Securities Class Actions Move North: A Doctrinal and Empirical Analysis of Securities Class Actions in Canada

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The article explores securities class actions involving Canadian issuers since the provinces added secondary market class action provisions to their securities legislation. It examines the development of civil liability provisions, and class proceedings legislation and their effect on one another. Through analyses of the substance and framework of the statutory provisions, the article presents an empirical and comparative examination of cases involving Canadian issuers in both Canada and the United States. In addition, it explores how both the availability and pricing of director and officer insurance have been affected by the potential for secondary market class action liability. The article suggests that although overall litigation exposure for Canadian companies remains relatively low when compared to their U.S. counterparts, Canadian issuers that have listed their shares in the U.S. face considerable uncertainty as to the extent of their exposure to securities class actions. Through analysis of case law in both jurisdictions, the article highlights the crucial role of liability caps relating to costs in the decision of which jurisdiction to file suit.

Cet article explore les recours collectifs relatifs aux valeurs auxquels des émetteurs canadiens sont mêlés depuis que les provinces ont ajouté des dispositions relatives au recours collectif de marché secondaire dans leur législation régissant la vente des valeurs. Il examine le développement des dispositions relatives à la responsabilité civile, la législation sur les recours collectifs et leur effet respectif. Par son analyse de la substance et des dispositions législatives, l'article examine de manière empirique et comparative les causes impliquant des émetteurs canadiens au Canada et aux États-Unis. En outre, il explore l'effet d'un recours collectif éventuel de marché secondaire sur la disponibilité et le prix de l'assurance pour les administrateurs et les dirigeants. L'article laisse entendre que bien qu'en général, les compagnies canadiennes demeurent relativement moins exposées aux litiges que leurs homologues aux États-Unis, les émetteurs canadiens dont les valeurs se transigent aux États-Unis font face à une grande incertitude quant à l'importance de leur exposition à des recours collectifs. L'article analyse la jurisprudence des deux juridictions et souligne le rôle crucial des limites de responsabilité en ce qui concerne les coûts au moment de choisir dans quelle juridiction intenté les poursuites.

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I. INTRODUCTION

Canadian companies have had to worry about securities fraud liability for 15 years now. In Canada, investors in public offerings have had a statutory cause of action for misrepresentation and failure to disclose material changes since the late 1970s. This cause of action did not become significant, however, until class action legislation was first introduced in Ontario in 1992. That legislation afforded plaintiffs financial support for such claims and a mechanism to reduce collective action problems. Yet there have been a modest number of cases and only one known case has been litigated to final judgment. During the same period, Canadian issuers cross-listed in the United States have faced not only primary market civil liability, but also potentially much greater exposure for secondary market liability. Virtually all of these secondary market cases settle prior to final judgment if they are not dismissed. The settlement amounts are occasionally eye-popping; Nortel's two $1 billion plus settlements of suits are notable examples.

The size of potential settlements in secondary market class actions has made them a controversial feature of the American securities regime. One objection to such suits has been that they are sometimes an exercise in "pocket-shifting." Shareholders are equally likely to be on the winning side of a fraudulent secondary market transaction as they are to be on a losing end, but the corporation is unlikely to accrue any benefit from secondary market transactions affected by misstatements. Notwithstanding this absence of benefit, the corporation often pays for the settlement directly or in the form of insurance premiums for its officers. Thus, in many cases shareholders as residual claimants are essentially paying themselves for any misconduct. In 1995, the U.S. Congress adopted legislation making it more difficult to bring such suits, but it failed to grapple with any pocket-shifting problem. More recently, a number of U.S. studies have called for a rethinking of secondary market liability, calling it a major factor undermining the competitiveness of the U.S. capital markets.

Notwithstanding these concerns about the U.S. system, secondary market class actions have now come to Canada. On 31 December 2005, the secondary market civil liability provisions became effective in Ontario, followed by five other Canadian provinces enacting almost identical amendments to their securities legislation effective 2007 and 2008. The amendments are significant in that 95 percent of capital markets activity in Canada is in the secondary market. Hence the possibility of remedies for investors and potential liability for...
issuers, corporate officers, and other specified persons is much greater than under the primary market civil liability provisions.

This article analyzes securities class actions in respect of Canadian issuers since the class action legislation was adopted. Although civil remedies have been the subject of considerable scholarly commentary, there has not been a systematic analysis of cases in which Canadian issuers have been sued in Canada and the U.S. The study drew on the TSX Datalinx data, the Stanford Class Action database, the Canadian Bar Association class action database, reported judgments, and interviews with class action counsel for both plaintiffs and defendants. It analyzes the nature of alleged claims, the quantum of relief sought, and the outcome of proceedings. Insights from these primary market and secondary market cases may inform some of the issues that will arise in the Canadian secondary market civil liability cases.

Our working hypothesis was that the seriousness of the allegations would influence the types of suits filed and would generate a larger settlement amount. Although the study found that the seriousness of allegations does seem to signal the likelihood of a suit, contributing factors to the amount of settlement appear to be jurisdictional complexity, the different cost regimes, and the number of parties seeking a remedy.

Another working hypothesis was that the availability of new secondary market civil liability provisions may affect the pricing and availability of director and officer (D&O) insurance. There is little understanding of how insurance factors into settlement of class action suits and the availability of D&O insurance. The study sought to examine how D&O insurance premiums may be an indicator of the expected cost of securities litigation, given that litigation expenses in securities class actions typically are paid from D&O liability insurance policies. We find that Canadian companies listed only in Canada experienced a substantial drop in D&O coverage from 2004 to 2005, while premiums remained relatively steady. At the same time, Canadian firms listed in the U.S. experienced little change in their coverage amounts, but a general reduction in their premiums. These data suggest that Canadian listed firms suffered a price increase for their D&O coverage relative to their counterparts who were also listed in the U.S.

Part II of the article sets out the context for the study and examines the development of civil liability remedies and class proceedings legislation and their influence on one another. Part III then examines the suits filed against Canadian issuers in Canada and the U.S. Part IV analyzes the effect of the secondary market legislation on D&O coverage and premiums for those companies. Part V concludes. Appendices A and B provide a summary chart of the differences between Canadian and U.S. primary market and secondary market civil liability provisions.

II. CONTEXT FOR THE STUDY

Canadian capital markets are regulated on a provincial and territorial basis only, putting them in stark contrast with the U.S. where the primary regulation is federal. Although there

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4 The authors acknowledge with thanks the use of the TSX Datalinx data and that of the Stanford Class Action database.
are 13 provincial and territorial regulators, 92 percent of all issuers in Canadian capital markets are based in Ontario, Alberta, British Columbia, and Quebec.6 Eighty-six percent of the aggregate market capital of companies listed on Toronto Stock Exchange (TSX), Canada's senior equities market, and the TSX Venture Exchange (TSXV), Canada's junior equities market, are located in these same four provinces.7

Both Canadian and U.S. securities laws seek to protect investors and promote investor confidence and market integrity.8 Canadian provincial statutes are similar, requiring the registration of persons involved in the securities business, prospectus disclosure on the distribution of securities, continuous disclosure of information after the distribution of securities, insider trading regulation, and takeover bid regulation.9 Mandatory disclosure is the major form of regulation imposed by both Canada and the U.S., although Canada has adopted a continuous disclosure regime whereas the U.S. requires only periodic disclosure. Liability concerns are one reason why the U.S. has not adopted a continuous disclosure requirement. Disclosure requirements impose costs on issuers, so striking an appropriate balance between the costs and benefits of increased disclosure obligations has been a major public policy challenge.

The new civil liability provisions give secondary market investors a statutory right of action against issuers and key related persons for making public misrepresentations or for failing to disclose material changes. The provisions, together with enforcement by securities regulators when issuers breach securities law, seek to prod directors, officers, and other persons of influence or control to ensure that the issuer meets its continuous disclosure obligations. Ostensibly, civil liability provisions are also aimed at compensation of individuals through redress for harms caused by the action or inaction of issuers in violation of securities law. In theory, civil liability, public enforcement, and quasi-criminal sanctions together provide an integrated approach that promotes investor protection, investor confidence, and market integrity through both deterrence and compensation.10

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6 Alberta Securities Commission, supra note 3 at 2.
7 Ibid. at 4. Based on aggregate market capital of companies with head offices in the respective provinces, the largest provincial capital markets are Ontario at 41 percent, Alberta at 26 percent, Quebec at 11 percent and British Columbia at 8 percent.
9 Although the OSA, supra note 3, has been amended a number of times over the last few years, the basic principles and structure remain relatively unchanged since the 1978 reforms. The Canadian Securities Administrators (CSA), an umbrella organization of provincial and territorial securities regulators, promulgates instruments as a mechanism to reduce the duplication required of market participants in matters where an issuer wants to sell securities in more than one province. A national instrument (NI) is one that has been agreed to by all provinces and territories and a multilateral instrument (MI) has been agreed to by some but not all of the provinces, which results in a lack of consistency in regulation across Canada. However, the instruments do not themselves have legal force; they must be implemented by rule or policy in each participating province — an important but technical requirement once provinces agree to be bound. Key instruments include Canadian Securities Administrators, National Instrument 51-102, “Continuous Disclosure Obligations” (28 September 2009) [NI 51-102]. There are also sector specific disclosure instruments. The CSA also creates and operates mutual reliance review systems for prospectus review, continuous disclosure review, registration, and exemptive relief applications.
10 There is an active debate in Canada regarding the precise goals of public and private enforcement of securities law and, more specifically, whether Canada should move towards more of a compliance culture based system rather than the current deterrence based system. For a discussion, see Mary Condon, “Rethinking Enforcement and Litigation in Ontario Securities Regulation” (2006) 32 Queen's L.J. 1.
A. **RELATIONSHIP BETWEEN SECURITIES LAW CIVIL LIABILITY PROVISIONS AND CLASS ACTION STATUTES**

Under common law, investors must base a claim concerning a misrepresentation on the common law action of negligent misrepresentation. This claim is difficult to establish as investors must prove reliance and loss causation. In similar actions in the U.S. under Rule 10b-5,\(^\text{11}\) promulgated under the *Securities Exchange Act of 1934*,\(^\text{12}\) courts have accepted proof of reliance on the basis of a "fraud on the market" theory. The empirical premise of that theory is that in an efficient market, information contained in disclosure documents will quickly be incorporated in the market price.\(^\text{13}\) Fraud on the market has been expressly rejected by Canadian courts.\(^\text{14}\)

In response to the hurdles posed by the negligent misrepresentation cause of action, the Canadian primary market statutory civil liability regime was enacted in the late 1970s to provide accessible remedies for harms to investors. For primary offerings, most Canadian securities statutes require the prospectus to provide "full, true and plain disclosure of all material facts" relating to the securities being distributed.\(^\text{15}\) Cost barriers to bringing suits and collective action problems discouraged investors from using the primary market civil liability provisions for a number of years. Some of those hurdles were removed by the introduction of class action proceedings statutes in some Canadian jurisdictions, most notably Ontario and British Columbia, in the early to mid-1990s,\(^\text{16}\) with other jurisdictions only recently enacting class proceedings legislation.\(^\text{17}\) The pattern in the U.S. was similar, but much earlier; a primary market liability provision was included in the *Securities Act of 1933*,\(^\text{18}\) but it was little used until the class action rules were relaxed in 1966.

