number of difficulties with the claim, one being the fact that there was alleged to have been "a number of representations made at various times". The Court noted that such circumstances "will not normally raise common issues". However, the volume of representations by itself is not definitive as the following case demonstrates.

In *Carom v. Bre-X Minerals Ltd.*,[56] the Ontario Court of Appeal ordered certification of a complex securities class action including claims for both fraudulent and negligent misrepresentation. *Bre-X* involved 160 representations over a period of time by the company and its insiders in relation to alleged gold deposits in Indonesia. When the fraudulent claims were exposed, the shares became virtually worthless.

Notwithstanding the number and variety of representations, the Court in *Bre-X* ordered that the proceeding be certified. The Court reasoned that the issues of the validity of the claims regarding gold deposits and the state of mind of the defendants at the relevant times were common issues which could best be dealt with in the context of a class proceeding.

A more significant problem than the number of representations is the existence of numerous *sources* of representations. In circumstances where alleged mis-

[54] See for example, *McKay v. CDI Career Development Institutes Ltd*. (1999), 30 C.P.C. (4th) 101 (B.C.S.C.)
[55] [2003] O.J. No. 2695 (S.C.J.), at para. 22
[56] (2000), 51 O.R. (3d) 236

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representations come not only through a prospectus or other corporate sources, but also through independent promoters, brokers and others, certification is much less likely.

A good illustration of this problem is the “vanishing premiums” litigation. These lawsuits are in response to diminishing returns on participating whole life insurance policies in light of falling interest rates in the 1990’s. Canadian courts have denied certification of these claims outside of the settlement context, in part because the alleged misrepresentations were made, to a significant extent, through a large number of independent brokers.[57]

However, the existence of representations from various sources is not always fatal to the certification of a class proceeding. In *Metera v. Financial Planning Group*[58] the Alberta Court of Queen’s Bench permitted a class action to proceed in relation to a failed investment in limited partnership units sold by or through the defendants. The alleged misrepresentations were said to come from the offering memorandum as well as through the promoters and salespersons. Nonetheless, the Court concluded that, “*where those involved are apparently going to point fingers at each other as to who made which representations, and whether they were accurate, there are advantages to deciding on the source and accuracy of the various representations at one time*”.[59]

In short, the existence of a large number of representations from a variety of sources, while not necessarily fatal to certification, will be one factor that militates against it.

2. Varied Circumstances of the Claimants

Another major issue relevant to the certification of class proceedings for misrepresentation is the extent to which the claimants themselves lack commonality as to their circumstances and interests. This problem will often be significant in a proposed class action involving purchasers of securities on the open market, where each claimant will have purchased, and perhaps sold, securities at a different time and price and with different information.

In *McDougall v. Collinson*[60], the plaintiff sought unsuccessfully to certify a class proceeding on behalf of 160 claimants who suffered losses on their investments in four different syndicated mortgage funds. The action was against the promoters and others and included allegations of misrepresentation in relation to information contained in the offering memoranda.

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[57] See for example *Kumar v. Mutual Life Assurance Co.* (2003), 226 D.L.R. (4th) 112 (Ont. C.A.)
[58] 2003 ABQB 326
[59] *Metera, supra*, at para. 98
[60] 2000 BCSC 398

The Court in *McDougall* concluded that there were no common issues, in part because the four investor groups entered into four different contracts at different times pursuant to four different offering memoranda. In addition, there were significant conflicts in the interests of the class members because each was in a different legal and financial position and, given the complex structure of the transaction, some groups were indebted to others.

Similarly, in *Samos Investments Inc. v. Pattison*[61] the British Columbia Court of Appeal denied certification of a claim by minority shareholders because "*there is no common issue among a changing group of minority shareholders who have different interests depending on the timing of their share purchases and dispositions*".[62] The claim related to alleged misrepresentations in relation to a series of corporate reorganizations that were alleged to have diluted the value of the minority shareholders' equity.

The Court in *Samos* distinguished the Ontario Court of Appeal's decision in *Bre-X*, where investors had purchased shares on the open market at different times and at different prices. The British Columbia Court noted the following about the *Bre-X* case:

> "*The Carom class was defined as shareholders on one specific date who all suffered immediate loss when the share price collapsed on disclosure of the fraud. There were no timing differences between the members of the Bre-X class like those that arise here, where the proposed class includes different shareholders on different dates and various alleged misrepresentations influencing the reorganisation at different times.*"[63]

A similar situation existed in *Millgate Financial Corp. v. B.F. Realty Holdings Ltd.*[64], where holders of corporate debentures claimed against the corporation and its directors and officers, among others, in relation to a conveyance of corporate property which was alleged to have been wrongful, rendering the debentures worthless. There were common issues as to the propriety of the conveyance but a class proceeding was not the preferable procedure.

The central reason for the denial of certification in *Millgate* was the fact that the proposed class members bought and sold the debentures at various times, at various prices and with various states of knowledge in relation to the conveyance. As a result, their interests differed greatly and the individual issues overwhelmed the common ones. Instead of certifying the class proceeding the Court agreed to the defendants' proposal to order the trial of the issue of whether the conveyance constituted a breach

[61] 2003 BCCA 87
[62] at para. 41
[63] at para. 45
[64] (1998), 28 C.P.C. (4th) 72 (Ont. Gen. Div.)

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of trust. The defendants in turn agreed to be bound by that decision and to consent to certification if the issue were decided against them.

The cases noted above illustrate the significance Canadian courts will attach to the different interests and circumstances of the proposed class members. As the British Columbia Supreme Court noted in *Collette v. Great Pacific Management Co.*:[65]

> *"Claims in negligent misrepresentation are most likely to be certified where the common question focuses on the conduct or knowledge of the defendant, usually at a particular point in time, and the resolution of that issue will move the litigation along. Ultimately, that was the case in Bre-X."*

3. Need to Prove Individual Reliance

An individual issue of particular significance is the need for each claimant to prove reliance on a misrepresentation. This requirement applies whether the action is framed in fraudulent or negligent misrepresentation.[66]

The issue of reliance may be inferred from all of the circumstances and, though necessarily an individual inquiry, will not always be a particularly vexing problem in the context of a class proceeding. However, it must be noted that in the case of *negligent* misrepresentation one must prove not only that one relied upon the offending misrepresentation but also that such reliance was reasonable.[67] A determination of whether reliance was reasonable requires an analysis of the context of the misrepresentation and the knowledge and circumstances of the individual claimant.

As the *Bre-X* case illustrates, the need to prove individual reliance will not, by itself, be fatal to certification. However, it is often noted as one of the reasons for denying certification, particularly when combined with other difficulties such as those outlined above. As the Court noted in *Collette*,[68] certification of misrepresentation cases has often been denied "*because the courts found that individual issues of reliance overwhelmed the common issues because of the need to inquire into multiple misrepresentations made in different circumstances and at different times*."

This is consistent with the results of the "vanishing premiums" litigation in Canada, where the combination of diverse representations being made from various sources and the need for each claimant to prove that they reasonably relied upon those representations meant that a class proceeding would "*result in a multitude of individual*

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[65] 2001 BCSC 237 at para. 90
[66] *Bre-X, supra*, at para. 57
[67] *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87 at 110
[68] at para. 88

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trials, which will completely overwhelm any advantage to be derived from a trial of the few common issues."[69]

Notably, in *Zicherman v. Equitable Life Insurance Company of Canada,*[70] unlike its companion case, *Williams v. Mutual Life Assurance Co.*, there was evidence of systemic marketing of the impugned "premium offset" feature and documentary evidence as to which policies had been sold on that basis. However, these factual distinctions did not overcome the problem that each proposed class member "*would still have to show that the agents with whom they dealt made misleading representations about the premium offset feature, and that the prospective policyholder reasonably relied upon the representation.*"[71]

It is perhaps notable that more recent decisions, such as *Bre-X* and *Metera*, have tended to downplay the importance of the reliance issue where significant common issues are found.

In short, the need to prove individual reliance will always be an issue in common law misrepresentation claims – fraudulent or negligent. In the case of negligent misrepresentation, this is exacerbated by the need to prove that reliance was reasonable. Since damages must typically be proved as well on an individual basis such claims are assured to have a number of significant individual issues.

However, it will typically require the existence of other significant individual issues or a lack of significant common issues, or both, before this concern will become an impediment to certification. Such an impediment is often found where there is a diversity of representations made by the defendants and a variety of circumstances applicable to proposed class members who purchased shares in the open market.

4. Other Factors

The policy objectives of class proceedings legislation – access to justice, judicial economy and behaviour modification – were alluded to in previous sections of this paper. In addition to the issues identified above, the application of these policy objectives can be an important factor in determining whether a misrepresentation claim will be certified – particularly in borderline cases.

In *Metera*[72] the Court, in granting certification, attached some significance to the fact that the claims were approximately $30,000 each and were too complicated for the province's "small claims" procedure. Trying each claim individually would not be economical. Conversely, where the individual claims are large enough to realistically

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[69] *Kumar v. Mutual Life Assurance Co.* (2003), 226 D.L.R. (4th) 112 (Ont. C.A.), at para. 53
[70] (2003), 226 D.L.R. (4th) 131 (Ont. C.A.)
[71] at para. 12
[72] at paras. 76-85

pursue on an economical basis, this factor may tilt the balance away from certification where there are significant challenges posed by a class proceeding.[73]

However, the fact that claims cannot be individually pursued on an economic basis will not justify the certification of an untenable class proceeding. In *Collette*[74] the Court recognized that over 80% of the claims were for less than $10,000 and likely could not be individually litigated given their cost and complexity. However, given the Court's conclusion that a class proceeding would devolve into "essentially individual actions", certification would, in reality, serve the goals of neither accessibility nor economy.

More than one case has noted that the goal of behaviour modification is not a significant factor in securities claims because such issues fall under the regulatory jurisdiction of the provincial securities commissions and are perhaps best addressed in that context.[75]

Another factor that is implicit in certain of the decisions is the court's view of the merits of the underlying claims. Though the allegations are, in theory, to be taken at face value for certification purposes, a court's view that the claims are spurious or incapable of proof appears to be an unspoken factor in certain decisions.

For example, in *Millgate* many of the causes of action advanced were "tenuous" and the viability of the claims was somewhat doubtful. Additionally, several class members were noted to have purchased the debentures after they were worthless suggesting they were "trafficking in litigation". While the Court could have certified the proceeding based on the common issue it identified, it instead directed a trial of that common issue *without* certification.

In contrast, cases involving significant matters of public interest, particularly those with a high public profile, are often certified notwithstanding their inherent difficulties.[76] Courts are no doubt mindful of the fact that certification of a class proceeding puts enormous pressure on the defendant to settle irrespective of the merits of the underlying claim. Given the reality that class actions are to a large extent "won" or "lost" at the certification stage, it is not surprising that the perceived merits of such claims may be an unspoken factor in the certification decision.

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[73] See for example *Shaw v. BCE Inc.*, [2003] O.J. No. 2695 (S.C.J.); *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Div. Ct.)

[74] at paras. 96-98

[75] *Metera*, *supra*, at para. 85; *Moyes v. Fortune Financial Corp*. (2002), 61 O.R. (3d) 770 (S.C.J.)

[76] See for example, *Bre-X, supra*; *Rumley v. British Columbia*, [2001] 3 S.C.R. 184

C. CONCLUSION

Securities misrepresentation cases in Canada can be brought against corporate issuers of shares and their directors and officers pursuant to the common law of fraudulent or negligent misrepresentation and, in limited circumstances, the civil liability provisions contained in the Securities Acts of most provinces.

The common factors inherent in claims brought pursuant to statute will tend to make such claims amenable to certification as a class proceeding. The factors determining whether common law misrepresentation claims will be certified are many and varied. While each case is dependent upon its unique facts the key issues appear to be the commonality between the various class members' situations, the extent to which the focus of the liability issues will be on the behaviour and knowledge of the defendants and, conversely, the extent to which individual issues such as reliance and causation dominate.

In addition, the extent to which access to justice requires certification, the economies of scale to be obtained from a class proceeding and, to a lesser extent, the perceived merits and public importance of the claims being advanced, will influence the courts' decisions.

Some recent cases have taken a liberal view of certification of common law securities class actions. Notwithstanding the invariable need to prove individual reliance in such claims, the trend in the case law suggests that these claims too may be amenable to certification where there is a common date or event which binds the various class members' claims and a significant focus on the knowledge and conduct of the defendants.

VIII. CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

The Securities Acts provide for civil causes of action for misrepresentations in prescribed disclosure documents, including prospectus's and bid circulars. However, until relatively recently, there were no statutory grounds for civil liability for secondary market disclosure.

The term "secondary market" refers to securities purchased on a stock exchange and is distinguished from purchases of securities made directly from underwriters during an initial public offering. The term "secondary market disclosure" refers to company documents like quarterly and annual financial statements, news releases and other forms of communications that companies issue on an on-going basis.

On December 31, 2005 Ontario became the first Canadian Province to proclaim into force Securities Act provisions imposing statutory liability for secondary market disclosure by public companies. Since then Alberta, Manitoba, Saskatchewan, and Nova Scotia have followed Ontario's lead by introducing substantively similar statutory regimes. British Columbia has also proposed similar amendments to its Securities Act.

