
LITIGATION – SECURITIES

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INTRODUCTION

The securities litigation landscape in Canada continues to evolve as increasing numbers of claims alleging misrepresentation in offering and secondary market disclosure documents are commenced and motions for leave and certification litigated.

Unfortunately for defendants, the courts appear to be leaning toward the adoption of a low evidentiary standard for granting leave to commence statutory claims for misrepresentation in secondary market disclosure documents, and a relaxed test for certification of common law misrepresentation claims both in relation to reliance and duty of care.

STATUTORY SECONDARY MARKET LIABILITY

a) The Test For Leave

Canadian provincial securities legislation now includes a statutory cause of action for misrepresentation in secondary market disclosure documents and oral statements. A common feature of the legislation is the requirement to obtain leave of the court in order for the claim to proceed.¹

To date, the interpretation of the test for obtaining leave under s. 138.8(1) of the Ontario *Securities Act* has been considered in only two cases. No cases on this point appear to have been decided in other provinces.

In *Silver v. IMAX Corp.* ("*IMAX*"),² the first case to consider this issue, the Ontario Superior Court set a low bar for satisfying the merits-based test for obtaining leave.

According to van Rensburg J., on an application for leave, the plaintiff need establish only that there is a mere or *de minimis* possibility of success at trial, based upon a reasoned consideration of the evidence and taking into account the evidentiary limitations of the motion procedure. Once the plaintiff adduces some evidence that the defendant made a misrepresentation, the onus shifts to the defendant to satisfy the court that the evidence in support of one of the statutory defences is strong enough to "foreclose the plaintiffs' reasonable possibility of success at trial."³

Following the decision of the Supreme Court of Canada in *Kerr v. Danier Leather Inc.*⁴ dealing with alleged prospectus misrepresentations, Justice van Rensburg also concluded that the business judgment rule has no application to the statutory defence of reasonable investigation in relation to decisions about secondary market disclosure. Rather, the statutory secondary market disclosure regime creates strict liability for material misrepresentations, "with a reverse onus on defendants to establish a reasonable investigation or other defence."⁵ To read in a standard of deference to directors' decisions about disclosure would be inconsistent, in Her Honour's view,

with the purpose of the statutory remedy, which is to protect investors and the capital markets.

Ultimately, leave was granted to permit claims against IMAX Corp. and certain of its officers and directors to proceed. In a separate decision, the same judge granted the plaintiffs' motion for certification.⁶

The defendants' application for leave to appeal the decision to certify was denied by the Divisional Court. In denying leave to appeal, the Divisional Court stated that the defendants had failed to establish that there was "good reason to doubt the correctness" of the decision on the facts found by Justice van Rensburg.⁷ Granting leave under s. 138.8 was "not a close call."⁸ In other words, even if the defendants were correct that a higher standard for granting leave ought to have been applied, the facts were such that leave would have been granted anyway. This leaves open the question of the correct interpretation of the test to another day.

In *Dobbie v. Arctic Glacier Income Fund* ("*Arctic Glacier*"),⁹ leave under s. 138(8) also was granted. Justice Tausendfreund described the statutory test for granting leave, which requires leave to be granted only where the court is satisfied that there is "a reasonable possibility that the action will be resolved at trial in favour of the plaintiff", as requiring more than a "mere possibility" of success, but something less than a probability.¹⁰ However, precisely how much more than a mere possibility of success is required is difficult to discern from the decision.

Regrettably, the standard for granting leave applied in *IMAX* and *Arctic Glacier* appears to foreclose exercise by the courts of a meaningful role in screening out claims having a low probability of success at trial.

b) Dilemmas for Defence Counsel On Motions for Leave

Preliminary rulings on procedural aspects of such motions highlight the strategic dilemmas facing counsel defending these claims, including whether to risk exposing clients to cross examination on the merits of the claim at a very preliminary stage of the proceeding, or to give up the tactical advantage of contesting leave.