Class actions reduce the economic barriers to bringing suit by allowing investors with common interests to have their claims determined in a single court proceeding brought by representative plaintiffs of the class. Some regimes are opt in regimes, whereas others are opt

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\(^{13}\) The underlying notion of a semi-strong theory of market efficiency is that the market quickly assimilates and reflects material changes through price adjustments in share value. The investor is said to rely on the market price and thus implicitly relies on any misrepresentations in continuous disclosure documents that are reflected in the market price: see *Basic Inc. v. Levinson*, 485 U.S. 224 at 242 (1988) [*Basic*].

\(^{14}\) *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780 (Ct. J. (Gen. Div.)), in which the Court held at 794:

> The adoption of the fraud on the market theory by an Ontario court cannot be justified where neither the statutory duty, the cause of action founded upon its breach, nor the predominance test as a procedural barrier to class proceedings exist. More so, the plaintiffs seek to apply the theory to common law causes of action, to which it would not be applicable in the United States, and in a wholesale fashion, without the restrictions which circumscribe it there. Simply put, the proposition advanced is ill-conceived.... In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance in either tort.


\(^{16}\) See *Class Proceedings Act, S.O. 1992, c. 6 [OCPA]*; *Class Proceedings Act, R.S.B.C. 1996, c. 50 [BCCPA]*. There are also provisions allowing for a sub-class representative plaintiff or defendant for protection of their interests where there are common issues not shared by all class members: see e.g. *OCPA*, s. 5(2).


\(^{18}\) 15 U.S.C. §§ 77a-77aa [Securities Act].
out.\textsuperscript{19} In either case, class actions allow the courts a mechanism to resolve such claims efficiently and cost-effectively.

The court serves a gatekeeping function in that it must certify proceedings before they can proceed.\textsuperscript{20} In certifying a class action, the court must be satisfied that the pleadings disclose a cause of action, that there is an identifiable class of persons that could be represented, that the claims raise common issues that preferably should be resolved together, and that there is a representative plaintiff or plaintiffs who would fairly and adequately represent the interests of the class without conflict of interest and who has a workable plan for advancing the proceeding.\textsuperscript{21}

Under the Canadian statutes, the court must approve any agreement respecting fees and disbursements between a solicitor and a representative party.\textsuperscript{22} "Class members, other than the representative party, are not liable for costs except with respect to the determination of their own individual claims."\textsuperscript{23} The Ontario \textit{Class Proceedings Act, 1992} permits the solicitor to make a motion to the court to have his or her fees increased by a multiplier as fair and reasonable compensation for the risk incurred in undertaking and continuing the proceeding under a contingency fee agreement.\textsuperscript{24} In contrast, British Columbia has not adopted such provisions in its legislation and has expressly declined to award multiplier fees in securities law class action suits as undesirable and unnecessary.\textsuperscript{25} This different approach to fees may create incentives for plaintiff counsel to bring actions in the jurisdictions offering higher statutory caps on fees.
potential fees. American law allows for substantial multipliers in securities class actions, although the legislation limits the attorneys' recovery to a “reasonable percentage” of the amount paid to the class members.26 The multiplier compensates the plaintiffs' counsel for undertaking the risk of the proceeding; counsel ordinarily bears the expense of the proceeding, recovering those costs only if the plaintiff prevails.

Five Canadian jurisdictions have a no-cost regime in which each side in a class action bears their own costs, except where there is misconduct or injustice in the proceeding.27 In those provinces, plaintiffs have considerable protection against the cost consequences if they do not win. In contrast, New Brunswick and Alberta class action legislation specifies that ordinary rules of court apply in respect of costs.28 Quebec has a cost regime, but limits it by specifying that the amount of costs against a plaintiff will be limited by the tariff normally applied to plaintiffs in small claims court.29 Ontario generally has a cost regime, although s. 31(1) of the Ontario legislation allows courts to “consider whether the class proceeding was a test case, raised a novel point of law or involved a matter of public interest.”30 The potential cost consequences may have limited the number of primary market actions filed to date. In the U.S., cost shifting is permitted only in narrow circumstances, chiefly to prevent “abusive litigation.”31

The issue of costs awards against unsuccessful plaintiffs is somewhat unsettled currently, as the only case that has made it to final judgment, Kerr, resulted in a cost award against the representative plaintiff of more than $1 million dollars.32 Kerr was a primary market civil action that was ultimately dismissed by the Supreme Court of Canada. The sole representative plaintiff in the class action, Mr. Durst, had sought an order that no costs should be awarded against him, having regard to s. 31(1) of the OCPA, should the class action proceeding fail.

The Supreme Court of Canada held that there was no error in principle that would justify intervening in the costs order made by the Ontario Court of Appeal.33 The Court held that

26 Exchange Act, supra note 12, § 78u-4(a)(6); the percentage agreed to by the lead plaintiff at the time that counsel was engaged carries presumptive weight; see e.g. In re Cendant Corp. Litigation, 264 F.3d 201 (3d Cir. 2001).
28 ABCPA, supra note 16, s. 37; NBCPA, supra note 17, s. 39.
29 David Klein & Douglas Lennox, “What to Seek and What to Expect on Costs” (3rd Annual National Symposium on Class Actions, Osgoode Hall Law School, Professional Development CLE, York University, 6-7 April 2006), (Toronto: Osgoode Hall Law School, 2006).
30 OCPA, supra note 17, s. 31(1). See also Rules of Civil Procedure, r. 57.01, which directs the courts to consider principles of indemnity, the reasonable expectation of parties, the complexity of the proceeding, the conduct of litigation, and the importance of the issue when exercising discretion to award costs under the Courts of Justice Act, R.S.O. 1990, c. C-43, s. 131(1). Klein & Lennox, ibid at 3, observe that the cost consequences are potentially much greater in Ontario, because the fees tariff is much higher than in the rest of Canada; because the courts have been uneven in how they apply the s. 31(1) provision in exercising their jurisdiction to award costs against representative plaintiffs; and because there is an uncertainty under Ontario caselaw in respect of whether or not plaintiff's counsel should be indemnifying the representative plaintiff, an important factor in determining cost risk. They cite a number of cases outside of the securities law context in which the cost awards in certification applications have exceeded $100,000.
31 Exchange Act, supra note 12, § 78u-4(c).
32 Kerr, supra note 8.
33 Ibid. at paras. 68-69.
although the resolution of the dispute would affect future actions for prospectus misrepresentation, in essence the case was “a commercial dispute between sophisticated commercial actors who are well resourced” and that “converting an ordinary piece of commercial litigation into a class proceeding may be seen by some observers simply as an in terrorem strategy to try to force a settlement.” The Supreme Court held that the expression “matter of public interest” in s. 31(1) of the OCPA involves “either issues of broad public importance or persons who are historically disadvantaged in society.” The Court found that the proceeding before it was a dispute where private commercial interests predominated. It further held that general concerns about access to justice did not, in this case, “warrant a departure from the usual cost consequences” and that “it should not be assumed that class proceedings invariably engage access to justice concerns to an extent sufficient to justify withholding costs from the successful party.

The Supreme Court of Canada judgment gives little weight to the significance of the Court of Appeal’s findings on deference to business judgment. That aspect of the lower Court’s decision arguably raised a policy question of broad public importance whereby leaving the Court of Appeal judgment intact could have the market uncertain about the interplay between statutory disclosure requirements and deference to business judgments. The Supreme Court’s clarification of this issue is significant, and should have been a consideration in the cost decision.

The judgment may discourage class proceedings given the potential cost consequences. Although the courts may be less inclined to award costs against disadvantaged investors, those investors are not the most likely people to bring securities class action proceedings. It is the more affluent and knowledgeable investors that are likely to pursue such claims. Institutional investors, such as pension funds, have been key plaintiffs in U.S. securities class actions in recent years. The court’s future consideration of costs may also depend on whether the investors allegedly harmed by the impugned conduct have invested disposable cash or whether the investment represents retirement or other significant savings, given the link the court makes between public interest and historical disadvantage in determining cost issues. Subsequent to the Kerr judgment there have been a number of new cases filed, suggesting that it may not have acted as a deterrent but, rather, may have forced counsel to bring forward only the most meritorious claims. The judgment may also change the dynamic of settlement talks, as the fear of cost awards may drive plaintiffs to settle as much as fear of litigation costs drives the issuer side in settlement talks.

36 Kerr, ibid. at paras. 67-68.
37 Ibid. at para. 69.
38 One issue raised by the Supreme Court of Canada judgment in Kerr, ibid. is whether the court should take into consideration the amount of litigation generated by the defendants in a prolonged case. The Court held that while there is a strong public interest in setting the rules of adequate disclosure, regard must also be had to the situation of the defendants, who had incurred the costs of 50 hearing days (at para. 64). Even if one accepts the Court’s view that the plaintiff was a well resourced individual, there is some question as to whether a plaintiff should have to bear the full costs of defendant interlocutory and other motions. There may be need to apportion court costs in such a manner that recognizes the conduct of the parties and allocates expenses on a reasonable basis. Interestingly in Kerr, the Court did not attach weight to the fact that the plaintiff was truly a representative plaintiff in that he commenced and pursued the action; he was not the product of a search by class action counsel for a convenient representative plaintiff.
The availability of access to a no cost regime, particularly in those jurisdictions that are
opt out regimes, may influence where the first secondary market civil liability cases will be
brought.\textsuperscript{39} To date, however, most have been brought in Ontario, notwithstanding Kerr.