As the developments in Ontario are of the most importance, Ontario being Canada's largest province and the home of the Toronto Stock Exchange, Canada's pre-eminent capital market, this chapter will focus the Ontario Securities Act amendments that impose civil liability for secondary market disclosure. It will also discuss the significant expansion of the Ontario Securities Commission's powers to allow for rules for CEO/CFO certification, audit committees, auditor oversight, and impose administrative penalties. Finally, the similarities and differences between Ontario's legislation and that of the provinces that have followed Ontario's lead will be canvassed.

A. ONTARIO

1. Background

Historically, for reasons discussed in Chapter III, there has existed statutory liability for misrepresentations in a prospectus, offering memorandum or take over bid circular. However, the statutory liability regime created by these sections has only ever provided a statutory right of action in favour of a purchaser of a share during the distribution period pursuant to the prospectus and not to a shareholder who buys or sells securities in the secondary market (the "Investor").[77]

Liability for damages resulting from misrepresentations found in continuous disclosure documents, and relied upon by Investors in the secondary market, have traditionally only been enforceable against a reporting issuer under common law tort claims for negligent misrepresentation and/or fraudulent misrepresentation. However, practical considerations such as the high costs of litigation, the limitation of the availability of class action proceedings, and the likelihood of an adverse cost award if the claim is unsuccessful have deterred Investors from commencing legal actions. [78]

[77] Other statutory civil remedies, such as the application of a corporate remedy could arguably provide recourse for purchasers or sellers of securities in the secondary market that have suffered losses as a result of improper disclosure by issuers, but the likelihood of recovery is doubtful and to date has never been pursued.

[78] An issuer in breach of its continuous disclosure obligations under the OSA is subject to penalties and fines. Prosecution for an offence under the OSA requires the consent of the Ontario Securities Commission and is not a private remedy. Further, an investor in the secondary market is not entitled to recover damages merely by proving the breach of a statutory condition, although a breach of a statutory condition may constitute evidence of negligence.

2. Ontario Cause of Action for Secondary Market Liability

On December 31, 2005, Part XXIII.1 "Civil Liability for Secondary Market Disclosure" of the OSA finally came into force.

These amendments provide a statutory right of action to an Investor who acquires or disposes of the securities of a responsible issuer during a period of time in which:

(a) an uncorrected misrepresentation in a "document" is circulated by a "responsible issuer" or person or company with actual, implied, or apparent authority to act on behalf of a responsible issuer;[79]

(b) a "public oral statement" containing a misrepresentation relating to the business affairs of the responsible issuer is made by a person with actual, implied, or apparent authority to speak on behalf of a responsible issuer;[80]

(c) an "influential person" or a person or company with actual, implied, or apparent authority to act on behalf of the influential person releases a document or makes a public oral statement relating to the responsible issuer that contains a misrepresentation;[81] or

(d) the responsible issuer fails to make a disclosure of a "material change".[82]

The statutory right of action contained in Part XXIII.1 of the OSA extends to Investors acquiring or disposing of the securities of the responsible issuer between the time the misrepresentation is made, or the responsible issuer fails to make a timely disclosure, until the misrepresentation is corrected or the subsequent disclosure is made.[83] An

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[79] "Document": any written communication including an electronic communication that is filed with the OSC, any government or stock exchange, and any communication the content of which would reasonably be expected to affect the market price or value of a security of the issuer. "Responsible issuer": a reporting issuer (a.k.a. public company), or any other issuer with a substantial connection to Ontario.

[80] "Public oral statement": an oral statement made in circumstances in which a reasonable person would believe that the information contained in the statement would become generally disclosed. (s. 138.1 of the OSA)

[81] "Influential person": in respect of a responsible issuer, (a) a control person, (b) a promoter (c) an insider who is not a director or officer of the responsible issuer, (d) or an investment fund manager, if the responsible issuer is an investment fund. (s. 138.1 of the OSA)

[82] Sections 138.3, (1)(4)

[83] The right of action for damages and the defences to a proceeding under Part XXIII.1 of the OSA are in addition to and without derogation from any other rights and defences the plaintiff or the defendant may have in another proceeding.

Investor also has the right to sue, "without regard to whether the person or company relied on the misrepresentation".[84]

Part XXIII.1 amendments also limit the defences available to responsible issuers and their directors and officers in respect of "core documents"[85]. For misrepresentations made in non-core documents, or by public oral statements, the Investor must prove that the potentially liable party (see section 4 below) knowingly permitted the misrepresentation, was wilfully blind to the misrepresentation or was guilty of gross misconduct in connection with the misrepresentation. Conversely, misrepresentations in core documents attract a form of strict liability subject to only "due diligence" type defences. Available defences are further discussed in section 8 below.

3. Commencing the Action

Leave must be obtained before the action can be commenced. Obtaining leave requires that the following conditions are satisfied[86]:

(a) the action is being brought in good faith; and

(b) there is a "reasonable possibility" that the action will be resolved at trial in favour of the Plaintiff.[87]

The purpose of requiring the leave of the court before commencing an action under Part XXIII.1 of the OSA is to discourage frivolous securities litigation. Further towards this end, a proceeding cannot be discontinued, stayed, settled, or dismissed for delay without the consent of the court on such terms as the court thinks fit including a *mandatory* award of costs to the prevailing party.[88]

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[84] Civil liability under U.S. securities legislation Rule 10b-5 demands that a plaintiff prove the defendant intended to deceive manipulate or defraud, reckless and wilful blindness included.

[85] "Core documents", where used in relation to a director or officer, include: a prospectus, rights offering circular, take-over bid circular, issuer bid circular, directors' circular, MD&A (Management Discussion and Analysis), AIF, information circular, material change reports (officers only), annual financial statement and interim financial statements.

[86] Section 138.8(4) of the OSA requires the Investor to send a copy of the application for leave to proceed to the Ontario Securities Commission. Pursuant to s. 138.8, the OSC has the authority to intervene in an application for leave and a proceeding.

[88] The mandatory requirement to award costs to the prevailing party does not abrogate the court's discretion with respect to the amount of the award of costs.

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4. Limitation Period

Part XXIII.1 of the OSA provides that once leave is obtained to commence an action under section 138.3 the action must be commenced within six months after the issuance of a news release disclosing that leave has been granted. The news release must be issued by the party seeking leave "promptly" upon leave being granted.

Further, section 138.14 provides that no action for secondary market disclosure can be commenced later than three years after the misrepresentation was made (inclusive of the six month period referenced above). This is a longer limitation period than the 180 days provided for misrepresentations in prospectuses, as discussed in Chapter III.

5. Potentially Liable Parties

Part XXIII.1 of the OSA casts the net of potentially liable parties broadly to include the following:

(a) the responsible issuer (i.e. the company);

(b) each director of the responsible issuer who authorized, permitted or acquiesced in the release of the document; [89]

(c) each officer of the responsible issuer who authorized, permitted, or acquiesced in the release of the document;

(d) each influential person, and each director and officer of an influential person, who knowingly influenced, i) the responsible issuer or any person or company acting on behalf of the responsible issuer to release the document, or ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and

(f) each expert, defined in the OSA to include accountants, actuaries, appraisers, auditors, engineers, financial analysts, geologists, and lawyers, who consented in writing to the use of its report, statement, or opinion being included in either a document released or a public oral statement made.

6. Damages Assessment

Under Part XXIII.1 of the OSA damages may be assessed by a court in favour of an Investor who acquires or disposes of responsible issuer's securities after the release of a

[89]if a public oral statement containing a misrepresentation is made by a person with authority, the person who made the statement is liable, whether or not they are an officer of an insider of the responsible issuer.

document or public oral statement containing a misrepresentation or after a failure to disclose a material change. Where such an Investor subsequently acquires or disposes of the securities *on or before* the 10th trading day after the violation is publicly corrected, the damages will be calculated on the basis of the difference between the average price paid for the shares and the price received upon disposition. For later trades, the damages will be calculated based upon the average trading price for the security during the 10 trading days following the public correction.[90]

Damages payable under Part XXIII.1 will not include any amount that the defendant proves is attributable to a change in the market price of the securities that is unrelated to the misrepresentation or the failure to make timely disclosure.[91]

7. Limits on Damages

As set out in the definitions section of Part XXIII.1, the total liability of a responsible issuer or a corporate influential person is limited to the greater of $1 million or 5% of its market capitalization. The liability limit of an individual director, officer or influential person is the greater of $25,000 and 50% of their total 12-month compensation from the issuer and its affiliates.[92]

An expert's liability is limited to the greater of $1 million and the revenue that the expert has earned from the responsible issuer and its affiliates during the 12 months preceding the misrepresentation.

It is important to note, however, that the monetary limits described above do not apply to a defendant, other than the responsible issuer, who knowingly authorized or permitted the misrepresentation. In other words, the limits only apply when the defendant unknowingly authorized or permitted a misrepresentation. In the case where the defendant knowingly authorized or permitted the misrepresentation, each defendant is liable for the totality of the Plaintiff's proven damages.[93] At this point, it is unclear whether plaintiffs will have to show intent to deceive, recklessness or merely negligent misrepresentation on the part of a defendant in establishing a "knowing violation" that gives rise to unlimited damages.

Part XXIII.1 of the OSA permits a court to treat multiple misrepresentations or multiple instances of failure to make timely disclosure as a single misrepresentation or single

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[90] Subsection 138.5(1) and (2)
[91] Subsection 138.5(3)
[92] Compensation is defined in s. 138.1 to mean cash compensation received during the 12 months prior to the misrepresentation of failure to make timely disclosure plus the fair market value of all deferred compensation including options, pension benefits and SARs granted during the 12-month period, valued as of the date such compensation is awarded.
[93] Subsection 138.6(2)

failure to make timely disclosure, respectively, if the multiple misrepresentations or multiple failures have a common subject matter or if the multiple misrepresentations have a common content. It should be expected that commensurate with liability limits there will be considerable dispute regarding whether one or not multiple allegations of misrepresentations have a common subject matter or content.

8. Application of Liability Limits

In the ordinary course, if the court finds one or more defendants liable each defendant is only liable for his or her proportionate share of the amount of damages awarded to the plaintiff up to the applicable liability limit. However, if a shareholder successfully alleges that one or more of the defendants knew that a disclosure contained a misrepresentation or was not made in a timely manner and the defendants authorized, permitted or acquiesced in or influenced the making of the misrepresentation or the failure to make timely disclosure, the limits on liability are not applicable and the defendant will be jointly and severally liable for the total amount of the damages awarded.

9. Defences

Part XXIII.1 of the OSA provides several defences to the new statutory civil cause of action for secondary market liability including, but not limited to:

(a) ***Reasonable Investigation -*** A person or company will not be not liable if that person or company can prove that they conducted or caused to be conducted a reasonable investigation and, as a result of that investigation, had no reasonable grounds to believe that there was a misrepresentation or that a failure to make timely disclosure would occur.[94]

(b) ***"Non-core" Documents and Statements -*** Liability for a misrepresentation in a "non-core" document is limited to certain persons and provides those persons with a defence based on a lesser standard of care, the absence of gross negligence. Classifying a document as a "core document" depends on the party in relation to whom the term is used. For instance, a material change report is a core document for an officer of a company but not for a director, control person or insider of the company. [95]

(c) ***Forward-Looking Information Cautions -*** Persons will not be liable with respect to "forward-looking" information, defined as

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[94] Section 138.4(6)

[95] Section 138.4(1)

disclosures regarding possible events, conditions or results, that is presented as either a forecast or a projection, provided that the document containing the forward-looking information contains cautionary language, identifies material factors that could cause actual results to differ and states the material factors or assumptions that were applied in making a forecast or projection.[96]

(d) *Knowledge of the Shareholder* – A shareholder will not be able to recover an investment loss if the defendant can prove that the shareholder knew of the misrepresentation or the failure to make a timely disclosure when he or she traded the security.[97]

(e) *No Involvement* – A defendant will not be liable for a misrepresentation in any document, other than those required to be filed with the Ontario Securities Commission by the issuer, if the defendant can demonstrate that he or she did not know and had no reasonable grounds to believe that a document containing a misrepresentation was going to be released.[98]

(f) *No Implied or Actual Authority* – Provides a defence for a defendant, other than the speaker, for any misrepresentation made in a public oral statement by a person who had apparent authority, but not actual authority to speak on behalf of the responsible issuer.[99]

(f) *Reliance on Experts* – A defendant, other than an expert, may defend an action for a misrepresentation in a document or public oral statement quoted from an expert's opinion or report provided that: (i) he or she did not know and had no reasonable grounds to believe that there had been a misrepresentation in the expert's opinion or report; (ii) the part of the document or public oral statement fairly reflected the expert's report or opinion; and (iii) the expert consented to the use of its report in the document or pubic oral statement. [100]

10. The Ontario Securities Commission's Expanded Powers

The Ontario legislation for secondary market liability also significantly expanded the powers of the OSC to make broad rules requiring: (i) the appointment of and