In *IMAX*, in *obiter* comments on a motion to compel the defendants to answer questions refused during cross-examination on their affidavits, Justice van Rensburg interpreted s. 138.8 of the Ontario Act as imposing an affirmative obligation on each prospective defendant opposing leave in an action under Part XXIII.1 of the *Securities Act* "to put forward information" about its defences "with evidence in support."¹¹ In addition, Her Honour held that on cross-examination, prospective defendants may be required to answer questions only "potentially relevant" to the facts alleged in the claims and defences raised in the affidavits, even if that may reveal other potential issues or wrongdoing not yet pleaded.¹² A motion for leave to appeal that decision was dismissed.¹³

If Justice van Rensburg is correct, contesting motions for leave will allow plaintiffs to obtain valuable disclosure about the defendants' case at a very early stage of the proceeding, even prior to the plaintiffs making documentary disclosure and before a theory of the case may be fully developed.

Justice Lax reached a very different conclusion about s. 138.8 in *Ainslie v. CV Technologies Inc.* ("*CV*").¹⁴ Her Honour decided that on a motion for leave, defendants are not under any onus to file affidavits or "assist plaintiffs in securing



evidence upon which to base an action under Part XXIII.1.”¹⁵ In addition, Lax J. determined that examination of defendants who have not filed affidavits is not permitted under the Rules of Civil Procedure on a motion for leave, as it would permit the plaintiffs to do indirectly what they cannot do directly under section 138.8. Leave to appeal this decision to the Court of Appeal was granted.¹⁶ However, the appeal was not decided as the case ultimately settled.¹⁷

In *Arctic Glacier*,¹⁸ Justice Tausenfreund agreed with Justice Lax’s decision in CV that section 138.8 should not be read as requiring defendants to file affidavits in response to a leave motion. However, until this issue is resolved by an appellate court, prospective defendants will be required to tread carefully.

S. 138.8 (4) further complicates matters for defendants. It requires the parties to deliver copies of any affidavits filed on the application for leave with the Ontario Securities Commission. There is a risk that the affidavits could potentially be used by Commission staff as a basis for commencing or furthering a regulatory investigation into the same matter. As such affidavits also must be filed with the court, unless a sealing order is obtained, there is an additional risk that they could end up in the hands of US counsel intent on pursuing a class proceeding south of the border.

IMAX highlights other risks of contesting motions for leave. Justice van Rensburg decided, even prior to the leave motion being argued, that certain communications involving in-house counsel were not covered by litigation privilege, and that solicitor-client privilege attaching to a report to the board of IMAX had been waived. These types of rulings could potentially have far-reaching implications for the defence of actions if leave ultimately is granted.

CERTIFICATION OF COMMON LAW CLAIMS FOR NEGLIGENT MISREPRESENTATION

a) Proof of Reliance

In order to succeed with a common law claim for negligent misrepresentation in a disclosure document, the plaintiff bears the onus of proving that an untrue or misleading representation was made by a person in a special relationship to the plaintiff, that the plaintiff reasonably relied upon the misrepresentation and that he suffered damages as a result.¹⁹

The challenge of having to prove actual reliance previously led some courts to refuse to certify claims for misrepresentation, as it was viewed as an issue that was required to be tried and determined on an individual basis.²⁰

Recently, however, Ontario courts have indicated a willingness to certify these claims where it is alleged that essentially the same misrepresentation was made to all of the proposed class members. (It may be of some significance that statutory claims for misrepresentation also were certified in the same actions, suggesting that the courts are allowing common law claims to be piggybacked on the certification of statutory claims).

In *McCann v. CP Ships Ltd. et al (“CP Ships”),*²¹ *IMAX,*²² and *Arctic Glacier,*²³ common law claims of negligent misrepresentation were certified on the basis that reliance could be inferred, including from the mere act of the plaintiffs having purchased securities in the secondary market.

It is noteworthy that the claims in *CP Ships* and *IMAX* both involved at their core a single misrepresentation. In *CP Ships*, the alleged misrepresentation pertained to a single erroneous misstatement of the company’s net annual income over a two-year period, which was contained exclusively in financial documents issued and filed with the System for Electronic Document Analysis (SEDAR). In *IMAX*, the alleged misrepresentation related to a single misstatement of IMAX’s 2005 financial results. Although the alleged misrepresentation was publicized and repeated in regulatory filings, press releases and IMAX’s annual report, there was essentially only one misrepresentation at issue.