\section*{B. Brief History of the Secondary Market
Civil Liability Provisions}

The enactment of secondary market civil liability provisions was more than three decades
in the making. Over a period of almost 30 years, there had been a number of proposals to
extend statutory civil liability to continuous disclosure and to align remedies arising out of
secondary market transactions with those available for primary market transactions.\textsuperscript{40} These

\textsuperscript{39} Several Canadian jurisdictions have created class proceedings funds to assist with the potential barriers
created by the costs of class action proceedings. These funds pay for disbursements related to the
proceeding: see e.g. Law Society Act, R.S.O. 1990, c. L-8, s. 59.1 [\textit{OLS}]; The Law Foundation of
Ontario, Class Proceedings Committee, Practice Direction \#1 (2004), online: The Law Foundation of
Ontario <http://www.lawfoundation.on.ca/pdf/cpp/practice_direction_1.pdf>; The Law Foundation of
Ontario, Class Proceedings Committee, Practice Direction \#2 (1995), online: The Law Foundation of
Ontario <http://www.lawfoundation.on.ca/pdf/cpp/practice_direction_2.pdf>; Regulation respecting the
percentage withheld by the Fonds d'aide aux recours collectifs, R.R.Q. 1981, c. R-2.1, r. 3.1. Although the
Ontario Class Proceedings Fund is not available for fees of plaintiff counsel, it does facilitate class
actions on a contingency fee basis as the risk to plaintiff counsel is time and energy, not the full costs
of the proceeding (see \textit{OLS}, s. 59.5(1)). The Committee is made up of Government appointed and
Ontario Law Foundation appointed members (s. 59.2(1)). A defendant to a class action proceeding may
also apply for payment from the Ontario Class Proceedings Fund in respect of a costs award made in the
proceeding in the defendant's favour against a plaintiff that has received financial support from the
Fund (ss. 59.4(1)-(3)). This provision provides significant protection to the plaintiff, given the Canadian
rule of costs following the event, as it provides a form of cost indemnification if the plaintiff is not
successful. Thus the Committee that approves class action funding plays a partial gate-keeping role; it
considers the merits of a case before awarding access to the Fund, the likelihood that it will be certified,
the public interest engaged, and the plaintiff's efforts to raise funds

\textsuperscript{40} In 1979, the federal Department of Consumer and Corporate Affairs recommended a statutory civil
liability regime covering continuous disclosure: see Canada, Department of Consumer and Corporate
Affairs, Proposals for a Securities Market Law for Canada by Philip Anisman et al. (Ottawa: Consumer
and Corporate Affairs Canada, 1979) at 109-11. In 1984, the Ontario Securities Commission (OSC)
recommended the same: "Civil Liability for Continuous Disclosure Documents Filed under the
Columbia government developed a proposal to introduce a limited scheme of civil liability for certain
disclosure in response to the Matkin Inquiry and recommendations reflected in Vancouver Stock
Exchange & Securities Regulation Commission, \textit{Restructuring for the Future: Towards a Fairer
Venture Market} by James G. Matkin & D. Geoffrey Cowper (Victoria: Vancouver Stock Exchange &
Securities Regulation Commission, 1994). However, at the time, the Allen Committee had been
established and the British Columbia government agreed to await the release of that committee's report
with the aim of aligning provisions for national adoption: see Toronto Stock Exchange, Committee on
Corporate Disclosure, \textit{Toward Improved Disclosure: A Search for Balance in Corporate Disclosure}
(Toronto: Toronto Stock Exchange Committee on Corporate Disclosure, 1997) [Allen Committee Final
efforts culminated in the recommendation of statutory civil actions by the TSX Committee on Corporate Disclosures (the “Allen Committee”) final report issued in 1997, which created momentum for legislative change.\textsuperscript{41}

The new statutory civil liability regime is based on draft legislation that the OSC and Canadian Securities Administrators (CSA) proposed for public comment in 1998 and 2000.\textsuperscript{42} That draft legislation, based on the Allen Committee’s recommendations, became the subject of further public policy debate. The major concerns expressed with respect to the draft legislation were the potential costs to issuers and their directors of having to defend against unmeritorious class actions. To discourage the use of the statutory right of action to bring coercive strike suits, leave requirements were adopted to bolster the “loser pays” cost regime in Ontario and proportionate liability provisions.\textsuperscript{43} Ontario introduced its legislation in the form of Bill 198 in October 2002;\textsuperscript{44} however, the civil liability sections of the bill were not proclaimed into force.\textsuperscript{45} In 2003, however, the Ontario Ministry of Finance tabled the Final report of the Five Year Review Committee, which was appointed to review the OSA.\textsuperscript{46} One of the most significant recommendations of that report was that the secondary market civil liability provisions should be brought into force.\textsuperscript{47} This report, combined with pressure to align secondary market remedies for Canadian market participants with those available in the U.S., provided the impetus for the Ontario government to introduce the current regime effective 2005. The other provinces have followed suit.

III. SECURITIES CLASS ACTIONS AGAINST CANADIAN ISSUERS

Although few cases have been filed to date in Canada, Canadian firms that cross-list on U.S. exchanges have been exposed to litigation in U.S. courts under U.S. securities laws for
some time now. Our purpose here is to assess the exposure of Canadian companies to securities class actions on both sides of the border. We compare briefly the Canadian and U.S. causes of action. We then offer empirical evidence on the securities suits that have been brought against Canadian issuers in both Canada and the U.S. through July 2009. The pre-existing litigation exposure that U.S. listed Canadian firms had prior to the recent enactment of secondary market liability in Canada allows us to examine how the different legislative frameworks may have influenced the number and type of suits.

A. CAUSES OF ACTION AND BURDEN OF PROOF

1. PRIMARY LIABILITY

Under the Canadian primary market civil liability provisions, a purchaser of a security offered by a prospectus during the period of distribution has a right of action against the issuer and others where the plaintiff can establish that there was a misrepresentation. A "misrepresentation" is broadly defined to mean "an untrue statement of a material fact" or an omission to state a material fact that is either required to be stated or is necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made. This latter phrasing is aimed at capturing half-truths. The term "material fact" is defined as a fact that significantly affects, or could reasonably be expected to significantly affect, the market price or value of the securities. A "material change" is defined as "a change in the business, operations or capital 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." There is a deemed reliance provision such that the plaintiff does not have to establish the existence of a duty of care or reliance on the misrepresentation.

In Canada, there is also a right of action for those that purchased securities during the period of distribution where a misrepresentation is made in an offering memorandum. Where the misrepresentation has occurred in a takeover bid circular, any security holder has the right to bring an action. These provisions are generally consistent with the rules in the U.S., which provide for liability for misstatements in the registration statement for investors who can trace their shares to that statement. Misstatements in the prospectus are also actionable by those who are entitled to receive the prospectus during the delivery period. American law also provides a remedy for oral misstatements made in connection with the offering, as well as written materials other than the prospectus. Unlike Canadian legislation,....
however, U.S. law does not impose liability for material changes. The accuracy of the registration statement is measured as of the time of its effective date; the prospectus is assessed as of the time that it is sent to investors. Subsequent changes to the issuer’s business that render the disclosures in those documents inaccurate do not give rise to liability. U.S. law also omits a reliance requirement with respect to misstatements in the registration statement or prospectus. Failures to disclose are actionable only if the defendant has traded on confidential information in violation of a fiduciary duty to disclose, either to the counterparty to the trade or to the source of the information. Both jurisdictions provide a remedy for false forward-looking statements.

2. SECONDARY LIABILITY

In respect of secondary market civil liability, Canadian securities law provides a cause of action to anyone who acquires or disposes of the issuer’s securities during the liability period. The liability period extends from the time the document was released, or public oral statement that contained a misrepresentation was made, or there was a failure to make timely disclosure, and the time the misrepresentation was publicly corrected or disclosure was made. American law defines liability the same way with respect to misrepresentations, but does not require disclosure of material changes.

As with the primary market provisions, there is a deemed reliance provision under the new secondary market provisions in Canada. Under this provision, the plaintiff does not need to demonstrate reliance on the misrepresentation, or on the issuer’s failure to disclose as required. American law retains a reliance requirement, but judicial interpretations have left that requirement somewhat attenuated. In cases of pure omission in violation of a duty to disclose, the plaintiff need only show materiality of the omitted statement. For affirmative statements, the U.S. Supreme Court has adopted a presumption of reliance — the “fraud on the market” theory discussed above — when the misstatement was released into a capital market with active trading and a wide following among institutional investors and analysts.

The Canadian secondary market civil liability provisions distinguish core and non-core documents. Core documents include a prospectus, takeover-bid circular, issuer circular, directors’ circular, rights offering circular, management discussion and analysis, annual information form, interim and annual financial statements when used in relation to an outside director, an influential person who is not an officer, or a director or officer of such an influential person. Core documents for issuers, their officers, or investment fund managers includes the same list of documents, plus material change reports and any other document prescribed by regulation. Non-core documents require a higher burden of proof; specifically, the plaintiff must prove that the person or company knew that the document or public oral statement contained a misrepresentation, deliberately avoided acquiring the knowledge, or acted with gross misconduct in connection with release of the document or

60 See Gallagher v. Abbott Laboratories, 269 F.3d 806 (7th Cir. 2001).
61 OSA, supra note 3, s. 138.3.
63 Basic, supra note 13.
64 OSA, supra note 3, s. 138.1.
65 Ibid.
public oral statement containing the misrepresentation. This higher burden of proof is also required where outside directors and influential persons are being sued for failure to make timely disclosure and knew the change was material, but it is not required in relation to the issuer and its officers, or investment fund manager.

American law does not distinguish between types of disclosure; press releases and oral statements are held to the same standard as filings made with the SEC. For all alleged misstatements, the plaintiff must plead with particularity that the defendant made the misstatement with scienter, generally held to require at least recklessness. For forward-looking statements, the plaintiff must plead actual knowledge of the falsity of the projection.

3. Procedures

In both Canada and the U.S. there has been concern about class action counsel generating class actions without a representative plaintiff that is truly directing counsel. Professor Garry Watson has expressed concern about “entrepreneurial lawyers” that initiate and run the class action, often with a view to maximizing their own financial return to the potential prejudice of class participants and to the integrity of the class action system. Although entrepreneurial lawyers facilitate the access to justice goals of class actions, Watson suggests that the desire to maximize financial amounts may lead such counsel to refuse reasonable offers of settlement, or alternatively, may encourage counsel to seek a settlement that fully covers their expenses and remuneration, but results in an inadequate or unfair remedy for investors.

To help address these concerns, no action can be commenced without leave of the court under Canadian secondary market civil liability provisions. The court is to grant leave only where it is satisfied that “the action is being brought in good faith” and “there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.” This provision gives a significant gatekeeping role to the court as it will have to conduct at least a preliminary examination of the impugned act or inaction in order to determine whether there is a reasonable possibility that the plaintiff will succeed at trial. To date there are only a few judgments in respect of granting leave to commence a class action where the parties consented to the certification as part of the settlement of the action.

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66 Ibid., s. 138.4(1). The plaintiff is not required to prove this in relation to an expert (s. 138.4(2)).
67 Ibid., ss. 138.4(3)-(4).
68 Exchange Act, supra note 12, § 78u-4(b)(2).
69 Ibid., § 78u-5(c)(1)(B).
70 Garry Watson, “Class Actions and the Dilemma of ‘Entrepreneurial Lawyering’: The Good and the Not So Good Aspects of Class Actions” (2005) at 5 [unpublished, on file with authors].
71 Ibid. at 6-7. An Ontario Court has noted that “class proceedings raise certain ethical issues, such as the potential conflict of interest between the lawyer’s duty to the representative plaintiff and to other members of the class”: Epstein, supra note 24 at para. 37.
72 OSA, supra note 3, s. 138.8(1). Notice of the motion must be given granted on motion with notice to each defendant.
73 Ibid. On application for leave to commence an action, the plaintiff and each defendant are to serve and file one or more affidavits setting forth the material facts on which each intends to rely, and the maker of such an affidavit can be examined on it in accordance with the rules of court.
74 See for example both actions against Southwestern Resources Corp., where the Court certified the class action and granted a requested settlement order on consent of the parties and there were no reasons on the criteria for granting leave: A. Stastny v. Southwestern Resources Corp., (3 November 2008), Windsor 07-CV-009525 (Ont. Sup. Ct. J.) [Stastny]; Vézina c. Southwestern Resources Corp., 2008 QCCS 5907, [2008] J.Q. no 12894 (Qc. C.S.) (QL) [Vézina].
contested motion for leave to commence an action pursuant to the secondary market provisions of the OSA, has assisted in determining the ease or difficulty with which plaintiffs will be able to commence and maintain an action. The Ontario Superior Court of Justice held that the plaintiffs met the test for leave under s. 138.8 of the Act to pursue a statutory claim for misrepresentation in the secondary market, concluding that the action was brought in good faith and that the plaintiffs had a reasonable possibility of success at trial in pursuing the statutory claims. The plaintiffs brought their claim against a number of directors and officers, in addition to the company. With respect to the audit committee directors, the Court held that there was a reasonable possibility, based on evidence of their direct involvement in accounting decisions and reporting, that the plaintiffs would succeed in establishing that they “authorized, permitted or acquiesced in the release of the document[s]” containing the misrepresentation. The motion with respect to two other directors was dismissed. These directors had a limited role in respect of the company’s financial reporting and there was no reasonable possibility of success against them at trial.