[96] Subsection 138.4(9).
[97] Subsection 138.4(5).
[98] Subsection 138.4(13).
[99] Subsection 138.4(7)
[100] See subsection 138.4(11).

prescribing requirements of audit committees; (ii) systems of internal controls; (iii) disclosure controls and procedures; (iv) chief executive officers and chief financial officers to provide certifications related to internal controls and to disclosure controls and procedures; and (v) defining auditing standards for reporting on internal controls.[101]

On June 27, 2003, the OSC issued three proposed rules for comment, including:

(1) a rule that will require CEO and CFO certification of annual and interim disclosures directing CEOs and CFOs of all Canadian public companies to personally certify four times a year that their issuers' annual and interim filings do not contain a misrepresentation and that they fairly present the issuers' financial condition; [102]

(2) a rule that outlines the role and composition of audit committees requiring every reporting issuer to have an independent audit committee with at least three members, each of whom is independent and financially literate, to address the conflict of interest that may arise when management assumes the role of overseeing the relationship between the issuer and its external auditors;[103] and

(3) a rule requiring public accounting firms that audit the financial statements of reporting issuers to participate in the public oversight program established by the Canadian Public Accountability Board ("CPAB") and to remain in good standing with the CPAB.[104]

To ensure the enforceability of the new OSC rules, the Ontario legislation also empowers the OSC to administer an administrative penalty on a person or company up to $1 million for each failure to comply with Ontario securities law or order a person or company to disgorge amounts obtained as a result of non compliance with Ontario securities law (e.g., repayment of stock options or bonuses obtained by executives as a

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[101] The OSC is required to submit proposed rules to a formal "notice and comment" procedure prior to their being adopted. The notice in respect of a proposed rule must set out, *inter alia*, the proposed rule, a statement of its substance and purpose and a reference to the authority under which the rule is proposed. Following the initial publication of a proposed rule, the public is to be provided at least 90 days to consider the proposed rule and submit comments to the commission. If material amendments to a proposed rule are made by the Commission after the conclusion of the initial notice and comment period, the OSC is obligated to subject the proposed rule to a subsequent round of notice and comment.

[102] Multilateral Instrument 52-109 *Certification of Disclosure in Companies Annual and Interim Filings.*

[103] Multilateral Instrument 52-110 *Audit Committees.*

[104] Multilateral Instrument 52-108 *Audit Oversight.*

result of a material misstatement in the financial statements filed with the OSC).[105] Fines that may also be imposed by the court for offences under Part XXIII.1 of the Act have also been increased from $1,000,000 or two years imprisonment less a day to $5,000,000 or five years imprisonment less a day.[106]

The new OSC rules have been heralded for their close parallel to SOX without dismissing "unique Canadian concerns." The new OSC rules have also received near-unanimous national backing by 12 of Canada's 13 provincial and territorial securities regulators.[107]

B. OTHER PROVINCES WITH SECONDARY MARKET DISCLOSURE LIABILITY LEGISLATION

1. Alberta

Alberta has enacted provisions for secondary market liability. The legislation came into force on December 30, 2006. Part 17.01 of the Alberta *Securities Act*[108] entitled *Civil Liability for Secondary Market Disclosure* is substantially the same as Part XXIII.1 of the Ontario *Securities Act*[109]. Like the Ontario scheme, and consistent with its *Class Proceedings Act*, Alberta's legislation permits successful parties to recover their costs.

2. British Columbia

B.C.'s Bill 38 proposes significant changes to the current B.C. *Securities Act* along the same lines as, though with some significant differences from, Ontario's secondary market liability scheme. It passed third reading on May 11, 2004 but has not yet been proclaimed into force.

In February 2006, the B.C. Securities Commission recommended that the government further defer bringing Bill 38 into force. The government agreed with the recommendation and deferred implementing Bill 38 until at least December 31, 2007. The BCSC wanted to devote full attention to working with other provincial securities regulators to develop the regulatory "passport system". The passport system is meant to harmonize and streamline legislation across the country. The hope is that the passport system will enable issuers and registrants to deal only with the securities regulator in their principal jurisdiction making regulation streamlined, cost effective and simple to use for investors and other market participants.

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105 Paragraph 127(1)9 of OSA

106 Subsection 122(1)

107 British Columbia has not yet determined whether it will adopt the proposed rules.

108 *Securities Act*, R.S.A. c. S-4. Part 17.1

109 *Securities Act*, R.S.O. 1990, c. S.5

On June 19, 2006, a consultation report was published by the Ministry of the Attorney General inviting the public to provide input on secondary market civil liability in B.C. No further developments have occurred since then and it remains to be seen whether B.C. moves forward with the proposed changes to its *Securities Act*.

If enacted, Bill 38 appears to be more favourable to investors than Ontario's legislation as it does not have a cap on damages. It leaves the question of damages up to the courts. In addition, B.C.'s proposed legislation integrates the remedies available for misrepresentation in the primary and secondary markets such that the remedies are essentially the same. Conversely, the Ontario scheme distinguishes between the remedies available for misrepresentations in the primary and secondary markets.

Furthermore, unlike the Ontario scheme where there is a different standard of care depending on the category of document disclosure, i.e. core or non-core, B.C.'s proposed legislation makes no such distinction. In addition, Bill 38 creates a new defence for issuers and their directors such that there is no liability if they can prove that they had a reasonable system in place to ensure compliance with the legislation and a process to monitor the effectiveness of such a system.

Another noted distinction between Ontario's scheme and B.C.'s proposed legislation is the exposure of experts for misrepresentations. Unlike the Ontario scheme, B.C.'s proposed legislation includes a defence for experts where an expert can establish that a misrepresentation was the result of misinformation given to the expert that the expert reasonably relied upon. The Ontario scheme caps the potential liability of experts at $1.0 million whereas B.C.'s proposed legislation limits the damage award to the amount of remuneration received by the expert in the previous year.

Finally, the cost protections under section 37 of the B.C. *Class Proceedings Act*, remains intact, precluding an award of costs in class actions for secondary market disclosure.

3. Saskatchewan

Saskatchewan's amendments to its *Securities Act* passed first reading on November 6, 2006 and second reading on March 12, 2007. The amendments have not yet been proclaimed into force.

Saskatchewan's proposed legislation is substantially the same as Ontario's with one exception. Saskatchewan's amendments do not alter the cost protections available to representative plaintiffs under Saskatchewan's *Class Proceeding Act*.

4. Manitoba

Manitoba's provisions for secondary market liability came into force on January 1, 2007.[110] Manitoba, like Saskatchewan, adopted legislation substantially the same as Ontario's. However, again Manitoba's legislation does not oust the cost protections afforded to representative plaintiffs under Manitoba's *Class Proceedings Act*.[111] Under Manitoba's *Securities Act*, costs are left to the discretion of the courts under its *Rules of Civil Procedure*.

5. Nova Scotia

Nova Scotia's Bill No. 75 contains a section for secondary market liability substantially the same as Ontario's. It passed third reading on November 23, 2006 but as of the time of writing had not been proclaimed into force. Bill 75 leaves the issue of costs to the discretion of the courts under Nova Scotia's *Civil Procedure Rules*. Nova Scotia, along with Prince Edward Island, are the only two Canadian provinces without class action legislation.

C. SECONDARY MARKET DISCLOSURE ACTIONS

To date only one action has been commenced pursuant to the new secondary market disclosure liability provisions. Not surprisingly it was commenced in Ontario. Filed in September 2006, *Silver v. IMAX Corp.* is a class action alleging that IMAX misrepresented its revenue and earnings for the fourth quarter and fiscal year ending December 31, 2005 and in the first quarter of 2006. IMAX shares dropped 40% in value after the company revealed that the U.S. Securities Commission had started an informal inquiry in respect of the alleged misrepresentations. The lawsuit was commenced on behalf of all shareholders who purchased IMAX shares on or after March 9, 2006 and held them at market close on August 9, 2006. The lawsuit seeks $500 million in damages and an additional $100 million in punitive damages.

The outcome of the IMAX lawsuit will likely generate considerable interest, as it will hopefully provide prospective plaintiffs guidance respecting the "merit assessment" the court must engage in when deciding whether to grant leave to bring the action under Part XXIII.1 of the OSA and may also provide guidance on how to establish the underlying merits of secondary market disclosure claims.

Finally, while it may at first seem surprising that only one secondary market disclosure action has been commenced, it must be remembered that this cause of action only

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[110] *Securities Act*, C.C.S.M. c. S50, Part XVIII
[111] *Class Proceedings Act*, C.C.S.M. c. C130

applies to misrepresentations made after the enactment of the legislation. As such, the "slow start" to such suits may yet become the predicted flood in years to come.

IX. LIABILITY FOR FAILURE TO MAKE CONTINUOUS DISCLOSURE OF MATERIAL FACTS

Canadian directors and officers can face regulatory/quasi-criminal penalties for authorizing, permitting or acquiescing to the withholding of material information that ought to be disclosed to shareholders of public companies. Certain large provinces have also enacted a statutory civil cause of action for failure to make continuous disclosure of facts material to a public company, as discussed in the previous chapter.

This chapter provides a survey of directors and officers' responsibilities in relation to the disclosure of "material information" in a public company and the penalties that can flow from a breach of this duty.[112] A brief overview of the source of disclosure obligations under various provinces' securities legislation will be followed by an examination of the consequence of their breach and the various Securities Commissions enforcement processes and remedies. In addition, this chapter will include a discussion of the influential 1994 Supreme Court of Canada decision in *Pezim v. British Columbia (Superintendent of Brokers)*.

Specific references to the applicable legislation of British Columbia, Ontario and Alberta, the domicile of the majority of Canada's publicly listed corporations, are included. Comparable legislation exists in most other provinces, though individual Securities Commissions may take significantly different approaches or seek different penalties when faced with a failure to disclose material information. All in-text citations are to the British Columbia *Securities Act* followed by references to the comparable sections of the Ontario and Alberta statutes.

This chapter is also restricted to continuous disclosure obligations of ongoing material developments concerning a reporter issuer and does not deal with disclosure obligations arising in the context of securities offering documents such as a prospectus.

A. SOURCE OF DISCLOSURE OBLIGATIONS

In British Columbia, the disclosure obligation of every reporting issuer is found at section 85(1) of the *Securities Act* (Ontario *Securities Act* section 75; Alberta *Securities Act* section 146), which provides:

[112] Updating W. Derby and C. Gagnon, The Advocate, (1996) 54: 91-101, "The Consequences of Incomplete Disclosure Under the B.C. Securities Act"

85(1) Where a material change occurs in the affairs of a reporting issuer, the reporting issuer shall

(a) as soon as practicable issue and file a press release that is authorized by a senior officer and that discloses the nature and substance of change, and

(b) file a required report, as soon as practicable, but in any event no later than 10 days after the date on which the change occurs.

This disclosure obligation does not arise on the occurrence of any change but only on the occurrence of a *material change*. The expression "material change" is defined at Section 1 (1) of the *Securities Act* as follows:

> "material change" means, where used in relation to affairs of an issuer, a change in the business, operations, assets or ownership of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer and includes a decision to implement that change made by
>
> (a) senior management of the issuer who believe that confirmation of the decision by the directors is probable, or
>
> (b) the directors of the issuer;

The materiality of a change depends on several factors, including the magnitude of the change, the size of the issuer, the nature of the issuer's securities and the maturity or probability of occurrence of the change. For example, a $1,000,000 contract may be material for a small issuer but it may not be material for a large issuer. Even if two issuers are similar size, the same change may be material to one and not the other, where, for example, the former has warrants outstanding (the price of which may vary significantly even though the price of the underlying shares may vary less significantly) and the latter does not.

For many material changes, the "maturity" or "probability" factor is probably the most difficult to deal with because it involves a judgment call as to whether a probable transaction, decision or event will materialize. The materiality of such a change is a function of both its probability of materialization and magnitude. Changes of high magnitude but low probability are particularly problematic because hindsight can result in criticism on management of an issuer; a temptation that is sometimes irresistible to angry shareholders or securities regulatory authorities.

National Instrument 51-102 Continuous Disclosure Obligations contains policy statements and guidelines on the issue of continuing disclosure. It includes a somewhat useful list of events that are deemed to be material changes. Unfortunately, several items on the list contain a built-in materiality test that renders the exercise circular. The fact remains that the determination of materiality will always require a judgment call no matter how well drafted or precise the guidelines may be.

In the case of sensitive information, the release of which would cause prejudice to the issuer, subsection 85(2) (O: 75(3); A: 146(2)) allows the filing of information on a confidential basis:

> 85(2) Subsection (1) does not apply to a reporting issuer that immediately files the report under subsection 1(b) marked "confidential" together with written reasons why there should not be a press release under subsection (1)(a) so long as
>
> (a) in the opinion of the reporting issuer, the disclosure required by subsection (1) would be unduly detrimental to its interests, or
>
> (b) the material change in the affairs of the reporting issuer
>
> (i) consist of a decision to implement a change made by senior management of the issuer who believe that confirmation of the decision by the directors is probable, and
>
> (ii) senior management of the issuer has no reason to believe that persons with knowledge of the material change have made use of that knowledge in purchasing or selling securities of the issuer.