Subsequently, in *McKenna v. Gammon Gold (“Gammon Gold”),*²⁴ Justice Strathy undertook a thorough review of the case law on negligent misrepresentation. Given the number, variety and breadth of the misrepresentations alleged by the plaintiff in that case, Justice Strathy concluded that “[i]ndividual inquiries would have to be made into what alleged misrepresentations were made to each class member and whether he or she relied upon any of those misrepresentations,”²⁵ and on that basis declined to certify the claim.

Justice Sachs declined the plaintiff’s motion for leave to appeal Justice Strathy’s decision and provided further clarification of the issue.²⁶ Her Honour determined that there was no conflict in the law and endorsed the concept that negligent misrepresentation claims exist on a “spectrum,” as set out in Justice Strathy’s earlier decision in *Ramdath v. George Brown College of Applied Arts and Technology.*²⁷

Justice Sachs therefore concluded that the decisions in *CP Ships*, *IMAX* and *Gammon Gold* can all be read harmoniously. Her Honour suggested that the decision whether to certify a negligent misrepresentation claim depends on the number and type of misrepresentations that are involved, stating:

Carom v. Bre-X Minerals Ltd. (2000), 51 O.R. (3d) 236 (C.A.) is another case involving multiple misrepresentations, but all the representations had a common import that was known to be false—namely, that the company had discovered a mine with lots of gold when there was in fact no gold. Similarly, in *McCann v. CP Ships Ltd. et al*, [2009] O.J. No. 5182 (S.C.) the representations all had one import—that the company had misstated its income. The same was true in *Silver v. IMAX Corp.*, [2009] O.J. No. 5585 (S.C.) ... In the case at bar the motion judge found that there were ‘multiple misrepresentations’ that ‘relate to a variety of complaints’.²⁸

Subsequently, in March 2011, Justice Tausenfreund certified a claim for negligent misrepresentation in *Arctic Glacier*²⁹ notwithstanding that the plaintiffs alleged that misrepresentations were made in multiple disclosure documents. His Honour characterized the law on this issue as in a state of “evolution.” Justice Tausenfreund recognized that, depending upon the type and nature of alleged misrepresentations, reliance issues could potentially overwhelm the common issues, making certification unsuitable. However, the misrepresentation in *Arctic Glacier* was “consistent and repetitive,” and therefore capable of being treated as essentially a single misrepresentation.

Claims involving either a single or a group of substantially similar misrepresentations thus appear more likely to be certified than those involving multiple types of misrepresentations.

Alternatively, claims involving distinct misrepresentations could potentially result in certification, but with numerous subclasses of claimants. This line of cases will no doubt influence how plaintiffs plead their claims.

The new statutory cause of action avoids this problem by expressly excusing individual claimants from having to prove reliance upon an alleged misrepresentation. A right of action exists “without regard to whether the person or company relied on the misrepresentation.”³⁰

The statutes do not make lack of reliance a defence. However, proof that the plaintiff acquired or disposed of the security in question with knowledge that the disclosure document contained a misrepresentation is a defence.³¹

Arguably this puts defendants in a worse position than if the legislation instead created a rebuttable presumption of reliance through a deeming provision. A rebuttable presumption of reliance would allow defendants to escape liability either because the plaintiff did not know of the misrepresentation and therefore could not have relied upon it, or because the plaintiff was aware of it but made the decision to invest based upon other factors.

The fact that plaintiffs need not prove reliance increases the likelihood of a statutory claim for secondary market liability being certified as a class proceeding. This has important strategic ramifications. Once certification is granted, defendants lose potential settlement leverage that they otherwise would have had by threatening to litigate that issue.

b) Duty of Care

The existence of a duty of care is pivotal to a claim negligent misrepresentation at common law. A duty of care will exist where the plaintiff can satisfy the two part test in *Anns v. Merton London Borough Council*:³²

1. A *prima facie* duty of care is owed by the defendant to the plaintiff; and
2. That duty is not limited by policy considerations of indeterminate liability: *Hercules Management Ltd. v. Ernst & Young*.³³