The Court held that the statutory remedy for secondary market misrepresentation was afforded directly to shareholders to recover damages for their own benefit and was not a vehicle to sue on behalf of the company for a wrong to the company. Accordingly, the Court concluded that there was no reason to read in a high or substantial onus requirement for good faith in this type of proceeding. Another purpose of the statutory remedy was to enforce a corporation’s disclosure obligations and thereby to protect and enhance the integrity of the secondary market. The Court was satisfied that the plaintiffs acted in good faith in pursuing the proceedings. They had a personal financial interest in the action as persons who acquired shares during the class period, and they asserted altruistic reasons for commencing the action: “to hold the defendants accountable for misrepresentations to the public, and to send a message to directors and officers of other public companies that they too will be held accountable for misrepresentations to the public.”

The Court further held that these reasons for pursuing the action are consistent with the legislative purpose of the statutory remedy, which is deterrence.
The second branch of the leave test requires that the court be satisfied that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff. The Court noted that the plaintiffs pleaded a misrepresentation supported by the evidence of the company’s restatement, and that there was no evidence of any ulterior motive or conflict of interest. Accordingly, the plaintiffs met the test of having a reasonable possibility of success at trial in establishing a misrepresentation. The Court expressly rejected a request to adopt a standard akin to the U.S. test of scienter.

The Court expressly refused to “read in” the business judgment rule, finding it “both unnecessary and inconsistent with the legislative approach to the statutory remedy and defences.” The Court held that the wording of s. 138.4(11) regarding the expert reliance defence “suggests that it is intended to apply where the misrepresentation at issue originates with the expert, in circumstances where it has been communicated to the secondary market by the person or company on the authority of the expert.”

Factors applicable to the individual respondents are also relevant, including their qualifications, knowledge, experience, and their role within or in relation to the organization and in connection with the company’s financial reporting. The second part of the “reasonable investigation” defence “involves a consideration of the specific knowledge of each respondent and the knowledge someone in his or her position ought to have had with respect to the misstatement of the Company’s financial results”; this part of the test focuses on a “consideration of the true state of affairs.” The Court expressly refused to “read in” the business judgment rule, finding it “both unnecessary and inconsistent with the legislative approach to the statutory remedy and defences.” The Court held that the wording of s. 138.4(11) regarding the expert reliance defence “suggests that it is intended to apply where the misrepresentation at issue originates with the expert, in circumstances where it has been communicated to the secondary market by the person or company on the authority of the expert.”

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79 Ibid. at para. 310.
80 Ibid. at paras. 310, 334. The Court held that, with respect to the defences relied upon by each respondent, it must be shown that there is a reasonable possibility that such respondent could not establish at trial both elements of the defence of “reasonable investigation” given by the OSA, supra note 3, s. 138.4(6). These include:
   (i) that the respondent conducted or caused to be conducted a “reasonable investigation”; and
   (ii) at the time of the release of the document the respondent had no reasonable grounds to believe that the document contained the misrepresentation;

or, to the extent the expert reliance defence is applicable:
   (i) that the respondent did not know that there had been a misrepresentation in the part of the document made on the authority of the expert; and
   (ii) the respondent had no reasonable grounds to believe that there had been a misrepresentation in the part of the document made on the authority of the expert.

81 Ibid. at paras. 340-46. The Court held at para. 345: [T]he legislative history of the Ontario statutory remedy reflects an informed decision to put in place a screening mechanism that differs from the U.S. pleadings-based approach. The CSA noted that the Ontario proposed legislation, as a specific and comprehensive code, was fundamentally different from Rule 10b-5, which is a general anti-fraud rule from which the courts have implied a right of action. The key element of intent or recklessness that a plaintiff must establish to succeed in a Rule 10b-5 action need not be proved in an Ontario statutory proceeding, where the mental element is the absence of due diligence.

82 Ibid. at para. 361.
83 Ibid. at para. 360.
84 Ibid. at paras. 361-63. The Court held that the “reasonable investigation” defence requires the application of objective criteria on two points: the defendant must establish that an investigation that he or she undertook or caused to be undertaken was reasonable in the circumstances, and he or she must have had no reasonable grounds to believe that there was a misrepresentation and in determining whether an investigation was reasonable. The court is directed to consider all relevant circumstances, including a non-exhaustive list of relevant circumstances, citing the list of factors set out in the statute (paras. 358-59).
85 Ibid. at para. 372.
expert," and that the expert reliance defence "would not appear to apply to the alleged misrepresentations in this case, which originated with the Company."86

In the U.S., plaintiffs are not required to seek leave of the court before filing an action for primary liability. In secondary liability cases, however, the plaintiff's complaint must plead the facts relating to the fraud, including facts "giving rise to a strong inference that the defendant acted with the required state of mind," with particularity.87 Complaints that do not plead facts relating to the fraud with sufficient particularity are subject to dismissal. The challenge that this requirement poses for the plaintiff is heightened by the stay of discovery that applies while a motion to dismiss is pending.88 In practice, complaints are routinely met by a motion to dismiss, meaning that the action is effectively stayed until the court decides the motion.89 Thus, U.S. law provides an implicit gatekeeping role for the court as well.

Under the Canadian provisions, once the court has granted leave to commence an action the plaintiff must promptly issue a news release disclosing that leave has been granted and must send written notice to the securities commission.90 Once commenced, the action cannot be discontinued, abandoned, or settled without the approval of the court on such terms as the court thinks fit, including terms as to costs.91

In the U.S., the plaintiff must provide notice to members of the prospective class within 20 days of filing the complaint.92 Members of the class then have 90 days from the filing of the notice to make a motion to the court to be appointed lead plaintiff.93 The member of the class with the largest losses enjoys a presumption that it should be appointed as lead plaintiff,94 with the authority to select the lawyer to represent the class.95 Settlement of a U.S. class action also requires judicial approval. Before the court can approve the settlement, notice must be given to the members of the class, setting forth the aggregate amount of the settlement, the recovery per share, and the parties' views on the amount of damages potentially recoverable.96

Having set out the various causes of action and applicable procedures, the next part discusses the class action proceedings filed to date against Canadian issuers under these provisions.

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86 Ibid. at paras. 434-35.
87 Exchange Act, supra note 12, §§ 78u-4(b)(1)-(2).
88 Ibid., § 78u-4(b)(3).
89 In Canada, litigants have different disclosure obligations under the different provincial class action statutes. In Quebec, for example, there is no compulsory disclosure of documents until after discovery, although courts will consider making a safeguard order; see Option consommateurs (Benoit Fortin) c. Banque Amex du Canada, 2007 QCCS 6414, [2007] J.Q. no 15986 (QL).
90 OSA, supra note 3, s. 138.9(1). It must also "send a copy of the statement of claim or other originating document to the Commission when filed" (s. 138.9(1)(c)).
91 Ibid., s. 138.10. This is consistent with the general rule in class actions, which can only be settled or discontinued with the approval of the court; see also OCPA, supra note 16, ss. 29(1)-(2): in determining whether to approve the settlement of an action, the court is to consider, among other things, whether there are any other actions outstanding under the same or comparable legislation in other provinces or territories in respect of the same misrepresentation or failure to make timely disclosure; OSA, s. 138.11 specifies that "[d]espite the Courts of Justice Act and the Class Proceedings Act, 1992, the prevailing party in an action under section 138.3 is entitled to costs determined by a court in accordance with applicable rules of civil procedure."
93 Ibid., § 78u-4(a)(3)(B)(i).
96 Ibid., § 78u-4(a)(7).
B. **INCIDENCE AND CHARACTERISTICS OF SECURITIES FRAUD CLASS ACTIONS**

In Figure 1, below, we show the number of lawsuits faced by Canadian issuers. For purposes of this chart, we count lawsuits as one suit even when there are proceedings in multiple jurisdictions. For example, if proceedings are brought in both Ontario and Quebec, these proceedings count as one suit in the “Canada” tally; if proceedings are brought in Ontario and New York, these count as one suit in the “Both” tally. The reality of these multi-jurisdictional proceedings is that the complaints allege essentially similar facts and class periods; the second filed complaints are generally copies of the initial complaint and some of the proceedings appear to have been coordinated. For the cross-border proceedings, the U.S. suit is typically filed first. Generally the actions are settled simultaneously, subject to the approval of courts in both Canada and the U.S.

![Figure 1: Number of Securities Class Action Suits Against Canadian Companies](image)

Two salient features emerge from this tally of lawsuits. First, the overall number of lawsuits remains relatively low, with no more than a handful in any given year. With a total of 90 lawsuits, the average is a mere five suits per year. Given the need for adequate damages to support a contingent fee recovery, the main litigation targets are likely to be issuers listed on the TSX. The total translates to approximately 0.3 percent chance of being sued in a securities class action in a given year for the approximately 1,500 TSX issuers. By way of comparison, NERA Economic Consulting (NERA) reports that the overall probability of lawsuit for all U.S. listed companies has ranged from 1.3 to 1.8 percent over that same period.

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97 The numbers for 2009 go only through 31 July 2009.
The second salient feature is that, until quite recently, lawsuits against Canadian companies were overwhelmingly heard in American courts. The litigation was based almost exclusively in the U.S. until the mid-1990s, with a very small number of both and Canada only suits until the last few years, when we begin to see a rise in Canada suits. We speculate that the class action bar in Canada is still finding its feet with respect to securities class actions; the recent adoption of the secondary market legislation greatly expands the number of available targets.

Table 1, below, reveals that one prominent feature of the lawsuits with proceedings in both jurisdictions is that the fraud allegations are relatively serious. Nearly 70 percent of the companies sued were the subject of some sort of regulatory investigation. “Govt. Enforcement” is defined to include a government investigation conducted by entities, such as the RCMP, provincial securities commission, SEC, or Federal Bureau of Investigation, whether formal or informal against the sued company or officers, as well as an investigation by a stock exchange. A government investigation is regarded as a proxy for cases of intentional fraud, and disclosure of such an investigation is a prominent signal for the plaintiffs’ bar.