The confidential nature of the information filed under this subsection must be reviewed every 10 days in accordance with subsection 85(3) (O: 75(4); A: 146(3)):

> 85(3) Where a report has been filed under subsection (2), the reporting issuer shall advise the commission in writing, within 10 days of the date of filing the initial report and every 10 days the after that, that it believes the report should continue to remain confidential until
>
> (a) the material change is generally disclosed in the manner referred to in subsection (1)(a), or
>
> (b) if the material change consists of a decision of the type referred to in subsection (2)(b), that decision

The option to file on a confidential basis may be an alternative when management experiences difficulties in reaching a decision on the ripeness of certain types of changes. The filing of a confidential report may operate so as to allow management to involve the Securities Commission in its disclosure duties.

During the embryonic phase of a potentially material change, the issuer must carefully monitor the trading activities of its securities in order to identify any indicia of rumours.

In accordance with NPS 40, the Securities Commission may prompt the issuer to make a clarifying statement if unusual trading patterns are detected. Since any statement released by an issuer must be accurate and contain no misinterpretation, the change must be disclosed in the issuer's clarifying statement if the rumours are accurate.

While the disclosure obligation rests primarily on the issuer, the various Securities Commissions take the position that the issuer's directors and officers are responsible for its fulfillment. As such, directors and officers are exposed to potential personal liability or sanction in case of a failure to cause an issuer to make timely disclosure.

B. CONSEQUENCES OF FAILURE TO DISCLOSE

The various Securities Acts provide for several remedies in the case of a breach of their provisions, their Regulations or the administrative policies of the Securities Commission or NI 51-102. These remedies include the following:

(1) offence under section 155 (O: 122; A: 194);

(2) compliance order under section 157 (O: 128; A: 197);

(3) enforcement order under section 161 (O: 127; A: 198);

(4) cease trading order under section 164 (O: 127; A: 198);

(5) administrative penalty under section 162 (O: 127; A: 199);

(6) freeze of property under section 151 (O: 126; A: 47); and

(7) appointment of a receiver under section 152 (O: 129; A: 48).

In addition, a reporting issuer's failure to make timely disclosure may result in the suspension of trading in the issuer's shares.

1. Offence

The failure to comply with disclosure obligations is an offence. Any employee, officer, director or agent of the issuer who authorized, permitted or acquiesced in the failure to disclose is deemed to have committed an offence. Someone who is found guilty of this offence is liable to a fine of up to $1,000,000 in British Columbia and Alberta and $5,000,000 in Ontario or to imprisonment for a maximum of 3 years in British Columbia or 5 years in Ontario and Alberta.

In view of its criminal nature, this offence must be proven beyond a reasonable doubt and nor merely on a balance of probabilities, as is the case in civil lawsuits. Given this heavy evidentiary burden, the Securities Commissions rarely use this remedy. The Securities Commissions appear to prefer more expeditious remedies in order to attain their regulatory policy objectives.

2. Compliance Order

The various provincial Securities Commissions may apply to their local Courts for orders directing issuers and their officers and directors to comply with the disclosure requirements contained in the relevant Securities Act. The order may also set aside or cancel any transaction entered into on the basis of undisclosed information. Such an order may be made notwithstanding that a penalty has already been imposed in respect of the same non-compliance.

Since such an order requires the intervention of the Court, it is infrequently used by the Securities Commissions, which appear to prefer to use more expeditious remedies that do not require the Court's intervention.

3. Enforcement Order

The power to make enforcement orders is based on the "public interest". The provincial Securities Commissions have liberally interpreted what is meant by the "public interest" to the point that its limits have become difficult to ascertain. For instance, no contravention of a specific provision of a Securities Act, the Regulations or a policy statement needs to be established by a Securities Commission in order to justify its intervention. A breach of corporate law may be considered sufficient by a Securities Commission to justify its intervention in the public interest. Under National Policy 34-201, violations of the securities laws of any jurisdiction and violations of the rules of a self-regulatory organization that are adopted for the protection of investors are considered in principle to be prejudicial to the public interest.

The provincial Securities Acts provide that the Securities Commissions must hold a hearing before making an enforcement order that is to extend for more than 15 days. However, this hearing requirement is eroded by the power of the Securities Commission to make temporary orders in cases where it considers that the length of time required to hold a hearing could be prejudicial to the public interest. Nevertheless, any extension of the temporary order beyond 15 days may be challenged before the

Courts and the Securities Commission's failure to provide an acceptable justification may cause the order to be stayed or varied.

The Securities Commissions may, among other things, order the directors and officers who failed to make timely disclosure:

(1) to cease trading in a specific security;

(2) to resign from their position with any issuer;

(3) to refrain from becoming a director of officer of any issuer; or

(4) to refrain from engaging in any "investor relations activities",

and may also order that the trading exemptions contained in the Securities Acts no longer apply to them.

While an enforcement order may effectively remove or greatly limit an individual's capacity to trade in securities, it may have the undesired effect of inducing the individual to go "underground" and become an unregistered, unregulated promoter or to move to another jurisdiction and conduct similarly offensive activities from that jurisdiction.

Depending on the circumstances, the sanctions imposed pursuant to an enforcement order may extend over a long period of time and be extremely damaging to the activities and careers of the subject individuals.

4. Cease Trading Order for Failure to Make Statutory Filings

When an issuer fails to make adequate and timely disclosure, the Securities Commission or the Superintendent/Director of Brokers may order, without any prior hearing, that all trading ceases in the securities of the issuer or order specific persons (e.g. the issuers' directors and officers) to cease trading in the securities of the issuer.

As one can imagine, this remedy is very expeditious and allows the Securities Commission and the Superintendent/Director to react quickly to any unusual trading pattern in a given issuer's securities. Where all the securities of an issuer are cease traded, great detriment may be caused both to the issuer and to its shareholders and so the Securities Commission or the Superintendent/Director, as the case may be, must ensure that it acts in the public interest.

5. Administrative Penalty

The Securities Commission, after a hearing, may impose an "administrative penalty" of up to $500,000 in British Columbia and Alberta and $1,000,000 in Ontario on any person who has contravened the provisions of the Securities Act, the Regulations, a policy statement or any of its decisions. Even where the decision of the Securities Commission that has been contravened is not based on any breach of the Securities Act or the Regulations, it is possible for the Commission to impose a penalty.

6. Order to Freeze Property

In contemplation of an investigation the Securities Commissions may require that the assets of the person subject to the proposed investigation be frozen. This power of the Securities Commission has so far withstood constitutional challenge.

7. Appointment of Receiver

The Securities Commission may apply to the Court for the appointment of a receiver to administer the assets of a person subject to an investigation.

8. Enforcement of Securities Commission Orders

Any decision of the Securities Commissions, provided it was made following a hearing, may be filed in the Court registry. Upon filing the decision has the same force and effect as a judgment of the Court and is capable of being executed upon.

9. Fees and Costs

The fees and costs incurred by the Securities Commissions or the Superintendent/Director of Brokers in connection with the conduct of an investigation and the ensuing hearing can be very substantial. The various Securities Acts give the person presiding at the hearing has the power to order the person whose affairs are the subject of the hearing to pay the costs of the investigation and hearing. These costs include, among other things, the time spent by the Securities Commission and its staff, expert fees and the costs of legal services.

These costs are determined in accordance with the tariff rates prescribed by the Regulations. The broad scope of the costs that may be recovered and the relatively high tariff rates prescribed under the Regulations permit the Securities Commissions to impose much higher costs than those that could be imposed by a Court in a civil trial against an unsuccessful defendant. Moreover, costs imposed by the Securities Commission cannot be taxed and can be carried only by the Securities Commission. In case of disagreement with a Securities Commission's decision with respect to costs one may always try to appeal the Securities Commission decision to the Court, but such an appeal would prove costly and is unlikely to be successful.

This ability of the Securities Commissions to recover their costs has been unsuccessfully challenged on a number of occasions on the ground that the Securities Commission is biased because of its financial interest in the outcome.

It should be noted that cost recovery is not linked to the outcome of the case and, hence, gives the Securities Commission complete discretion to obtain partial or total recovery even in cases where it is not entirely successful.

10. Limitation Period

The Securities Commissions must institute proceedings within six years after the date of the failure to make disclosure. Consequently, where a Securities Commission does not acquire knowledge of a failure to disclose until after the expiration of the six-year period, no proceeding can be initiated.

11. Appeals

The Securities Commission may review a decision of the Superintendent/Director.

A decision of the Securities Commission made under any of the remedies discussed above may be appealed to the Courts. However, a decision of the Securities Commission may not be appealed on issues of fact alone or issues that relate to matters falling within the Securities Commission's expertise. Several factors considered in determining whether a leave to appeal should be granted include :

(1) whether the proposed appeal raises a question of general importance as to the extent of jurisdiction of the tribunal appealed from;

(2) whether the appeal is limited to questions of law involving the application of statutory provisions statutory, statutory interpretation of particular importance to the litigant or the interpretation of standard wording that appears in many statutes;

(3) whether there was a marked difference of opinion in the decisions below and sufficient merit in the issue put forward;

(4) whether there is some prospect of the appeal succeeding on its merits;

(5) whether there is any clear benefit to be derived from the appeal; and

(6) whether the issue on appeal has been considered by a number of appellate bodies.

12. Other Remedies

In addition to the remedies provided under the Securities Acts, a failure to disclose may lead to the exercise of remedies from other sources. For instance, the security holders who suffered from a failure to disclose may have a civil recourse. Inappropriate disclosure may also prompt the listing exchange to suspend trading in the securities of the issuer. Finally, any trading performed by insiders while material information remained undisclosed may serve as the basis for insider trading allegations under either the Securities Act or applicable corporate legislation.

C. THE *PEZIM* DECISION

The decision of the Supreme Court of Canada in *Pezim v. British Columbia (Superintendent of Brokers)*[113] case constitutes the leading case on the issue of disclosure obligations and has had a considerable impact on the way in which tribunals across the country have approached subsequent Securities Commission decisions.

1. The *Pezim* Case

Messrs. Pezim, Page and Ivany were three of the 15 directors of Prime Resources Corporation ("Prime") and were also directors of Calpine Resources Inc. ("Calpine"). Prime owned approximately 23% of the shares of Calpine. Both Prime and Calpine were reporting issuers (i.e. "public companies") under the British Columbia *Securities Act* and as such were obliged to make timely disclosure of all material changes. In addition, both companies were listed on the then Vancouver Stock Exchange and hence were subject to its rules.

In the spring of 1990, the Superintendent instituted proceedings against Messrs. Pezim, Page and Ivany alleging violation of the disclosure provisions and insider trading provisions in connection with various transactions that occurred during Calpine's 1989 summer drilling programme.

Prior to the commencement of the drilling programme Calpine had put into place a "Chinese Wall" whereby Messrs. Pezim, Page and Ivany were protected from having actual knowledge of the drilling results before they were released to the public. During the summer of 1989, Calpine issued four news releases of increasingly favourable results. During the same period, Calpine issued and repriced options and issued shares to Prime and other insiders.

The Securities Commission ruled the Messrs. Pezim, Page and Ivany should have ensured that there were no undisclosed material changes before engaging in securities transactions. While no breach of the insider trading provisions was found because the

[113] (1994), 92 B.C.L.R. (2d) 145 (S.C.C.)

protection afforded by the Chinese Wall, the Securities Commission held that Messrs. Pezim, Page and Ivany had breached their disclosure obligations, suspended them for one year by removing their trading exemptions and ordered them to pay two-thirds of the costs of the investigation and hearing.

The majority of the British Columbia Court of Appeal reversed the Securities Commission's decision on the technical ground that the drilling results did not constitute a material change in Calpine's assets and, hence, no disclosure was required.

In a unanimous decision, the Supreme Court of Canada (the "SCC") allowed the appeal and reinstated the decision of the Securities Commission. First, the SCC concluded that because of the Securities Commission's expertise and the legislature's intent to give the Securities Commission a very broad discretion, the decisions of the Securities Commission that fall within its area of expertise deserve deference.

Second, the SCC found that drilling results can give rise to material changes:

> *"In the mining industry, mineral properties are constantly being assessed to determine whether there is a change in the characterization of the property. Thus, from the point of view of investors, new information relating to a mining property (which is an asset) bears significantly on the question of that property's value. Accordingly, I agree with the approach taken by the Securities Commission, namely, that a change in assay and drilling results can amount to a material change depending on the circumstances."*

Third, the SCC confirmed the Securities Commission's interpretation of the disclosure obligation and found that the directors and officers of an issuer have a duty to inquire as to the existence of any undisclosed material changes notwithstanding the fact that such a duty is nowhere expressed the legislation.

Fourth, while accepting that the erection of a "Chinese Wall" may prevent directors and officers from having inside information, the SCC held that it does not relieve them of their duty to ensure that no material changes remain undisclosed.

Fifth, the SCC confirmed the Securities Commission's order with respect to costs and held that considerable deference should be given to the decision of the Securities Commission in that respect.

2. Consequences of the *Pezim* Decision

The decision of the Supreme Court of Canada in the *Pezim* case is not important for its findings with respect to the nature of material changes so much as for the clear message it sends to Canadian courts that decisions of the provincial Securities Commissions should be afforded great deference and should not be lightly interfered with.