With respect to the first part of the test, a *prima facie* duty of care will exist where (a) the defendant ought reasonably to have foreseen that the plaintiff would rely on his representation, and (b) that reliance by the plaintiff in the circumstances was reasonable.³⁴

The second part of the test comes into play once a *prima facie* duty of care is established: *Haskett v. Equifax Canada Inc.*³⁵ The primary policy reason for limiting a duty of care centres on the possibility that the defendant might be exposed to “liability in an indeterminate amount for an indeterminate time to an indeterminate class”.³⁶

In *Cooper v. Hobart*, the Supreme Court of Canada commented on the second part of the test as follows:

These [residual policy considerations] are not concerned with the relationship between the parties, but with the effect of recognizing a duty of care on other legal obligations, the legal system and society more generally. Does the law already provide a remedy? Would recognition of the duty of care create the spectre of unlimited liability to an unlimited class?

Are there other reasons for broad policy that suggest that the duty of care should not be recognized?³⁷

Recent decisions suggest that at certification, the courts are not prepared to engage in rigorous analysis to determine whether exposure to the risk of indeterminate liability ought to preclude recognition of a duty of care owed to investors alleging negligent misrepresentation in secondary market disclosures.

In *IMAX*, the defendants conceded that a *prima facie* duty of care could be owed to the plaintiffs. However, they relied on *Menegon v. Philip Services Corp.*³⁸ to argue that in the circumstances, the duty of care should be limited or precluded for policy reasons, because the imposition of such a duty would lead to indeterminate liability and could conflict with the statutory remedy under the *Securities Act*.

Justice van Rensburg rejected the defendants’ arguments. Citing *Mondor v. Fisherman*³⁹ and *Hercules Managements Ltd. v. Ernst & Young*,⁴⁰ Her Honour determined that it was not “plain and obvious” that the policy reasons asserted by the defendants precluded a claim of misrepresentation from proceeding at the certification stage.

Her Honour concluded that a duty of care may have been owed in the circumstances, as the intended recipients of the documents containing the misrepresentation were members of the investing public, including the plaintiffs and proposed class members, and that IMAX issued the documents for the purposes of attracting and informing investors. She was therefore not prepared to limit or restrict the alleged duty of care based on concerns of indeterminate liability at the certification stage of the proceeding. Instead, whether a duty of care was owed was certified as a common issue.

Justice van Rensburg also determined that the common law cause of action for negligent misrepresentation does not conflict with the statutory remedy contained in the *Securities Act*, given the explicit language of section 138.13. That section provides that the statutory right of action for damages and the defences to an action are “in addition to and without derogation from, any other rights or defences the plaintiff or defendant may have in an action [brought under the Act].”⁴¹

Leave to appeal that decision was denied.⁴² According to the Justice Corbett, given the importance and complexity of the issues, “appeal courts will be in a better position to address them on a full factual record, after trial.”⁴³

Justice Tausenfreund reached a similar conclusion in *Arctic Glacier*⁴⁴ and certified a common law claim for negligent misrepresentation notwithstanding concerns about whether there was a special relationship of proximity between the defendants and investor plaintiffs, and issues of indeterminate liability.

CONCLUSION

It appears that Ontario courts are reluctant to embrace meaningful limits on certification of claims for misrepresentation in securities disclosure documents at this time, leaving issuers, and their directors, officers, underwriters and auditors at risk of exposure to protracted and expensive litigation of questionable merit.

1. See, for example, s.138.8(1) *Securities Act*, R.S.O. 1990, c.S.5; s.140.8 *Securities Act*, B.C.S.C. 1996, c. 418; s. 211.8(1) *Securities Act*, R.S.A. 2000, c. S-4
2. *Silver v. IMAX Corp.* [2009] O.J. No. 5573 (S.C.)