Another prominent signal is the announcement of a restatement of earnings or revenues by a company, which is essentially an admission that its prior financial statements included a material misrepresentation. Half of the both suits involve a restatement, and 43 percent of all actions involve accounting allegations, which are often revealed in either restatements or public disclosure to investors.

Roughly half of all actions involved forward-looking information. This figure suggests that not withstanding the existence of defences through the use of cautionary language when issuing forward-looking information, there is a risk, at least at the stage of commencement of actions, of being sued for the content of the forward information, particularly for cross-listed issuers. This suggests that Canadian issuers are not any more likely to face a suit for forward-looking information than are American issuers sued in the U.S.\footnote{These numbers in fact appear somewhat low, given that Marilyn Johnson, Karen Nelson, and A.C. Pritchard found that forward-looking allegations were included in 74 percent of the post-litigation reform complaints in their sample: see Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, “Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act” (2007) 23 J.L. Econ. & Org. 627 at 637.} The incidence of forward-looking allegations remains relatively high in the U.S., despite the more stringent version of safe harbor in effect there, although there are very few complaints that allege forward-looking misstatements standing alone.\footnote{We discuss the differences between the Canadian and U.S. forward-looking safe harbors in Part III.D, below.}
**TABLE 1**

**CLAIMS AND ALLEGATIONS IN U.S. AND CANADIAN SECURITIES CLASS ACTIONS AGAINST CANADIAN COMPANIES**

<table>
<thead>
<tr>
<th></th>
<th>U.S.  (n=57)</th>
<th>Canada (n=17)</th>
<th>Both (n=16)</th>
<th>Total (n=90)</th>
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<tbody>
<tr>
<td></td>
<td>Number  %</td>
<td>Number  %</td>
<td>Number  %</td>
<td>Number  %</td>
</tr>
<tr>
<td>Govt. Enforcement</td>
<td>11  19</td>
<td>6  38</td>
<td>10  63</td>
<td>27  30</td>
</tr>
<tr>
<td>Primary Offering</td>
<td>21  37</td>
<td>10  59</td>
<td>5  31</td>
<td>36  40</td>
</tr>
<tr>
<td>Secondary Market</td>
<td>47  82</td>
<td>812  71</td>
<td>16  100</td>
<td>75  83</td>
</tr>
<tr>
<td>Forward-Looking</td>
<td>32  56</td>
<td>3  18</td>
<td>10  65</td>
<td>45  50</td>
</tr>
<tr>
<td>Accounting</td>
<td>21  37</td>
<td>7  41</td>
<td>11  71</td>
<td>39  43</td>
</tr>
<tr>
<td>Restatement</td>
<td>10  18</td>
<td>7  41</td>
<td>8  50</td>
<td>25  28</td>
</tr>
<tr>
<td>Laddering</td>
<td>4  7</td>
<td>0  0</td>
<td>0  0</td>
<td>4  4</td>
</tr>
</tbody>
</table>

Overall, 83 percent of the cases involve secondary market civil liability actions, and they comprise 100 percent of the cases in which issuers are sued in Both jurisdictions. Given how recent the Canadian secondary market provisions are, this figure is likely to increase in the future because of the greater scope of available damages.

The initial cases under the Canadian secondary market provisions appear to support the supposition that restatements or admission of misrepresented information are the most likely to result in the certification of initial applications for class actions. The Silver proceeding involved claims that Imax Corp. (Imax) and its officers knowingly overstated revenues for 2005, thereby artificially inflating the trading price of Imax securities. Imax had announced an earnings increase of 62 percent for the fiscal year ended on 31 December 2005. In August 2006, Imax stated that it had recognized revenue in the fourth quarter of 2005 on ten theatre system installations in theatres that did not open in that quarter; this disclosure was followed by a sharp drop in share price in the market. The claim alleged that the press release issued by the company, the individual certifications, and the revenue statements were knowingly false and/or materially misleading. It also alleged that Imax’s financial results between 17 February 2006 and 9 August 2006 did not comply with Generally Accepted Accounting Principles (GAAP) and were materially false and misleading.

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101 “Both” signifies lawsuits brought against the same issuer in Canada and the U.S.
102 Silver v. Imax Corp., [2008] O.J. No. 1844 at para 20 (Sup. Ct. J.) (QL) [Silver II], leave to appeal an interlocutory order refused, [2008] O.J. No. 2751 (C.A.) (QL) [Silver III]. The value of Imax’s securities declined by approximately 40 percent when the alleged misrepresentations were disclosed.
103 See supra note 75 and accompanying text.
A class action claiming $110 million in general damages and $10 million in punitive damages was filed against CV Technologies Inc. (CV) and its Chief Executive Officer (CEO), two directors, and the auditor alleging misrepresentation and negligence in disclosure. The action arose out of the June 2007 restatement of CV’s financial statements and alleged misstated financial results based on non-GAAP revenue recognition. Another class action application, against Southwestern Resources Corp., alleged misrepresentation in assay drill results reporting and controls, after errors in reporting were publicly corrected. The action settled for in September 2008 for more than $15.5 million. Yet another class action alleges that Celestica Inc. and certain of its officers and directors made misrepresentations or failed to make timely disclosure to investors, resulting in alleged damages to the plaintiff and other investors of $320 million. The parties reached a settlement 28 April 2010, which is subject to the approval of the Ontario Superior Court of Justice. The settlement agreement provides that the defendants will pay $7.1 million in full and final settlement of all claims.

Another case that will test the scope of law is the class action filed in November 2008 against American International Group Inc. (AIG), alleging that the failure to disclose caused substantial losses to Canadian investors. The $550 million class action was filed in Ontario against AIG, AIG Financial Products Corp. (AIGFP), and specified current and former directors and officers in November 2008. The AIG class action arises out of AIGFP’s credit default swaps (CDS) and the decline in AIG’s stock price when collateral calls on the CDS caused the financial collapse of the corporate group. The AIG disclosures are currently being investigated by regulatory authorities as well. Although the case is not included in the sample data as the issuer is not Canadian, the lawsuit in Canada parallels one in the U.S. The defendants have moved to dismiss the action, a motion that will be heard early in 2010.

The pattern illustrated by these few examples indicates that parties are pursuing cases where there is some indication in public disclosures of misconduct that was known or ought reasonably to have been known.

C. DEFENDANTS IN SECURITIES CLASS ACTIONS AGAINST CANADIAN ISSUERS

Table 2, below, provides a summary of types of defendants in the class actions to date. In primary market civil liability in Canada, a civil action for misrepresentation in a prospectus can be brought against the issuer or, in the case of a sale by a control person, against the selling security holder. The action can also be brought against the underwriter, directors, any expert who consented to the use of all or part of his or her opinion or report, and every

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104 Ainslie v. CV Technologies Inc. (2008), 93 O.R. (3d) 200 (Sup. Ct. J.) [CV Technologies]. The class action was brought by two investors on behalf of all persons who acquired CV shares from 11 December 2006 to 23 March 2007.

105 Stasny, supra note 74; Vézina, supra note 74. In 2007, Southwestern issued a press release and disclosed that there were deficiencies in its control procedures for its Boka Gold Project and errors in reported assay due to the integrity of drill core samples being compromised. The statement of claim in suits filed in three Canadian jurisdictions allege that the defendants negligently or recklessly misrepresented the quantity of gold in its drill samples taken from the Boka Gold Project and claims $320 million in damages on behalf of the class members.

106 The action was commenced on 30 July 2007. It is ongoing as of publication. See CV Technologies [Settlement Agreement], online: Sutts, Strosberg LLP <http://www.coldfxclassaction.com>.

107 The AIG class action is brought on behalf of all persons and entities resident in Canada who acquired AIG securities during the period from 16 March 2006 to, and including, 16 September 2008.

108 There are AIG subsidiaries in Canada.
person who signed the prospectus. Every person in a special relationship with the issuer who buys or sells securities with knowledge of a material fact or material change that has not been generally disclosed is liable to compensate the buyer or seller for damages as a result of the trade. Hence, both the decision-makers and the gatekeepers are potentially liable for misrepresentation during a primary offering. American law provides a remedy against issuers, underwriters, directors, experts, and signatories of the registration statement; control persons face liability, whether or not they are selling shares, unless the control person can show they “had no knowledge of or reasonable ground to believe in the existence of the facts” alleged to be misleading.

Under the Canadian secondary market civil liability provisions the class of potential defendants is broader than for primary market disclosure. The class includes the responsible issuer, its directors and officers, “influential persons” and, in the case of written or oral statements, experts. The definition of “influential person” with respect to a responsible issuer includes control persons, promoters, and insiders who are not directors or senior officers. The addition of influential persons is significant, given the traditional notion of limited liability for shareholders, and could arguably result in such shareholders engaging in a higher degree of monitoring. However, the liability for this class of potential defendants is narrow; unless the influential person released the impugned document or made the public oral statement, “knowing influence” on the responsible issuer will be required to ground an action.

American law does not specify a class of defendants in the statute; the class of defendants has been determined by case law. The most important case on this point is Central Bank, in which the Supreme Court held that individuals who merely “aid and abet” a violation could not be held liable. According to the Court, “the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.” The Court recently rejected “scheme liability” for third parties that allegedly entered into sham transactions to facilitate fraud by an issuer. However, the statute does provide for liability for control persons, subject to a defence that the control person acted in good faith and did not directly or indirectly induce the violation.

Table 2, below, illustrates that the number of suits naming auditors as defendants is quite low, 5 percent, in the U.S. category. This figure likely stems from the U.S. Supreme Court’s rejection of aiding and abetting liability. The less restrictive standard for secondary actors under the Canadian regimes produces a higher percentage of suits naming auditors in Canada. Underwriters are also named more frequently in lawsuits with a Canada component, likely as a result of the greater prevalence of offering claims in those suits. However, given how few cases there have been to date, broad conclusions cannot be drawn from the data.

109 Typically, the CEO and the Chief Financial Officer (CFO) of the issuer sign the prospectus, as well as promoters of the issuer.
110 OSA, supra note 3, s. 134(1).
111 Securities Act, supra note 18, § 77o.
112 OSA, supra note 3, s. 138.1.
113 Ibid., ss. 138.3(1)-(3).
115 Ibid. at 177.
117 Exchange Act, supra note 12, § 78t(a).
118 Central Bank, supra note 114.
Other important differences show up in the slightly higher percentage of officers sued in suits with a U.S. component, and the higher percentage of directors appearing as defendants in suits with a Canada component. These discrepancies highlight the importance that the scienter requirement plays in Rule 10b-5 claims. In the U.S., plaintiffs need to include the officer to establish the corporation’s scienter. Allegations of scienter against the directors are likely to be difficult to sustain given their lack of proximity to the corporation’s information flows. The number of cross-listed firms is quite high for the U.S. and Both categories, as expected; the handful of Canadian firms sued in the U.S. without listing there involved private placements to U.S. investors.