One of the immediate and direct consequences of the policy statement enunciated in the *Pezim* case is that the courts will be much more reluctant to overrule a Securities Commission's decision which in turn renders the prospect of obtaining leave to appeal even more difficult.

3. Effect of the *Pezim* Decision on Directors and Officers of Reporting Issuers

The *Pezim* decision also sends a clear message to directors and officers of public corporations that they will be personally responsible for the timely disclosure of material changes and that ignorance of their occurrence is no excuse. Company managers must thus put into place an efficient information system within their organization in order to ensure that senior management is always kept abreast of the latest changes affecting the company's business, operations and assets.

All issuers should take steps to reinforce the importance of information within one's company and increase the general understanding of the disclosure requirements that must be complied with. All employees should be made aware of the importance of collecting, safeguarding and handling information in accordance with all legal requirements. Seminars and memoranda to all new staff or a chapter in the Company's personnel manual are common ways of achieving this.

A second step would be to implement and adequate information management system in which information could be safely stored and from which information could be quickly retrieved. Access to information would need to be tightly controlled in order to prevent leaks and permit the creation of "Chinese Walls", which are now recognized as a valid defence to insider trading allegations. Once the information management system is in place, it is crucial that clear guidelines be adopted on how to classify the information and that such guidelines be meticulously complied with.

Since management cannot blindly rely of their staff to pass on the material information the information system should allow management to perform their duty of inquiry by providing up-to-date information. Since members of management may lack the financial resources to adequately defend proceedings instituted by the Securities Commission, and given the responsibilities imposed on directors and officers in connection with continuous disclosure, management should ensure that indemnity agreements and appropriate insurance coverage are in place. Finally, management should consult their legal advisers on a regular basis in order to keep abreast of the developments in this area of the law.

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X. DAMAGE ISSUES IN A CANADIAN SECURITIES CLAIM

This section will canvass three issues that commonly arise when determining damages in the event of an action for securities fraud whether advanced pursuant to a provincial Securities Act or for common law fraudulent and/or negligent misrepresentation.

A. BACKGROUND

Before embarking on a discussion of Canadian damage assessment it is important to point out the fundamental difference between the Canadian and American treatments.

1. Canadian Rejection of the "Fraud on the Market" Theory

D&O insurers in the United States are familiar with the "fraud on the market" theory. However, the "fraud on the market" theory of damages in a securities case has been routinely rejected by Canadian courts[114], except in Quebec.

This doctrine, as it is applied in the U.S., developed out of U.S. federal and judge made law. The theory is based on the idea that a company's price on the open market is determined by the available information regarding the company and its business. A misleading statement will defraud a purchaser of the security even if the purchaser has not relied directly on an alleged misrepresentation. The causal connection between the defendant's fraud and the plaintiff's purchase of stock is no less significant than in a case of direct reliance or misrepresentation.

This doctrine allows for the proof of reliance through the fiction of "market reliance". Every statement made in the marketplace is assumed to affect the price of a stock. Therefore, every purchaser has relied on every statement through this impact. The market's integrity, it is assumed, regulates the price of securities fairly and correctly. A shareholder is presumed to have been misled because the market, given misinformation, is unable to correctly value the security. Ideally, the price paid reflects each and every statement made about the security in the marketplace. The price therefore differed from the security's true value. A shareholder is damaged because the security will necessarily have been bought at too high a price or sold at too low a price.

In Canada, the doctrine of "fraud on the market" has not been adopted except in Quebec. Actual reliance is a necessary component under Canadian law where negligent or fraudulent misrepresentation is pled. The presumption of reliance created by the fraud on the market theory has no application in Canada as a substitute for the requirement of actual reliance in either fraudulent or negligent misrepresentation.

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114 *Kripps v. Touche Ross & Co.* (1990), 52 B.C.L.R. (2d) 291 (S.C.); *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780 (Gen. Div.).

2. Impact on the Assessment of Damages

In the United States, the "fraud on the market" theory provides a mechanism for the assessment of damages through the opinion of experts on the impact of each statement on the market price. This doctrine postulates that upon the revelation of a misrepresentation the impact is immediately experienced in the trading price of the share and thus the difference between the pre-disclosure trading price and the post-disclosure trading price reflects the measure of the damages. So, if there are 1.0 million publicly traded shares in Enron and management discloses that it must restate first quarter earnings - and the share price in Enron drops from $5.00 a share to $4.00 a share following disclosure of the misrepresentation, the measure of damages is 1.0 million shares times $1.00 per share for a total aggregate damages to the class of $1.0 million dollars split evenly among the class members.

In contrast, in Canada, under traditional Anglo-Canadian law relating to misrepresentation, the measure of damages in a misrepresentation case is the difference between the price paid for the share and the true value of the share (measured at the time of purchase) had the misrepresentation not occurred. In practice this results in a smaller measure of damages than the "fraud on the market" theory used in U.S. securities case.

Although the "fraud on the market" theory has been rejected as a basis of liability in Canada this rejection is based on the requirement to prove actual reliance where reliance is not "deemed". Notwithstanding this seeming rejection, it is arguable that the Canadian rejection can be limited to cases involving "deemed" reliance. The utility of the assessment of damages under this theory ought to be applied in Canada as a sophisticated aid to the measurement of damages in class action, particularly where reliance is deemed by a provincial Securities Act[115].

B. THE MEASURE OF DAMAGES UNDER SECURITIES LEGISLATION

As discussed at length in Chapter III, provincial securities legislation provides the right to elect either the remedy of rescission or damages against a defendant. When rescission is chosen, damages against that defendant are forever abandoned. The election of rescission simplifies the litigation considerably since it renders an assessment of damages unnecessary. However, if a shareholder prefers damages, how are they to be quantified?

Provincial securities schemes provide for a right of damages against a broad group of defendants, including the issuer, underwriters, directors and officers, and auditors.

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[115] See, for example, 131(1) of the B.C. Act: *If a prospectus contains a misrepresentation, a person who purchases a security offered by the prospectus during the period of distribution (a) is deemed to have relied on the misrepresentation if it was a misrepresentation at the time of purchase*.

However, the legislation does not prescribe how damages are to be measured, though there are certain liability limits, including:

(1) An underwriter is not liable for more than the total public offering price represented by the portion of the distribution underwritten by him;

(2) The defendants are not to be liable for all or any portion of the damages that they prove do not represent the depreciation in value of the security as a result of the misrepresentation; and

(3) The amount recoverable is not to exceed the price at which the securities were offered to the public.

Canadian law surrounding the measurement of damages for misrepresentation has developed from English law and has been adopted and expanded in Canadian jurisprudence. Subject to one case discussed in more detail below, some of the central elements include:

- The proper measure of damages with respect to misrepresentation in a prospectus is the difference between the purchase money paid for the shares and what would have been a fair price to have been paid for the shares, or, the true value had the misrepresentation not been made: *Davidson v. Tulloch* (1860), 2 L.T. 97; *Derry v. Peek* (1887), 37 Ch. 541, reversed in the result (1889), 14 A.C. 337.

- The measure of damages is the difference between the contract price and the true value of the shares valued as of the date of the contract of purchase. Subsequent fluctuations in the value of the shares following disclosure of the misrepresentations (including an increase in value) are irrelevant: *McConnel v. Wright*, [1903] 1 Ch. 546; *Jamal v. Moola Dawood, Sons & Co.*, [1916] 1 A.C. 175; *Secord v. Global Securities Corp.* (2000), 81 B.C.L.R. (3d) 235.

- Provided that there is an intrinsic value of the shares as of the date of the contract of purchase, the measure of damages as a result of the misrepresentation will usually be calculated as the price paid for the shares minus the value of the shares as of the date of disclosure of the misrepresentation: *Allan v. McLennan* (1916), 31 D.L.R. 617; *Burke v. Cory* (1959), 19 D.L.R. (2d) 252; *Culling v. Sansai Securities Ltd.* (1974), 45 D.L.R. (3d) 456; *Dixon v. Deacon Morgan McEwen Easson et al.* (1993), 102 D.L.R. (4th) 1.

- The decrease in price of the shares as at the date of disclosure of the misrepresentation can be influenced by other investor risks unrelated to the misrepresentation, such as the loss of a major contract or the removal of a CEO under a cloud of suspicion. The measure of damages should be the difference between the purchase price paid and the value of the shares as of the date of disclosure of the misrepresentation nonetheless as the plaintiff would not have been subjected to these investor risks but for the misrepresentation. The "transaction date rule" is intended to avoid the difficulties in measuring damages resultant from investor's risks: *Smith v. Newcourt Securities Ltd.*, [1996] 3 W.L.R. 1051; *Dixon v. Deacon Morgan McEwen Easson et al.* (1993), 102 D.L.R. (4th) 1.

- If the shares were worthless as of the date of the contract of purchase (for example, in the case of the company's insolvency), the measure of damages will be the full purchase price paid for the shares: *Derry v. Peek* (1887), 37 Ch. 541, reversed (1889), 14 A.C. 337; *Twycross v. Grant* (1877), 2 C.P.D. 469; *Broome v. Speak* [1903] 1 Ch. 586; *Fawcett v. Johnson* (1914), 15 N.S.W. State Rep. 51; *Burke v. Cory* (1959), 19 D.L.R. (2d) 252.

- If the plaintiff has sold the shares, the defendant must receive a corresponding credit: *Twycross v. Grant* (1877), 2 C.P.D. 469.

- If subsequent events are considered, the defendants are not liable for any portion of the damages they prove do not represent the depreciation in value of the shares as a result of the misrepresentation.

- In any case, any damages are reduced by sale proceeds received by shareholders who sold or by reason of the failure to take reasonable steps to mitigate for those shareholders who continued to hold post misrepresentation.

While there is relatively little Canadian law on the calculation of damages for statutory securities misrepresentation claims, the one case that must be referenced is that of *Kerr v. Danier Leather Inc.*[116]. The trial decision in *Kerr* is not consistent with the above framework in certain respects.

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116 [2001] O.J. No. 4000

Kerr was a statutory securities class action arising out of misrepresentations in a prospectus. A revised sales forecast, allegedly material and detrimental to the share value, was not included in the prospectus. Upon the information being disclosed to the shareholders following the offering the share price dropped. A few months later the original sales targets were met and the share price rebounded.

After finding liability for the misrepresentation, the trial judge in *Kerr* departed from the analytical approoach that measures the difference between the sale price of the shares and the "fair price" or "true value" of the shares. In *Kerr*, the trial judge concluded that the measure of damages was the difference between the sale price and the price of the shares after the misrepresentation became public and the market had "absorbed" the revised sales forecast. In effect, the Court accepted that the value set by the stock market following the announcement of the revised forecast was necessarily the "fair value" of the shares.

The trial judge in *Kerr* did not conduct any further analysis of the intrinsic value of the shares, as is suggested by the preceding caselaw. It remains to be seen this issue is addressed in future cases.

C. IMPACT OF CLAIMED TAX BENEFITS ON SHAREHOLDERS' DAMAGES

The purchase of flow-through shares results in a tax advantage to the shareholder. Flow-through shares are described by Vijay M. Jog as follows:

> "*Flow-through shares (FTS) are one of several ways in which mining and petroleum companies can finance their exploration and development activities in Canada. These equity instruments receive special income tax treatment and are issued by means of agreements between resource companies and their investors. An investor who purchases FTS from a mining or petroleum company under such an agreement receives both an equity interest in the company and the right to claim income tax deductions for the new expenditures by the company on exploration or development.*
>
> *In exchange for transferring (or renouncing) exploration and development expenses (and the right to the associated income tax deductions) to investors, a resource firm receives for the FTS the price of its common shares plus a premium based on the tax value to the investor of the transferred expenses*."[117]

In acquiring these shares, the shareholders paid a premium for the shares based on the tax value of the transferred expenses. These shares are one of several ways in which companies finance their exploration and development activities and companies. These

[117] "Flow-Through Shares: Premium-Sharing and Trust Effectiveness" (1996), 44 Canadian Tax Journal at p. 1017.

equity instruments receive special income tax treatment and are issued by means of agreements between resource companies and their investors. An investor who purchases shares such as these receives both an equity interest in the company and the right to claim income tax deductions for new expenditures by the company on exploration or development.

In exchange for transferring exploration and development expenses (and the right to the associated income tax deductions) to investors, a resource firm receives the price of the common share plus a premium based on the tax value to the investor of the transferred expenses.

The right to the tax benefit is non-assignable and accrues only to the subscriber of the share. For instance, at the time of the initial distribution, a subscriber has a zero adjusted cost base for tax purposes and the right to deduct the full value of the purchase money for the shares from his personal income. This right arises because under the *Income Tax Act* and pursuant to the terms of the company's prospectus, the corporation has covenanted to expend all the funds raised by the prospectus on Canadian Exploration Expenses ("CEE"). This is the tax advantage for which the shareholder has paid a premium.

The initial shareholders, assuming they actually received the tax advantage for the amount actually expended on CEE, can have their damages calculated on a rescissionary basis, with the Court directing the return of the amount paid, less the actual flow-through premium.