3. *Ibid* at para 333
4. *Kerr v. Danier Leather Inc.*, [2007] 3 S.C.R. 331
5. *Supra* note 2 at para 371
6. *Silver v. IMAX Corp.*, [2009] O.J. No. 5585 (S.C.)
7. *Silver v. IMAX Corp.*, [2011] O.J. No. 656 (Div. Ct.) at paras. 5; 24-26
8. *Ibid* at para. 24
9. *Dobbie v. Arctic Glacier Income Fund* [2011] O.J. No. 932 (S.C.)
10. *Ibid* at para. 130
11. *Silver v. IMAX Corp.*, [2008] O.J. No.1844 at paras. 17-19 (S.C.)
12. *Ibid* at para. 30
13. *Silver v. IMAX Corp.*, [2008] O.J. No. 2751 (Div. Ct.)
14. *Ainslie v. CV Technologies Inc.*, [2008] O.J. No. 4891 (S.C.)
15. *Ibid* at para 15
16. *Ainslie v. CV Technologies Inc.*, [2009] O.J. No. 730 (S.C.)
17. *Ainslie v. CV Technologies Inc.* [2011] O.J. No. 3302 (S.C.)
18. *Supra* note 9
19. *Queen v. Cognos*, [1993] 1 S.C.R. 87
20. See for example, *Millgate Financial Corp. v. B.F. Realty Holdings Ltd.* [1998] O.J. No. 4547 (Ont. S.C.); *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Ont. Div. Ct.); *Collette v. Great Pacific Management Co.* (2001), 86 B.C.L.R. (3d) 92 (S.C.)
21. [2009] O.J. No. 5182 (S.C.)
22. *Supra* at note 6
23. *Supra* at note 9
24. [2010] O.J. No. 1057 (S.C.)
25. *Ibid* at para 160
26. [2010] O.J. No. 3183(Div. Ct.)
27. [2010] O.J. No. 1411 (S.C.)
28. *Supra* note 26 at para 37
29. *Supra* at note 9
30. See, for example, s.138.8(1) *Securities Act*, R.S.O. 1990, c.S.5; s.140.8 *Securities Act*, B.C.S.C. 1996, c. 418; s. 211.8.(1) *Securities Act*, R.S.A. 2000, c. S-4
31. See, for example, s. 138.4(5) *Securities Act*, R.S.O. 1990, c. 5.5; s. 140.4(5) *Securities Act*, B.C.S.C. 1996, c. 418; s. 211.04(5) *Securities Act*, R.S.A. 2000, c.S-4
32. [1978] A.C. 728
33. [1997] 2 S.C.R. 165
34. *Carom v. Bre-X Minerals Ltd.*, [1999] O.J. No. 1662 (S.C.), overturned on appeal on another issue at [2000] O.J. No. 4014 (C.A.)
35. (2003), 63 O.R. (3rd) 577 (C.A.), at para 42
36. *Hercules*, *supra* note 35 at 192
37. *Cooper v. Hobart*, [2001] 3 S.C.R. 357 at para 37
38. [2001], O.J. No. 5547 (S.C.); [2003] O.J. No. 8 (C.A.)
39. [2001] O.J. No. 4620 (S.C.)
40. *Supra* note 33
41. *Supra* note 6 at para 48
42. *Supra* note 7
43. *Supra* note 7 at para 46
44. *Supra* note 9



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LINDA L. FUERST is a partner at Lenczner Slaght. Linda's litigation practice includes a broad range of commercial and professional liability matters, with a particular focus on securities litigation and regulatory issues. She has appeared before all levels of court in Ontario, and in connection with investigations and proceedings by the Ontario, Alberta and Nova Scotia Securities Commissions, Market Regulation Services (now IIROC), the Mutual Fund Dealers Association and the Competition Bureau. She has also provided legal advice and services relating to internal investigations into matters including possible insider trading and backdating of stock options.

Linda graduated from Osgoode Hall Law School with an LL.B. in 1981, clerked for the Chief Justice of the High Court of Ontario, and was admitted to the Ontario Bar in 1983. She practised criminal law and served as a part-time Assistant Crown Attorney before joining the Enforcement Branch of the Ontario Securities Commission, where she was appointed Senior Investigation counsel. She joined Lenczner Slaght in 1994 after a rotation at the U.S. Securities and Exchange Commission in Washington, D.C. She is recognized for her expertise in Lexpert, Best Lawyers in Canada and Martindale-Hubbell.

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