**TABLE 2**

**DEFENDANTS IN U.S. AND CANADIAN SECURITIES CLASS ACTIONS AGAINST CANADIAN COMPANIES**

<table>
<thead>
<tr>
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<th>U.S. (n=57)</th>
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<tbody>
<tr>
<td>Number</td>
<td>%</td>
<td>Number</td>
<td>%</td>
<td>Number</td>
</tr>
<tr>
<td>Company</td>
<td>53 93%</td>
<td>15 89%</td>
<td>15 94%</td>
<td>82 91%</td>
</tr>
<tr>
<td>Insolvent</td>
<td>7 12%</td>
<td>5 31%</td>
<td>5 31%</td>
<td>17 19%</td>
</tr>
<tr>
<td>Cross-listed</td>
<td>55 96%</td>
<td>3 19%</td>
<td>14 88%</td>
<td>72 80%</td>
</tr>
<tr>
<td>Officers</td>
<td>51 88%</td>
<td>13 81%</td>
<td>15 94%</td>
<td>78 87%</td>
</tr>
<tr>
<td>Directors</td>
<td>28 49%</td>
<td>11 69%</td>
<td>12 75%</td>
<td>50 56%</td>
</tr>
<tr>
<td>Auditor</td>
<td>3 5%</td>
<td>3 19%</td>
<td>5 32%</td>
<td>11 12%</td>
</tr>
<tr>
<td>Underwriter</td>
<td>9 16%</td>
<td>5 31%</td>
<td>4 25%</td>
<td>18 20%</td>
</tr>
</tbody>
</table>

Only 19 percent of firms filed insolvency proceedings overall. The percentage in the Both category is considerably higher, which may be attributable to the relatively well-developed cross-border mechanisms for restructuring proceedings and their ability to deal with class actions suits. As amendments to Canadian insolvency legislation have now come into force, there is likely to be an increased number of insolvency filings in connection with securities class action suits, as claims arising out of securities law violations will be completely subordinated in any insolvency workout.19

**D. REMEDIES, OUTCOMES, AND DEFENCES**

1. REMEDIES

There are rights to rescission and to damages under both Canadian and U.S. securities law. In Canada, there is a right of rescission under the primary market civil liability provisions. Purchasers may elect to exercise a right of rescission against a person, company, or underwriter that sold them the securities, in which case they have no right of action for

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There are rights to rescission for misrepresentations in an offering memorandum and takeover circular as well. American law affords a right of rescission against the issuer, as well as the underwriter in a firm commitment offering, for misrepresentations in the prospectus, as well as in written and oral statements made in the course of the offering. Misstatements in the registration statement only allow for damages.

There are limitations to primary market liability that are consistent in the U.S. and Canada. In an action for damages, the defendant is not liable for any portion of the damages that the defendant proves does not represent the depreciation in value of the security as a result of the misrepresentation. The amount recoverable cannot exceed the price at which the securities were offered to the public.

In an action for damages for misrepresentation in an offering memorandum or takeover circular, the defendant is not liable for portions of the damages that the defendant proves do not represent the depreciation in value of the security as a result of the misrepresentation. Defendants are afforded a similar loss causation defence in the U.S. for misstatements in the prospectus; plaintiffs bear the burden of proving loss causation for misrepresentations made in connection with a tender offer.

The clearest division between Canada and the U.S. arises on the question of damages under the secondary market provisions. Under U.S. law, damages are potentially unlimited. Canada, however, caps damages payable by a defendant issuer or an influential person that is not an individual to the greater of $1 million or 5 percent of the issuer’s market capitalization. Damages payable by a director or officer of the issuer, individual influential person or director or officer of an influential person are limited to the greater of $25,000 or 50 percent of annual aggregate compensation received from the issuer or influential person and affiliates. The liability cap for experts is $1 million or the revenue that the expert and its affiliates have earned from the issuer and its affiliates during the 12-month period immediately preceding the day on which the misrepresentation or the failure to make timely disclosure occurred.

The Canadian secondary market liability limits are inapplicable, except for the responsible issuer, if the plaintiff can prove the defendant authorized, permitted, acquiesced in, or influenced “the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or failure to make timely disclosure.”

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120 OSA, supra note 3, s. 130(1).
121 Ibid., ss. 130.1(2), 131.
122 Securities Act, supra note 18, §§77k(e), 77l(a)(2).
123 See e.g. OSA, supra note 3, s. 130(7); Securities Act, ibid., § 77k(e).
124 OSA, ibid., s. 130(9); Securities Act, ibid. Underwriters enjoy a special protection: they cannot be held liable for more than the total public offering price represented by the portion of the distribution underwritten by the underwriter: OSA, s. 130(6). The OSA, s. 130(8) provides for joint and several liability; in the U.S., outside directors are protected by proportionate liability: Securities Act.
125 OSA, ibid., ss. 130.1(3), 131(9).
126 Securities Act, supra note 18, § 77l(b).
128 OSA, supra note 3, s. 138.1.
129 Ibid.
130 Ibid., s. 138.6. Liability can be proportionately allocated in respect of each defendant’s responsibility for the damages assessed. American law also provides for proportionate liability, although joint and several liability applies to knowing violations: Exchange Act, supra note 12, § 78u-4(f).
131 OSA, ibid., s. 138.7(2).
is a significant exception to the liability limits for individuals. It may result in actions being brought only in the clearest cases of fraud or misrepresentation, such as earnings restatements, in order for plaintiffs to avoid the liability cap. It may be that the only cases that are financially worth pursuing, given the costs of litigation, are those cases in which the cap on damages would not apply. Of course, if the issuer has a large market capitalization, even 5 percent of that figure would justify the cost of a lawsuit.

The damages cap seeks to balance remedies for investors against the desire to protect and advance capital market activity through the protection of officers and other persons. The limit on damages encourages plaintiffs to focus on actions likely to have merit. The downside is that it is likely to result in investors recovering less than the full amount of their losses, absent clear evidence of fraud. Even then, the liability cap for issuers means that investors are unlikely to recover full compensation in cases of significant fraud. One question is whether the liability cap has been appropriately priced in terms of creating the appropriate mix of remedies and deterrence. Mary Condon has suggested that the limit on damages indicates that legislators were more interested in achieving deterrence than compensation, but she questions whether the liability limits are set high enough to achieve the desired deterrence. This focus on deterrence is consistent with the “pocket shifting” critique of secondary market class actions discussed in Part I, above.

There is highly codified language in respect of how the court is to assess damages, including specified trading dates and how to calculate the value of damages. The provisions do not require plaintiffs to crystallize those losses by selling the security in order to compute damages. However, the defendant is not liable for any amount that it can prove “is attributable to a change in market price of the securities that is unrelated to the misrepresentation or the failure to make timely disclosure.” American law makes loss causation part of the plaintiff’s burden of proof; the plaintiff must also plead loss causation in its complaint.

2. OUTCOMES

Table 3, below, illustrates the outcomes of the lawsuits. Whereas in Figure 1 and Tables 1 and 2, above, we compiled suits with both Canada and U.S. proceedings as one suit, in Table 3, Panel A, we separately break out the resolution of those cross-border lawsuits. Some cases were dismissed on one side, but were settled or remain active on the other side of the border. The settlements are reported on a consolidated basis in Panel B however, as most of the settlements involve a universal resolution. The settlement figures are reported in U.S. dollars.
TABLE 3
OUTCOME OF SECURITIES CLASS ACTIONS AGAINST CANADIAN COMPANIES

<table>
<thead>
<tr>
<th>Panel A</th>
<th>U.S. (n=57)</th>
<th>Canada (n=17)</th>
<th>Both (n=32)</th>
<th>Total (n=106)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>%</td>
<td>Number</td>
<td>%</td>
</tr>
<tr>
<td>Dismissed</td>
<td>15</td>
<td>26</td>
<td>3</td>
<td>18</td>
</tr>
<tr>
<td>Settled/Judgment</td>
<td>33</td>
<td>58</td>
<td>6</td>
<td>35</td>
</tr>
<tr>
<td>Active</td>
<td>9</td>
<td>16</td>
<td>8</td>
<td>47</td>
</tr>
</tbody>
</table>

Panel B

<table>
<thead>
<tr>
<th></th>
<th>Mean Settlement</th>
<th>Excluding Nortel I &amp; II</th>
<th>Median Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>9,425,384</td>
<td>11,350,718</td>
<td>3,825,000</td>
</tr>
<tr>
<td></td>
<td>216,768,214</td>
<td>38,417,797</td>
<td>5,782,465</td>
</tr>
<tr>
<td></td>
<td>62,597,228</td>
<td>16,111,758</td>
<td>27,622,803</td>
</tr>
</tbody>
</table>


The dismissal rate of 20 percent appears to be somewhat low given that the overall dismissal rate in the U.S. is around 50 percent for cases filed between 2003 and 2007.\textsuperscript{137} It is premature, however, to conclude that Canada is a more plaintiff friendly jurisdiction as the dismissal rate is likely depressed by the significant percentage of cases that remain active. Undoubtedly, more cases will fall by the wayside. The damages limitation and potential cost consequences, however, may mean that plaintiffs are particularly careful in selecting their cases in Canada; if so, one would predict a generally lower dismissal rate.

The settlement amounts reported in Table 3 are striking, with a mean of $63 million overall and $217 million for suits in the Both category. These figures are inflated, however, by two outlier settlements involving Nortel of greater than $1 billion, both of which rank among the top ten in U.S. history.\textsuperscript{138} The valuation of these settlements is open to question, however, as the bulk of these settlements consists of newly issued Nortel shares.\textsuperscript{139} The effect of this issuance is that current Nortel shareholders saw their stockholdings diluted to compensate past Nortel shareholders as well as some current Nortel shareholders. The “pocket shifting” element of this exercise is transparent. Nonetheless, the mean and median for the Both category is quite high, even with the Nortel settlements excluded. Undoubtedly, a portion of this amount can be explained by the seriousness of the allegations documented in Table 1, above; stronger claims should be expected to settle for larger amounts.


\textsuperscript{138} Foster, et al., supra note 98 at 8

\textsuperscript{139} Subsequent to these settlements Nortel declared bankruptcy, rendering these shares effectively worthless.
The existence of suits on both sides of the border also provides plaintiffs with a strategic advantage in that the Canadian lawsuit is not subject to the discovery stay applied in U.S. courts before motions to dismiss are determined, which may give U.S. plaintiffs access to evidence that they would not otherwise have if plaintiffs’ attorneys coordinate their efforts.