The company and its directors and officers may contend that the statutory securities scheme does not allow a right of action for rescission to co-exist with a right of action for damages and, further, that the shareholder must elect at the outset to claim either damages or rescission.

Under the statutory securities scheme, the purchaser of a share has a right of action for damages against the issuer, the underwriters, the directors and anyone who signed the prospectus, which may include an auditor. Of this group of defendants, there is a specific subset against which rescission can be claimed: *the issuer and the underwriters; but not the directors and officers.*

It is only against the person or company that one has made an election for rescission that cannot be pursued in an action for damages. Namely, this includes the issuer and the underwriters. The provincial securities legislation does not say that an election made against the issuer and the underwriters will preclude an action against the other defendants. Rather, the legislation appears to contemplate an action for rescission against some defendants and an action for damages against others.

A purchaser who exercises a right of rescission has no right of action in damages against the person from whom rescission is claimed. While it may seem logical that the remedies were alternative and exclusive of the other for all purposes, this is not stated in the provincial securities legislation. Technically, the shareholder could rescind the purchase from the vendor and sue others in damages. It is unlikely that a Court would recognize both remedies, particularly because the legislation provides that a defendant will not be liable for damages that do not represent the depreciated value of the security as a result of the misrepresentation. Once the status quo is restored by rescission there are no damages for a shareholder to claim, except to the extent of brokerage fees.

The provincial securities legislation is not clear as to when the election must be made. Normally, one is under no obligation to elect between alternative remedies until trial. A rescission claim has the advantage for the purchaser in that the claim is for liquidated damages. Assessing damages is therefore not necessary. Further, rescission may allow for recovery where no damage flows from the misrepresentation itself. As a practical matter, a claim for damages will usually not be advanced against an issuer or underwriter where the rescission claim is time barred or where the securities have been sold.

Under common law, those who sold their shares would likely be precluded from claiming rescission and would be restricted to damages. The result under the statute may be the same but there is an argument that the statute may allow for rescission after sale.

Defendants may also assert that the filing of a lawsuit itself constitutes an election. If rescission is sought in the Statement of Claim the same person cannot seek damages in the same action except in the alternative.

However, a provincial Securities Act is a remedial piece of legislation. It provides that the remedies of rescission or damages are in addition to and should not derogate from any other remedy that the purchaser may have at law. Shareholders can argue that like other remedial legislation the statute must be construed as a whole with a liberal view to its overriding purpose and to harmonizing the various subsections. Section 8 of British Columbia's *Interpretation Act* R.S.B.C. 1996, c. 238, provides as follows:

> *Every enactment must be construed as being remedial, and must be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.*

So, a shareholder will contend that both remedies can be pursued in a single action. Election can be made up to the time of judgment. It is the election to pursue that remedy which amount to “exercising a right of action”. This has two advantages. First, it endows the word “if” with some real meaning for the collective plaintiffs by preserving the right of an election to a later point of time. Secondly, it ensures that the rights granted to the shareholder are not a derogation from any common law rights.

The purpose of the provincial securities legislation is to ensure that once the election is made to exercise the right of rescission, which can occur at any time, the purchaser cannot also have the benefit of a claim for damage. This dovetails with the legislative requirement that there is no recovery of an amount in excess of the purchase price of the shares. As against the underwriters the remedies are conjunctive but alternative which is the real purpose of this section.

Rescission unwinds a sale transaction. The shareholders are put in the position they would have been had the transaction not occurred. The unwinding requires each plaintiff to return its shares to the issuer or the underwriter who, in turn, would return the purchase price. Therefore, from a shareholder's perspective, rescission is only available to those shareholders who continue to hold their shares as they are the only ones able to return them.

Rescission is not available to a party that has affirmed the transaction sought to be rescinded. Once the election is made, it is determined forever. By accepting a contract and asserting its terms as to performance the shareholder has adopted it and cannot later claim rescission on the ground of the original misrepresentation.

If a shareholder claims a tax benefit associated with a flow through transaction they are arguably barred from claiming rescission because they affirmed their ownership of the shares in taking the tax benefit. Each shareholder could decline to take the benefit. Once affirmed this election can be fatal to the entire claim. The provincial Securities Act requires shareholders to elect either rescission or damages. The election of damages may preclude the shareholders from seeking damages of any kind at trial.

D. LIABILITY FOR LOSS FOR OTHER THAN THE MISREPRESENTATION

In the absence of legislated limits an unlimited right to damages would permit the opportunity for a windfall gain by a purchaser of shares if the prospectus contained a "misrepresentation" which did not affect the value of the security but where the securities declined in value after the distribution for other unrelated reasons, such as a change in interest rates. To prevent this unintended gain the legislation permits the defendant to limit its liability by avoiding damages that are proven not to result from the alleged misrepresentation. Section 131(10) of the British Columbia *Securities Act* provides such an example:

> *In an action for damages under subsection (1), the defendant is not liable for all or any part of the damages that the defendant proves does not represent the depreciation in value of the security resulting from the misrepresentation.*[118]

U.S. law applies the same principle. In *Huddleston v. Herman and MacLean*, 640 F.2d 534 (5th Cir. 1981), the Court stated:

> *"The entire loss to the defrauded buyer from the decline in the value of the securities purchased cannot be automatically attributed to the defendants' deceit unless this court were to adopt a theory of damages that views the entire loss as resulting from the fraud because, 'but for' the deceit, the buyer would not have purchased, and hence would have suffered no loss. The private cause of action under Rule 10(b-5) 'is essentially a tort claim … Thus, the private complainant must show not only a violation of the rule, i.e., an untrue statement or a material omission in connection with the sale of a security, but must also show that the omission or untrue statement resulted in or caused the complainant's damage."*

Therefore, in an action for material omissions or misstatements a shareholder must prove the misrepresentations or omissions caused the loss. No social purpose is served by encouraging those who lose money on an investment to uncover a non-causative misrepresentation and sue. This section does not make issuers in effect "insurers" against other causes of economic loss.

This limitation on liability manifests itself in two ways. First, it can be argued that if the public did not know of the misrepresentation the market price could not have been affected by it. It would be impossible for the market to have taken into account that there was any inaccurate information in the prospectus while unknown. The market operates on the assumption that the publicly disclosed information is accurate. Other factors, other than the unknown misrepresentation, are responsible for any change in share price.

Therefore, any shareholder who sells his or her shares before the misrepresentation is known did not suffer a loss. This was recognized in *Porth v. Merit* (January 7, 2000, Alta. Q.B. unreported):

> *"It's also, I think clear that a former Belfast shareholder who sold his or her Merit shares before November the 15th, 1999 was probably not affected by misrepresentations, and therefore suffered no loss. And certainly after November the 15th some shareholders may have decided to keep their shares."*

In *Green v. Occidental Petroleum*, 541 F.2d 1335 (9th Cir. C.A. 1976), the Court stated:

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[118] Corresponding provisions can be found it each province's *Securities Act* (except Quebec): Alberta, s. 203(9); Saskatchewan, s. 137(8); Manitoba, s. 97(9); Ontario, s. 130(7); New Brunswick, s. 149(8); Prince Edward Island, s. 16(7); Nova Scotia, s. 137(7) and Newfoundland, s. 130(7)

> *"Purchasers during the period in question who sell before disclosure present a somewhat more difficult issue."*

The difficulty springs from uncertainty about whether the spread between the price and value lines remained constant during the entire period. Assuming for the moment that the spread remained constant, class member purchasers who sold before disclosure have recovered from the open market the "cost" of the misrepresentations. To permit such a purchaser-seller to recover the same "cost", namely the spread between the price and the value lines at the date of purchase, from the defendant would be to provide the shareholder with "double recovery".

Shareholders who purchase pursuant to a prospectus and then sell prior to the revelation of a misrepresentation take advantage of an arguably inflated market value on their purchase and sale. No loss is suffered. For those shareholders to recover damages after the discovery of a misrepresentation would also be to permit "double recovery".

Second, it can be argued that a relatively small portion of the share price depreciation to the date of revelation of the misrepresentation results from the misrepresentation. This alternate analysis attributes some portion of the share price depreciation to the misrepresentation and some to other causative factors. Many factors, both specific to the industry of the issuing company and to the company itself, can result in the depreciation of share value. For example, a decline in the value of peer group companies, lower production rates, missed targets or a loss of confidence by influential analysts can all negatively effect the value of a company's shares.

XI. RESCISSION IN LIEU OF DAMAGES

This chapter will discuss the right of a shareholder, under the various provincial Securities Acts, to elect, within a defined time period, the remedy of rescission in lieu of damages. It will also discuss how the election of this remedy poses somewhat of a conflict for a D&O insurer since the obligation of an insurer under a D&O policy is to pay any award of damages or an agreed settlement. A claim for rescission is restitutionary in nature rather than compensatory. Therefore, a claim for rescission would not constitute "loss" under the D&O policy.

A. THE STATUTORY REMEDY OF RESCISSION

Rescission is an unmaking of a contract. Where a plaintiff is successful in claiming rescission, the parties are restored to their original positions and the contract is treated as if it never existed. This is different from a claim for damages for breach of contract. Damages are a right pursuant to an existing contract that has been breached.

Provincial securities legislation provides that a purchaser of securities may elect to exercise a right of rescission against a particular sub-group of defendants, including the issuer or a selling security holder and underwriters. Section 131(3) of British Columbia's *Securities Act* follows as an example:

> *If a prospectus contains a misrepresentation, a person who purchases a security offered by the prospectus during the period of distribution…*
>
> *(b) has a right of action for damages against*
>
> > *(i) the issuer or a selling security holder on whose behalf the distribution is made,*
> >
> > *(ii) every underwriter of the securities who is required under section 69 to sign the certificate in the prospectus,…*
>
> *(3) If the person referred to in subsection (1) purchased the security from a person or underwriter referred to in subsection (1) (b) (i) or (ii) or from another underwriter of the securities, the <u>purchaser may elect to exercise</u> <u>a right of rescission against that person or underwriter</u>, in which case the purchaser has no right of action for damages against that person under subsection (1).*

The legislation allows a claim for rescission against the subset of defendants referred to in section 131(1)(b)(ii) ("Subset of Defendants") to proceed in conjunction with claims for damages against other defendants. However, if the purchaser elects to exercise a right of rescission against a defendant that falls within the Subset of Defendants, there is no cause of action for damages against those defendants as well.

1. When is the Election by the Plaintiff Made?

The legislation is silent on when the election has to be made. Defendants will attempt to assert that a shareholder has somehow elected one remedy and is forever precluded from advancing the other.

From a shareholder's perspective, the ability to claim both remedies should be available until the time of judgment. However, if the shareholder is successful at trial and the status quo is restored through rescission, it is unlikely that a shareholder would then be entitled to damages.

Election at trial is consistent with the general common law approach to remedies. A claim for rescission has an advantage to a shareholder because the claim advanced is for a liquidated sum, i.e. the entire investment. Therefore, the calculation of the liquidated sum is straightforward. Rescission also carries the potential for recovery where no damages flow from the misrepresentation itself. As a practical matter, a claim for damages will usually not be advanced against an issuer, or if the issuer is insolvent against those directors and officers with D&O insurance, except where the rescission claim is time barred or where the securities have been sold.

Section 140 of British Columbia's Act provides an example of the applicable limitation periods for a claim of rescission:

> *Unless otherwise provided in this Act or in the regulations, an action to enforce a civil remedy created by this Part or by the regulations must not be commenced*
>
> *(1) in the case of an action for rescission, more than 180 days after the date of the transaction that gave rise to the cause of action, or*
>
> *(2) in the case of an action other than for rescission, more than the earlier of*
>
> (i) *180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or*
>
> (ii) *3 years after the date of the transaction that gave rise to the cause of action.*

The limitation period for an action for rescission is stricter than at common law. One of the reasons that the statutory limitation period is shorter than at common law is to protect defendants from the drastic effects rescission may have on corporate assets.

2. Is Rescission Available to the Plaintiff if the Securities have been Sold?

At one time under common law rules those who had sold their shares would be precluded from claiming rescission and would be restricted to damages. There is nothing to rescind where a shareholder has divested him or herself of the share. However, in more recent times this common law rule has not applied very strictly. In *Snell's Equity* it is stated*:*

> "*In general, a contract that is liable to be rescinded remains valid until it is set aside. A contract may cease to be capable of being rescinded as where the parties cannot be restored to their original position…But the rule is not applied very strictly; for equity will relieve wherever it can do what is practically just, even though it cannot restore the parties precisely to the state in which they were before the contract was made*."[119]

There is an argument that under provincial securities legislation the statute allows for a right of rescission after sale. Provincial Securities Acts, where they deal with purchases

[119] John McGhee, *Snell's Equity*, 3rd ed. (London: Sweet & Maxwell, 2000) at p. 688.

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from a registered dealer as principal in a non-prospectus context, provide that rescission is only available if the purchaser still beneficially owns the security. Section 138 of the British Columbia Act is an example:

> *If section 51 (2)* [dealing with a registered dealer] *applies to a contract and is not complied with, a person who has entered into the contract may rescind it by sending a written notice of rescission to the registered dealer within 60 days of the date of the delivery of the security to the person or by the person* ***if the person is****, at the time the notice of rescission is given,* ***the beneficial owner of the security purchased.***

In contrast, the provisions of the legislation dealing with misrepresentation in a prospectus are silent on the requirement that the security still be owned:

> *131(1) If a prospectus contains a misrepresentation, a person who purchases a security offered by the prospectus during the distribution…*
>
> *(3) If the person referred to in subsection (1) purchased the security from a person or underwriter referred to in subsection (1) (b) (i) or (ii) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against that person or underwriter, in which case the purchaser has no right of action for damages against that person under subsection (1).*

It is therefore arguable that this latter silence results in there being no ownership requirement. If rescission is available after sale, presumably a successful shareholder will have to go back into the market after trial and buy securities to fulfil its obligation to re-convey on rescission being granted. If the rescission right continues to exist notwithstanding a sale this would be another advantage of a statutory action over a common law right of action as it would avoid a damage calculation. Rescission may also be preferable to a shareholder where the actual damages are less than the recovery resulting from being put back into the situation that existed prior to the misrepresentation.

Arguably, the availability of election up to the time of judgment is the interpretation that gives meaning to all the relevant provisions of the Securities Act. The remedy of rescission is available at any time, at the election of the purchaser. Provincial securities law allows a plaintiff to "exercise a right of rescission". Provincial law further provides that rights conferred on a shareholder in an action for rescission are not to be derogated from any other rights. The relevant provision in the British Columbia Act follows:

> *131(14) The right of action for rescission or damages conferred by this section is in addition to and not in derogation from any other right the purchaser may have.*

To realize the intent of the provincial legislatures election must be available at any time.

The purpose of this assurance is to ensure that once rescission is elected the purchaser cannot also have the benefit of a claim for damages. This enhances the effect of the legislation, which indicates that the purchaser cannot recover an amount that exceeds the purchase price of the shares.[120] Thus, the remedies are available up to judgment, which ensures that a shareholder will receive a full, but not excessive, recovery. The purpose of the legislative scheme is not to force the purchaser into an early decision concerning remedy than that provided by the common law or to prohibit an initial claim for both remedies.

If an election between remedies was required at the time the action was commenced the purchaser would have to guess as to the availability of a due diligence defence before commencing an action. If they guessed incorrectly they would have no remedy since damages would be precluded.

3. Are Plaintiffs who have taken the Benefit of Tax Deductions Entitled to Rescind their Purchase?

In some instances shareholders who have purchased securities, such as flow-through shares, may receive the benefit of tax deductions.

In cases where a shareholder has received the benefit of tax deductions available as a result of his or her purchase of the securities, defendants contend that in accepting the tax benefits resulting from ownership of the securities the shareholders have affirmed their ownership of such shares. In affirming the ownership of the shares the shareholders are now barred from claiming rescission. The Ontario Court of Appeal in *Panzer v. Zeifman* has stated:

> "*the purchaser lost whatever right he had to rescission when he elected to affirm the contract. Such an election, once made, is determined forever. By accepting the contract and asserting its terms as to performance he has adopted it, and so he cannot now claim rescission on the ground of the original misrepresentation*."[121]

Conversely shareholders argue that accepting the tax benefits accruing from the purchase of the securities does not constitute an affirmation of the contract. Further, shareholders argue that in order to put the parties in their original positions, one way of adjusting the amount owed by the vendor or underwriter of the securities on a rescissionary basis is to direct the return of the original amount paid by the shareholder for the securities less the flow-through premium.

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[120] See for example, s.131(13) of B.C.'s legislation.

[121] (1978), 88 DLR (3d) 131 at 137 - 38 (OCA).

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B. COVERAGE ISSUE ARISING OUT OF A CLAIM FOR RESCISSION

Initially the shareholder will likely advance a claim for both rescission and damages. Under a D & O Policy, the insurer is obligated to indemnify the directors and officers for "Loss", which typically is defined as follows:

> ***"Loss"*** *shall mean* ***compensatory damages****, punitive, aggravated or exemplary damages, the multiple portion of any multiplied damage award, settlements and* ***Costs of Defense****, provided, however,* ***Loss*** *shall not include criminal or civil fines or penalties imposed by law, taxes, or any matter which may be deemed uninsurable under the law pursuant to which this Policy shall be construed…*

The obligation of an insurer under a D&O policy is to reimburse for any award of damages, or an agreed settlement, and costs of defence. If at the pleading stage a shareholder has not specifically elected to claim *only* rescission then the D&O insurer is obliged to defend the claim given that the claim for damages is "Loss" and where it otherwise falls within coverage.

In the initial stages of handling a claim against the directors and officers the insurer should handle the claim on the basis of a reservations of rights letter that addresses claims that fall within and outside coverage and the allocation of defence costs. Typically a D&O policy contains an allocation clause, an example of which is as follows:

> *If a Claim made against any Insured includes* ***both covered and uncovered matters, or is made against any Insured and others,*** *the Insured and the Insurer recognize that there must be an allocation between Insured and uninsured Loss.* ***The Insureds and the Insurer shall use their best efforts to agree upon a fair and proper allocation between insured and uninsured Loss.***

At the pleadings stage, the allocation of defence costs between the uncovered claim of rescission and the covered claim of damages could be premised on a 50/50 split between the insured and the insurer. Further, the insurer should advise the insured that if at a later stage, the plaintiff elects to proceed only with a claim for rescission instead of damages that repayment does not constitute "Loss" and, as of the date of the election, the insured could be responsible to pay 100% of the defence costs on a going forward basis.

For the purposes of coverage, this repayment does not constitute "Loss" under the policy since the shareholder has not suffered a pecuniary deprivation akin to damages. Effectively the shareholder returns the shares and receives a payment that puts him or her back in his or her original position. As such, there is no "Loss" as defined in the D&O policy.

There is a dearth of Canadian caselaw addressing the issue of whether a restitutionary claim, such as a claim for rescission, is "Loss" under a D&O policy. However, this issue was argued in the U.S. case of *Level 3 Communications Inc. v. Federal Insurance Company*[122]. In *Level 3* the insured successfully sued the D&O insurer alleging it was liable for reimbursement of the settlement amount the insured paid to settle an underlying securities fraud action. The insurer appealed.

In the underlying securities fraud action, shareholders alleged that the insured sold shares to the insured based on fraudulent representations of the insured. The Court of Appeal granted the insurer's appeal and concluded that the insured's restitution of its ill-gotten gains did not constitute a "Loss" for which the insurer could be held liable.

C. CONCLUSION

Where rescission is available remedy to a class of shareholders, it is important to analyze the relevant coverage issues at an early stage, issue a reservation of rights letter and discuss your position with the insured.

XII. CONCLUSION

It is reasonable to expect the number of securities-related class actions in Canada to increase over the coming years. This is particularly true given the relative ease with which class actions are certified in Canada as opposed to the U.S. And, with the spotlight continuing to shine on corporate governance issues, it is likely that many of these class actions will implicate D&O insurance policies. It behoves us all to recognize the massive exposure inherent in class action suits and to begin considering ways to limit the impact of such suits when they inevitably arise.

[122] 272 F. 3d 908, 2001 U.S. App. Lexis 25132 (*"Level 3"*).

XIII. APPENDIX 1

STATUTORY CAUSE OF ACTION IN SECURITIES LEGISLATION WITHIN CANADA	
Province/Territory	**Legislation**
British Columbia *Securities Act,* R.S.B.C. 1996, c. 418	131(1) If a prospectus contains a misrepresentation, a person who purchases a security offered by the prospectus during the period of distribution (a) is deemed to have relied on the misrepresentation if it was a misrepresentation at the time of purchase, and (b) has a right of action for damages against (i) the issuer or a selling security holder on whose behalf the distribution is made, (ii) every underwriter of the securities who is required under section 69 to sign the certificate in the prospectus, (iii) every director of the issuer at the time the prospectus was filed, (iv) every person whose consent has been filed as prescribed, and (v) every person who signed the prospectus.
Alberta *Securities Act,* R.S.A. 2000, s. S-4	203(1) If a prospectus contains a misrepresentation, a purchaser who purchases a security offered by it during the period of distribution is deemed to have relied on the misrepresentation and has a right of action for damages against (a) the issuer or a selling security holder on whose behalf the distribution is made, (b) each underwriter of the securities who is required to sign the certificate referred to in section 117, (c) every director of the issuer at the time the prospectus was filed, (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been

	made by them, and (e) every person or company, other than the ones referred to in clauses (a) to (d), who signed the prospectus.
Saskatchewan *Securities Act, 1988*, S.S. 1988-89, c. S-42.2	137(1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered by them during the period of distribution is deemed to have relied on that misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against: (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required to sign the certificate required by section 67 or an alternative certificate pursuant to section 68; (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and (e) every person who or company that, in addition to the persons or companies mentioned in clauses (a) to (d), signed the prospectus or the amendment to the prospectus.
Manitoba *Securities Act*, C.C.S.M., c. S50	141 Where a receipt for a prospectus has been issued by the director, notwithstanding that the receipt is thereafter revoked, every purchaser of the securities to which the prospectus relates shall be deemed to have relied upon the statements made in the prospectus whether the purchaser has received the prospectus or not, and, if a material false statement is contained in the prospectus, every person who, at the time of the issue of a receipt for the prospectus, is a director of a company issuing the securities or a person or company that signed the certificate required by section 52 is liable to pay compensation to all persons or companies who have purchased the securities for any loss or damage the persons or companies have sustained as a result of the purchase unless it is proved

Ontario *Securities Act*, R.S.O. 1990, c. S-5	130(1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against, (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required to sign the certificate required by section 59; (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and (e) every person or company who has signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d), or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter in which case the purchaser shall have no right of action for damages against such person, company or underwriter.
Quebec *Securities Act*, R.S.Q., V-1.1	217. A person who has subscribed for or acquired securities in a distribution effected with a prospectus containing a misrepresentation may apply to have the contract rescinded or the price revised, without prejudice to his claim for damages. The defendant may defeat the application only if it is proved that the plaintiff knew, at the time of the transaction, of the alleged misrepresentation. 218. The plaintiff may claim damages from the issuer or the holder, as the case may be, whose securities were

	distributed, from its senior executives, or from the dealer under contract to the issuer or holder whose securities were distributed. 219. The plaintiff may also claim damages from the expert whose opinion, containing a misrepresentation, appeared with his consent, in the prospectus.
New Brunswick *Securities Act*, R.S.N.B., c. S-5.5	149(1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against, (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required by the regulations to sign a certificate required to be contained in the prospectus; (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) every person or company whose consent has been filed as required by the regulations but only with respect to reports, opinions or statements that have been made by the person; and (e) every person who signed the prospectus or the amendment to the prospectus other than the persons referred to in clauses (a) to (d). 149(2) Where the purchaser purchased the security from a person referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such a person or underwriter, in which case the person shall have no right of action for damages against the person or underwriter.
Nova Scotia *Securities Act*, R.S.N.S. 1989, c. 418	137 (1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time

	of purchase and has a right of action for damages against (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required to sign the certificate required by section 64; (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and (e) every person or company who has signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d), or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, he may elect to exercise a right of rescission against such a person, company or underwriter, in which case he shall have no right of action for damages against such person, company or underwriter.
Prince Edward Island *Securities Act*, R.S.P.E.I. 1988, c. S-3	16(1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required to sign the certificate required by section 8.6; (c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and

	(e) every person or company who has signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d), or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, he may elect to exercise a right of rescission against such person, company or underwriter, in which case he shall have no right of action for damages against such person, company or underwriter.
Newfoundland *Securities Act*, R.S.N. 1990, c. S-13	130 (1) Where a prospectus together with an amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered by it during the period of distribution or distribution to the public is considered to have relied on the misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against (a) the issuer or a selling security holder on whose behalf the distribution is made; (b) each underwriter of the securities who is required to sign the certificate required by section 60; (c) a director of the issuer at the time the prospectus or the amendment to the prospectus was filed; (d) a person or company whose consent has been filed under a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and (e) a person or company who has signed the prospectus or the amendment to the prospectus other than the persons or companies included in paragraphs (a) to (d), or, where the purchaser purchased the security from a person or company referred to in paragraph (a) or (b) or from another underwriter of the securities, he or she may elect to exercise a right of rescission against the person, company or underwriter, in which case he or she shall have no right of action for damages against the person, company or underwriter.

Yukon *Securities Act*, R.S.Y. 2002, c. 201	25(1) A person or company that is a party to a contract as purchaser resulting from the offer of a security to which section 22 applies has a right to rescind the contract while still the owner of the security if the prospectus, any amendment to the prospectus, or the statement of material facts then filed with the registrar in compliance with section 22 received by the purchaser as of the date of receipt, contains an untrue statement of material fact or omits to state a material fact necessary in order to make any statement therein not misleading in the light of the circumstances in which it was made.
North West Territories and Nunavut *Securities Act*, R.S.N.W.T. 1988, c. S-5	30(1) A person or company that is a party to a contract as a purchaser resulting from an offer to a security to which section 27 applies has a right to rescind the contract while that person or company is the owner of the security if, as of the date that the amendments to the prospectus filed with the Registrar under section 27, the prospectus or any amendment to the prospectus (a) contains an untrue statement of a material fact; or (b) omits to state a material fact necessary in order to make a statement contained in the prospectus or amendment not misleading in the circumstances in which the statement was made.