The issue of how Canadian courts will treat this difference was recently litigated in Ontario in the context of a motion to compel answers to questions refused during cross-examination on a pending certification motion, in the first proceeding under the secondary market civil liability provisions. The respondents had argued that the court’s gatekeeping role under the new civil liability provisions should result in the court imposing a higher threshold for examination than the usual test of whether the information to be elicited has a “semblance of relevance” to issues in the action. The Court held that “each prospective defendant must come forward with its defences, with evidence in support,” and that the merits of the claim are clearly relevant to the test for leave. Based on the evidence adduced and tested, the plaintiffs must establish good faith and that the action has a reasonable possibility of success at trial. The Court held that while the examination was not a discovery process, the court will take a careful look at “what facts are potentially relevant and material to the statutory claim and defences, as presented in the draft pleading and in the respondents’ affidavits.” The defendants were ordered to provide answers to relevant questions regarding information posted on the internet, a year-end audit, Imax policies dealing with revenue recognition, and certain questions regarding the company’s internal reviews of financial statements. The Court held that “a question that is potentially relevant to the facts alleged in respect to the statutory claims set out in the proposed statement of claim and in the defences raised in the responding affidavits must be answered even if it might also reveal some other potential issues or wrongdoing not currently contemplated by the statutory claim.”

In CV Technologies, leave to appeal has been granted on the issue of whether the motions judge erred in concluding that s. 138.8(2) of the OSA did not require each defendant to file an affidavit in response to the plaintiff’s motion for leave to bring an action. The Court held that the issue was a novel one that was of general public importance, and the decision was the first interpretation of a new section of the Act. No decision on the appeal had yet been rendered. Depending on what the Court would have decided, the scope of information about decisions or conduct that defendants may have to disclose to plaintiffs prior to the court hearing a motion for certification may be broader than under the U.S. system. However, given the settlement of the class action, discussed in Part III.B, above, and pending its

140 Silver II, supra note 102.
141 Ibid. at para 18.
142 Ibid. The Court observed that in these first proceedings under secondary market civil liability provisions, the statute provides no guidance as to the interpretation of the threshold test and what type, quality, and quantity of evidence a court is to consider in making a determination of the plaintiffs’ good faith and the reasonable possibility of the plaintiffs’ success at trial (at para. 19).
143 Ibid. at para. 20.
144 They were not required to provide answers to questions regarding the internal review process that were too broad: ibid. at para. 31.
145 Ibid. at para. 20.
146 Ainslie v. CV Technologies, [2009] O.J. No. 730 (Sup. Ct. J.) (QL). The motions judge had earlier ruled that the OSA did not require each defendant to file an affidavit in response to the plaintiff’s motion for leave to bring an action. She also concluded that it would be an abuse of process to permit the appellants to rely on Rule 39.03, as such reliance was not contemplated either by the OSA or by the principles governing examinations under Rule 39.03: CV Technologies, supra note 104 at paras. 24-25, 27.
endorsement by the Ontario Superior Court of Justice, there is not likely to be an appellate decision rendered.

Part of the rationale for the discovery stay in the U.S. is to discourage issuers from settling frivolous actions to avoid the cost of litigation before the motion to dismiss is resolved. The Canadian approach essentially allows limited discovery in order that the parties understand the basis of the counterparty's claim or defence, and that the court has the information required to determine the leave application.

Another factor, however, may be in play: such lawsuits may be more costly to settle because of their jurisdictional complexity and a greater number of parties at the table wanting to be paid. Moreover, defendants face daunting costs in continuing with the litigation because of the expense of paying counsel in both Canada and the U.S., giving an additional incentive to resolve the litigation. Defendants in these cases presumably want universal peace. They appear to be generally successful in obtaining it, but at a price. Another factor is the role of the insurer and its interest in containing litigation costs, discussed in Part IV, below.

Once the outlier Nortel settlements are excluded, the overall mean settlement drops to slightly more than $16 million. This figure is consistent with the averages for suits in the U.S.; NERA reports an average settlement of $11.5 million from 1996-2001 and $23.2 million from 2002 to 2007. The overall median of $6 million is also consistent with the American experience; NERA reports median settlements in the U.S. of $4.7 million in U.S. from 1996-2001 and $6.4 million from 2002 to 2007. This relatively low median figure has two implications. First, most suits are settling for a small percentage of investor losses. Second, half of the suits are settling for an essentially nuisance value. If a suit has survived a motion to dismiss, it is unlikely that it could be defended for less than $6 million dollars.

An analysis of the average time between filing and resolution of class actions reveals slight differences only. For class actions filed in the U.S., the average was 1,094 days; for cases filed in Canada, 1,373 days; and for cases filed in Both jurisdictions, it was 1,461 days on average between filing and resolution. In all cases, the length of time that the action is pending creates considerable uncertainty for the issuer, officers, and others in terms of their potential liability. The complexity of trying to settle cases in both jurisdictions at the same time arguably adds time for Both, but the average length of time taken in Canadian cases was more than that taken in American cases. Canadian cases may take longer because there is little caselaw that serves as a benchmark in deciding and settling cases.

3. DEFENCES

The Canadian statutory civil liability provisions set out defences, including plaintiff knowledge of the misrepresentation, that the misrepresentation did not cause the loss, and a due diligence defence where the defendant conducted a reasonable investigation to provide reasonable grounds for a belief that there was no misrepresentation, and that he or she did not believe that there was misrepresentation. The defendant is also not liable for any part
of a prospectus based on a report or opinion of an expert where the defendant had no reasonable grounds to believe, and did not believe, that there had been a misrepresentation.\(^{150}\) Another defence is that the defendant either did not consent to the filing of the prospectus, or withdrew her or his consent prior to the purchase of the securities by the purchaser and gave reasonable general notice of, and reasons for, such withdrawal.\(^{151}\) These defences are also afforded by U.S. law.\(^{152}\)

Experts are held to a duty of reasonable investigation with respect to that part of the prospectus prepared on their authority as experts.\(^{153}\) Although the distinction between experts and non-experts is significant in due diligence defences, these terms are not defined in Canadian law. The portion of the prospectus prepared by an expert appears to include the audited financial statements as well as those parts of the issuer’s description of activities prepared by engineers, geologists, and other experts.\(^{154}\) American law specifies that this category includes “every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him.”\(^{155}\)

The issuer of the securities or selling security holder is strictly liable for misrepresentations in a prospectus as it is not entitled to claim the defence of due diligence, the defence of not having consented to the prospectus, or the defence that the misrepresentation was not made by it.\(^{156}\) Under U.S. law, the issuer is strictly liable for misrepresentations in the registration statement.\(^{157}\)

Similar provisions set out liability for misrepresentation in an offering memorandum under Canadian law.\(^{158}\) However, under the Canadian provisions, the issuer is not liable where it is not receiving any proceeds from the distribution and the misrepresentation was not based on information provided by the issuer.\(^{159}\) The exception is where the misrepresentation was based on information previously disclosed by the issuer and the misrepresentation was not corrected prior to completion of the distribution of the securities.\(^{160}\) Under U.S. law, issuers are liable for misrepresentations in the prospectus only for primary offerings, and all defendants are entitled to a defence of reasonable care for misstatements in a prospectus.\(^{161}\)

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150 See e.g. OSA, ibid., s. 130(3)(c).
151 ibid., s. 130(3)(b).
152 Securities Act, supra note 18, § 77k(b).
153 See e.g. OSA, supra note 3, ss. 130(4).
154 This issue is discussed in detail in the U.S. decision of Escott v. BarChris Construction, 283 F. Supp. 643 (S.D. N.Y. 1968), in the context of civil liability for a false registration statement under the Securities Act, supra note 18, § 77k. There is no case directly on point in Canada. However, in the context of administrative sanctions under OSA, ibid., s. 127, the OSC panel has discussed the due diligence obligations of directors, officers, underwriters, and experts associated with an issue of securities at a time when the issuer was being investigated by the U.S. Attorney’s office for potential illegal activity: see Re YBM Magnex International Inc. (2003), 26 O.S.C. Bull. 5285.
155 Securities Act, supra note 3, ss. 130(3)(a)(4).
156 OSA, supra note 3, ss. 130(3)(5).
157 Securities Act, supra note 18, § 77k(b).
158 OSA, supra note 3, s. 130.1. However, the section only applies with respect to an offering memorandum that has been furnished to a prospective purchaser in connection with a distribution of a security under an exemption from s. 53 of the Act that is specified in the regulations: see s. 130.1(8).
159 See e.g. OSA, ibid., s. 130.1(5).
160 Ibid.
In Canada, there are similar defences to misrepresentation in a takeover circular against directors of the offeror, issuer, or persons that signed a certificate in the circular or notice.\textsuperscript{162} Here too, the standard of reasonable investigation or reasonable grounds for belief under the defence is that required of a "prudent person in the circumstances of the particular case."\textsuperscript{163} Under U.S. law, the plaintiff must prove that the defendant acted recklessly or knowingly in making misrepresentations in connection with a tender offer.\textsuperscript{164}

In Canada, a person or company is not liable in an action for a misrepresentation in forward-looking information under the prospectus, offering memorandum, or circular provisions if the person or company can establish that the document containing the information contained reasonable cautionary language identifying it as forward-looking; identified material factors that could cause actual results to differ materially; included a statement of material factors or assumptions that were applied in making a forecast or projection; and the person or company had a reasonable basis for drawing the conclusions or making the forecast.\textsuperscript{165} This defence, however, does not relieve a person or company of liability in respect of forward-looking information in a financial statement or in a document released in connection with an initial public offering.\textsuperscript{166}

The U.S. safe harbour is similar, but does not require a reasonable basis for forward-looking statements if they are accompanied by meaningful cautionary language.\textsuperscript{167} Even if there is no cautionary language, the defendant will not be liable unless the plaintiff proves that the forecast or projection was made with actual knowledge of its falsity.\textsuperscript{168} Financial statements are excluded from the protection of the safe harbour, as are statements made in connection with a tender offer or an initial public offering.\textsuperscript{169}

In the only Canadian judgment that has rendered a final decision on forward-looking information in primary markets, the Supreme Court of Canada in Kerr held that the OSA "supplants the 'buyer beware' mind set of the common law with compelled disclosure of relevant information. At the same time ... the Act recognizes the burden it places on issuers and in Part XV sets the limits on what is required to be disclosed."\textsuperscript{170} The Court held that when a prospectus is accurate at the time of filing, the Act limits the obligation of post-filing disclosure to notice of a "material change," which the Act defines as a "change in the business, operations or capital 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."\textsuperscript{171} The Court held that "[a]n issuer has no similar express obligation to amend a prospectus or to publicize and file a report for the modification of material facts occurring after a receipt for a prospectus is obtained. That is where the legislature has drawn the line."\textsuperscript{172} Hence, the

\textsuperscript{162} See e.g. OSA, supra note 3, s. 131. This includes deemed takeover bid circulars or issuer bid circulars, essentially disclosure documents required to be filed where an issuer bid or takeover bid is exempted from circular provisions of the statute: see e.g. s. 131(10).

\textsuperscript{163} See OSA, ibid., s. 132. There are also provisions in respect of liability for persons in a special relationship with the reporting issuer where a material fact or change is undisclosed and for tipping, as well as provisions dealing specifically with mutual funds: see s. 134.


\textsuperscript{165} See OSA, supra note 3, s. 132.1(1).

\textsuperscript{166} See e.g. ibid., s. 132.1(2).

\textsuperscript{167} Securities Act, supra note 18, § 77z-2(c)(1)(A).