XIV. APPENDIX 2

U.S. CLASS PROCEEDINGS LEGISLATION AND EQUIVALENT RULES IN SELECT CANADIAN PROVINCES

Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Parties to Class Action	- plaintiffs & defendants **R. 23(a)**	- plaintiffs only **art. 999**	- plaintiffs & defendants **ss. 1-4**	- plaintiffs only - residency requirement **ss. 1-3**	- plaintiffs & defendants **ss. 2-3**
Criteria for Certification of Classes and Sub-Classes	- ascertainable class - numerosity - commonality - typicality - adequacy of representation <u>3 different types of class action (often overlap)</u> (i) **23(b)(1)** – risk of inconsistent verdicts or prejudice to rights of others (ii) **23(b)(2)** – injunctive or declatory relief in respect of common conduct (iii) **23(b)(3)** – common questions predominate over ind. questions and class action is superior method of resolving dispute (iv) **23(c)(4)(b)** – subclasses	- identical, similar or related issues - facts alleged justify conclusion - joinder impractical - adequate representation **arts. 1003, 1022**	- disclose cause of action - identifiable class of two or more - common issues -class action preferable - representative plaintiff would adequately represent the class or sub-class - certain differences among class members not bar to certification **ss. 5-6**	- disclose cause of action - identifiable class of two or more - common issues -class action preferable - representative plaintiff would adequately represent class or sub-class - certain matters not bar to certification **ss. 4-7**	- disclose cause of action - identifiable class of two or more - common issues - class action preferable - representative plaintiff would adequately represent the class or sub-class - certain matters not bar to certification **ss. 5-8**

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Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Refusal to Certify **Decertification**	- action can continue but not as class action - court has power to decertify **R. 23(c)(1)** **R. 23(d)(4)**	- action can continue but not as class action - court has power to decertify **arts. 1022, 1026**	- action can continue but not as class action - court has power to decertify **ss. 7, 10**	- action can continue but not as class action - court has power to decertify **ss. 9-10**	- action can continue but not as class action - court has power to decertify **ss. 10-11**
Notice Provisions **- notice of certification** **- notice of determination of common issues** **- notice for individual participation**	- best practical notice - right of individual participation **R. 23(c)(2)** **R. 23(d)(2)**	- description of group, common questions, right to participate or opt out etc. - publication of notice of final judgment **arts. 1005, 1006, 1030, 1046**	- representative party to notify other class members of proceeding and right to participate - notice to class members may be necessary where individual participation is required to determine individual issues - court may apportion costs of notification among parties **ss. 17-22**	- representative party to notify other class members of proceeding, and right to participate - notice of determination of common issues mandatory - court may apportion costs of notification among parties **ss. 19-24**	- representative party to notify other class members of proceeding, and right to participate - notice of determination of common issues mandatory - court may apportion costs of notification among parties **ss. 20-25**
Opting Out of Class Actions	- right to opt out - judgment binding if do not opt out **R. 23(c)(2)**	- right to be excluded - judgment not binding where exclusion requested **arts. 1007, 1008**	- right to opt out - if opt out, judgment not binding **ss. 9, 27**	- right to opt out - if opt out, judgment not binding **ss. 16, 26** - right of non-residents to opt in **s. 16(2)**	- right to opt out - if opt out, judgment not binding **s.17, 27** - right of non-residents to opt in **s. 17(2)**

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Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Discovery	- R. 23 is silent - use of judicial discretion in determining scope of discovery rights	- unless court orders otherwise, discovery only permitted of representative member or intervener **arts. 1019**	- generally only representative party may be discovered - court has discretion to order discovery of others **ss. 15, 16**	- generally only representative party may be discovered - court has discretion to order discovery of others **ss. 17, 18**	- generally only representative party may be discovered - court has discretion to order discovery of others **s. 18, 19**
Participation of individual class members allowed – court to exercise discretion	**R. 23(c)(C)**	**arts. 1017, 1018**	**s. 14**	**s. 15**	**s. 16**
Powers of Court to Determine Conduct of Proceeding	- power to prevent undue repetition or complication **R. 23(d)(1),(3), (4),(5)**	- court may prescribe measures to hasten progress - deemed opting out if member does not stay related proceeding **arts. 1008, 1045**	- court may make any orders and impose terms to ensure fair and expeditious determination - court may stay related proceedings **ss. 12, 13**	- court may make any orders and impose terms to ensure fair and expeditious determination - court may stay related proceedings **ss. 12, 13**	- court may make any orders and impose terms to ensure fair and expeditious determination - court may stay related proceedings **ss. 13, 14**
Aggregate Assessment of Monetary Relief	- Rule 23 is silent on avail. of aggregate relief or on methods of distribution of award - avail. of relief and methods of distribution are judicially determined	- court can order collective or ind. recovery of claims - court can bifurcate proc. between common and ind. issues for assessment of ind. liability and/or damages **arts. 1028**	- court may make aggregate monetary award without proof from individual members - award may be applied on average or prop. basis - individual claims/proof may be necessary - statistical evidence admissible - facilitation of proof of ind. claims through auditing or sampling available **s. 23, 24**	- court may make aggregate monetary award without proof from individual members - award may be applied on average or prop. basis - individual claims/proof may be necessary - statistical evidence admissible - facilitation of proof of ind. claims through auditing or sampling available **s. 29, 30, 31**	- court may make aggregate monetary award without proof from ind. members - award may be applied on average or prop. basis - individual claims/proof may be necessary - facilitation of proof of ind. claims through auditing or sampling avail. **s. 30, 31**

Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Determination of Individual Issues and Assessments	- allows class action to be brought only with respect to particular issues, if necessary - no statutory provisions regarding individual assessments **R. 23(c)(4)(A)**	- judgment on common issues may still be subj. to determination of ind. liability or assessments - court may render judgment on individual claims **arts. 1037-1039**	- court may order determin. of ind. issues or assessments of liability as necessary after granting judgm. on common issues binding on all members of class - procedures for facilitating determination of individual issues **ss. 24(4), 25**	- court may order determin. of ind. issues or assessments of liability as necessary after granting judgm. on common issues binding on all members of class - procedures for facilitating determination of individual issues **ss. 27, 28, 32**	- court may order determin. of ind. issues or assessments of liability as necessary after granting judgm. on common issues binding on all members of class - procedures for facilitating determination of individual issues **ss. 28, 29, 32**
Distribution of Award	Rule 23 is silent regarding distribution of award - methods of distribution differ depending on jurisprudence (some courts willing to approve non-traditional methods of distributing awards	- defendant can be required to pay award into court or to carry out a reparatory measure - either collective or ind. distrib. of claims available - costs and attorney fees must be paid before award is distributed - court has discretion to det. terms and cond. of payment - court has discretion to det. payment of balance – no req. that it be returned to defendant **arts. 1032-1035**	- court has wide range of powers to order distrib. of awards, incl. distrib. by abatement or credit - def. may be req. to rely on internal records to distribute award - court can order award be applied in any manner reas. expected to benefit class members, even if no ind. awards distributed - court can order cy–press distrib. of award (i.e. some persons who aren't class members may benefit - unclaimed amounts must be returned to def. **s. 26**	- court has wide range of powers to order distrib. of awards, incl. distrib. by abatement or credit - def. may be req. to rely on internal records to distribute award - court can order award applied in any manner reas. expected to benefit class members, even if no ind awards distributed - court can order cy–press distrib. of award (i.e. some persons who aren't class members may benefit - unclaimed amounts must be returned to def., but may also be applied against the cost of proceeding or forfeited to the govt. **s. 33, 34**	- court has wide range of powers to order distrib. of awards, incl. distrib. by abatement or credit - def. may be req. to rely on internal records to distribute award - court can order award be applied in any manner reas. expected to benefit class members, even if no ind. awards distributed - court can order cy–press distrib. of award (i.e. some persons who aren't class members may benefit - unclaimed amounts can be used or distributed as court considers appropriate **s. 33, 34**

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Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Settlement, Discontinuance Abandonment Dismissal	- class action cannot be settled or dismissed without court approval and proper notification **R. 23(e)**	- action cannot be discontinued without court's permission - unless the settlement is for the full amount, it must first be approved by the court - notice of the settlement must be given **arts. 1016, 1025**	- action cannot be settled, discont. or abandoned without ct approval - settlement binding only if approved by court - notice of dismissal, discont., abandonment or settlement may be required **s. 29**	- action cannot be settled, discont. or abandoned without court approval - settlement binding only if approved by court - notice of dismissal, discont., abandonment or settlement may be required **s. 35**	- action cannot be settled, discont. or abandoned without court approval - settlement binding only if approved by court - notice of dismissal, discont., abandonment or settlement may be required **s. 35**
Appeals	- no provision in Rule 23 - defendant has no right of appeal against a certif. order - pl. may not immed. appeal denial of certif., except with leave (without leave, pl. can appeal only after a "final order"	- representative plaintiff can appeal a denial of certification but defendant has no right of appeal against a certification order - final judgment on common issues can be appealed to the Court of Appeal - Court of Appeal can remand certain matters to trial court **arts. 1010 and 1041-1044**	- rep. pl. may appeal a denial of certification or decertif. to the Di*v*. Ct. - leave to appeal is req. to appeal order granting certification - any party may appeal judgm. on common issues or an aggregate award of damages to Court of Appeal - ind. claims, ind assessments, or dismissals thereof may be appealed to the Di*v*. Ct., with or without leave depending on monetary value of award **R. 30**	- plaintiff and defendant may appeal to Court of Appeal from a certification order, an order refusing certification, a final judgment on common issues - any party may appeal, with leave of the Ct. of Appeal, any order determ. or dismissing individual claim - if rep. pl. does not appeal, member may apply to Ct. of Appeal for leave to act as rep. pl. **s. 36**	- plaintiff and defendant may appeal to Court of Appeal from a certification order, an order refusing certification, a final judgment on common issues - any party may appeal, with leave of the Ct. of Appeal, any order determ. or dismissing individual claim - if rep. pl. does not appeal, member may apply to Ct. of Appeal for leave to act as rep. pl. **s. 36**

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Jurisdiction	U.S. Rule 23	Quebec	Ontario	BC	Alberta
Costs and Counsel Fees	- no provision in Rule 23 reg. costs or fees - although some exceptions exit, gen. rule is that each side must bear own costs, regardless of success or failure at trial or on appeal - rep. pl. may bring action without fear of large cost award against such Pl. if action is unsuccessful - class actions can be undertaken on a contingency fee basis, either on a percentage approach or based on modified contingency fee arrangement (base fee plus multiplier) - counsel fees may be subject to court approval	- costs awarded to successful party - rep. pl. is pers. liable for def.'s costs if action unsuccessful - other members not liable for costs - amount of fees which successful def. can claim against rep. pl. limited to tariff estab. for claims between $1,000-$3,000, such that def. effectively bears costs of def. action - attorney's fees paid out of monetary award before distrib. - contingency fee arrangements are possible - rep. pl. can also apply to receive public funding from Fonde d'aide au recours collectif to cover disbursements and legal fees - if funding is approved, the Fonds also indemnifies the rep. pl. against any adverse costs award if the class action is unsuccessful **arts. 1035(2) and 1050.1**	- costs are gen. awarded to successful party, and are within the discretion of ct. ("two-way" costs rule) - if class action not successful, only the rep. pl. can be liable for the def's costs; however, class members can be liable for def's costs with respect to determ. of their own ind. claims (although tariff costs limited to that of the Small Claims Court) - a rep. pl. can apply for public funding from the Class Proceeding Fund; if granted, funding covers disburs. (but not legal fees) and indemnifies the rep. pl. against adverse cost award if class action unsuccessful - agreement resp. counsel fees must be in writing and approved by ct. in order to be enforceable - any amounts owing under such agreement are first charge on settlement funds or monetary award - modified contingency fees are allowed, subject to ct. approval of the solicitor's base fee the appr. multiplier **ss. 31-33**	- adopts the US "no costs" rule, such that each party must bear own costs in any event - court retains discretion to award costs if either party has acted in a vexatious manner, has taken improper or unnecessary steps, abused process of court, or if exceptional circumstances make it "unjust" to deprive the successful party of costs - class members liable for costs with respect to determination of own individual claims only - agreement respecting counsel fees must be in writing and approved by court to be enforceable - any amounts owing under such agreement are first charge on settlement funds/ monetary award - contingency fees allowed, subject to ct's approval **ss. 37, 38**	- costs assessed as per the Alberta Rules of Court and as such a representative plaintiff could be liable for full value of defendants' costs on a dismissal - agreement respecting counsel fees must be in writing and approved by court prior to or at the certification motion to be enforceable - any amounts owing under such agreement are first charge on settlement funds/ monetary award - contingency fees allowed, subject to ct's approval **ss. 37, 38, 39**