\textsuperscript{168} Ibid., § 77z-2(c)(1)(B).

\textsuperscript{169} Ibid., § 77z-2(b)(2).

\textsuperscript{170} Kerr, supra note 8 at para. 32.

\textsuperscript{171} OSA, supra note 3, s. 1.

\textsuperscript{172} Kerr, supra note 8 at para. 32 [emphasis in original].
Court held that "[t]he distinction between material change and material fact is deliberate and policy-based."\textsuperscript{173} The Supreme Court further stated that poor intra-quarterly results may reflect a material change in business operations, for example, where a company has restructured its operations it may experience poor intra-quarterly results because of this restructuring, but it is the restructuring and not the results themselves that would amount to a material change and thus trigger the disclosure obligation.

The Supreme Court disagreed with the Ontario Court of Appeal in one significant aspect of the case: "while forecasting is a matter of business judgment, disclosure is a matter of legal obligation."\textsuperscript{174} The Supreme Court held that "the disclosure requirements under the Act are not to be subordinated to the exercise of business judgment."\textsuperscript{175} In the U.S., the Supreme Court has explicitly rejected any role for business judgment under the anti-fraud provisions.\textsuperscript{176} On this point, Canadian and U.S. jurisprudence are in accord.

Pursuant to Canadian securities law, a person in a special relationship with the issuer who buys or sells securities with knowledge of a material fact or material change that has not been generally disclosed has a defence to liability where the person proves that he or she reasonably believed that the material fact or change had generally been disclosed, or it was known or ought reasonably to have been known by the seller or purchaser.\textsuperscript{177} In the U.S., such a claim would have to be brought under Rule 10b-5 of the Exchange Act, which requires the plaintiff to plead with particularity and prove scienter.\textsuperscript{178}

Defences to civil liability under the secondary market provisions include a due diligence defence, a defence that the plaintiff knew of the misrepresentation,\textsuperscript{179} a reliance on experts,\textsuperscript{180} or the making of confidential disclosure to the regulator if there was a reasonable basis.\textsuperscript{181} In the U.S., the latter two defences are not available, but the first two questions are part of the plaintiff's case in the form of the scienter requirement and the materiality requirement. Unless the defendant has acted recklessly, he or she will not be liable. Moreover, if the true

\textsuperscript{173} \textit{Ibid.} at para. 38.
\textsuperscript{174} \textit{Ibid.} at para. 54. It also held that the forecast did carry an implied representation of objective reasonableness rooted in the language of the prospectus, but this implied representation extended only until the prospectus was filed (at paras. 49-51).
\textsuperscript{175} \textit{Ibid.} at para. 55. See also \textit{Re AIT Advanced Information Technologies} (2008), 31 O.S.C. Bull. 712 at paras. 209-25. The OSC held, at para. 6, that, in the context of merger discussions, in appropriate circumstances, a material change can occur in advance of the execution of a definitive binding agreement, and therefore, the determination of whether a material change has occurred is not a "bright-line" test. Instead, the assessment of whether a material change has occurred, particularly in the context of an arm's length negotiated transaction, will depend on the specific facts and circumstances of each case; ... there must be sufficient evidence by which the board could have concluded that there was a sufficient commitment from the parties to proceed and a substantial likelihood that the transaction would be completed before the disclosure obligation arises.

This decision indicates that some deference will be accorded to business judgment.

\textsuperscript{176} In \textit{Basic, supra} note 13, the Court rejected the argument that a company in the midst of merger negotiations was justified in denying the existence of those negotiations because premature disclosure would jeopardize the potential merger. The Court deemed such strategic concerns "irrelevant to an assessment whether their existence is significant to the trading decision of a reasonable investor" (234).
\textsuperscript{177} \textit{OSA, supra} note 3, s. 134(1).
\textsuperscript{178} \textit{Supra} note 12, § 78u-4(b)(2).
\textsuperscript{179} \textit{OSA, supra} note 3, s. 138.4(5). The burden of proof is on the defendant.
\textsuperscript{180} \textit{Ibid.}, s. 138.4(1). "Expert" is defined as "a person or company whose profession gives authority to a statement made in a professional capacity, including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist or lawyer, but not including an entity that is an approved rating organization for purposes of National Instrument 44-101" (s. 138.1).
\textsuperscript{181} \textit{Ibid.}, s. 138.4(8)(b).
state of affairs is known to market participants, the alleged misstatement will be deemed immaterial under the “truth on the market” defence.\textsuperscript{182}

The most relevant defence under Canadian law may be the due diligence defence whereby an outside director or influential person has conducted, or caused to be conducted, a reasonable investigation and has no reasonable ground to believe there is a misrepresentation.\textsuperscript{183} The due diligence defence thus differs from the primary market provisions in that the onus is on the defendant to establish the due diligence. The statutory language enumerates factors that should be considered by a court in determining whether the defendants undertook a reasonable investigation or alternatively were guilty of gross misconduct.\textsuperscript{184}

A significant factor is the existence of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations. Issuers are therefore likely to establish written disclosure policies to ensure adequate controls and monitoring of continuous disclosure, and for determinations as to when a change is material. This factor aligns with requirements in a number of Canadian jurisdictions whereby the CEO and CFO must personally certify, among other things, the accuracy of the issuer’s annual and interim filings and financial statements and the integrity of the issuer’s disclosure controls and procedures.\textsuperscript{185} The U.S. does not require continuous disclosure, although it does require certification of periodic filings by the CEO and CFO.\textsuperscript{186}

Under the \textit{OSA}, a defendant is not liable for a misrepresentation in forward-looking information if the defendant proves that the document or oral statement containing the information included, “proximate to” the information, reasonable cautionary language identifying the information as forward-looking, and identifying material factors that could cause results to diverge materially. In addition, the defendant must prove that it had a reasonable basis for the conclusion, forecast, or projection.\textsuperscript{187} If the forward-looking information is contained in an oral statement the cautions must be stated orally, in general terms, along with a reference to an available document that discloses the factors and

\textsuperscript{182} See e.g. \textit{Wielgos v. Commonwealth Edison Co.}, 892 F.2d 509 at 516 (7th Cir. 1989).
\textsuperscript{183} \textit{OSA, supra} note 3, s. 138.4(6).
\textsuperscript{184} In \textit{ibid.}, s. 138.4(7), the court is to consider all relevant circumstances, including:
  \begin{itemize}
  \item “the nature of the responsible issuer”;
  \item “the knowledge, experience and function of the person or company” and any office held;
  \item “the presence or absence of another relationship with the responsible issuer, if the person was a director”;
  \item the existence and nature “of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations”;
  \item “the reasonableness of reliance by the person or company on the responsible issuer’s disclosure compliance system” and on employees “whose duties would in the ordinary course have given them knowledge of the relevant facts”;
  \item “the period within which disclosure was required to be made under the applicable law”;
  \item “in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert”;
  \item “the extent to which the person or company knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement”;  
  \item “in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document” or public oral statement; and
  \item “in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.”
\end{itemize}  

\textsuperscript{187} \textit{OSA, supra} note 3, s. 138.4(9).
assumptions. Forward-looking information includes, but is not limited to, future-oriented financial information with respect to prospective results of operations, financial position, and/or cash flows that is presented as either a forecast or a projection. In the U.S., meaningful cautionary language will insulate forward-looking statements from liability; there is no additional requirement that the forecast have a reasonable basis. The current Canadian provision roughly corresponds to the state of U.S. law before the passage of the Private Securities Litigation Reform Act.

A further defence under the Canadian secondary market civil liability provisions is that a person or company is not liable for a misrepresentation in a document, other than a document required to be filed with the Commission, if the person or company proves that, at the time of release of the document, it did not know and had no reasonable grounds to believe that the document would be released. U.S. law does not contain specific provisions on this point; the question would be addressed under the scienter element.

The combination of the leave provisions, the liability cap, and the defences available make it likely that actions will be sought under the Canadian secondary market provisions only for the most egregious conduct or where the conduct can be easily established, such as following an earnings restatement with a significant market price drop immediately following the restatement. However, since liability can be assessed against individual defendants, the statutory framework is designed to contribute to the deterrence objective of private remedies. Since the liability limits are inapplicable if intentional misconduct can be proven, plaintiffs are likely to allege fraud in order to pressure defendants to settle in order to avoid unlimited exposure to damages.

With respect to the calculation of losses in order to compute damages, the provisions do not require plaintiffs to crystallize those losses by selling the security. A 2005 U.S. Supreme Court decision on this issue has adopted a stricter approach to the requirement for plaintiffs in U.S. cases to plead and prove a causal connection between the alleged misrepresentation and the economic loss suffered. Plaintiffs must not only show that there was a misrepresentation that affected the market price, but that there was subsequent correction to

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188 Ibid., s. 138.4(9.1).
189 Ibid., s. 1(1). "Forward-looking information" means "disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action and includes future oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented either as a forecast or a projection." The OSC gives earnings guidance as an example of forward-looking information, as well as management discussions and analyses (MD&A) that may contain forward-looking information. For purposes of the defence, a document filed with the Commission or otherwise generally disclosed is deemed to be "readily available" (s. 138.4(9.2)).
192 OSA, supra note 3, s. 138.4(13). A person or issuer is also not liable for derivative information drawn from information filed by another person or company, other than the responsible issuer, with a securities regulatory authority in Canada or a stock exchange and not corrected before the release of the document or the public oral statement and where the person had no reasonable grounds to believe that the document or public oral statement, contained a misrepresentation (s. 138.4(14)). There is also no liability where the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the person and, if, after the person or company became aware before it was corrected, the person or company promptly notified the board of directors of the responsible issuer (s. 138.4(15)). If no correction of the misrepresentation or no subsequent disclosure of the material change is made by the responsible issuer within two business days after the notification, the person or company, unless prohibited by law or by professional confidentiality rules, must have promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure (s. 138.4(15)(b)).
193 Broudo, supra note 136.
the price when the truth was revealed. The U.S. Supreme Court observed that it was seeking
to achieve the policy goal of avoiding “abusive” litigation. In Canada, the onus is on the
defendant to prove that losses were unrelated to the misrepresentation. Whether styled as an
element of the claim or an affirmative defence, the question of loss causation is likely to
tigger a contest between experts on the issue of what caused the issuer’s stock price to
dcline.

In summary, the overall litigation exposure for Canadian companies remains relatively
low when compared to their counterparts in the U.S. Not surprisingly, Canadian issuers that
have listed their shares in the U.S. face the greatest litigation exposure, particularly since the
possibility of having to defend lawsuits in both jurisdictions exists. Such lawsuits are
substantially more costly to resolve. The introduction of secondary market legislation makes
this risk considerably more acute. The marginal deterrence provided by the threat of
additional litigation in Canada for issuers that are already at risk of litigation in the U.S. is
likely rather limited.

IV. THE EFFECT OF SECONDARY MARKET
CIVIL LIABILITY ON DIRECTORS’ AND OFFICERS’ INSURANCE

This part explores the link between D&O insurance and class action suits and their
settlement. D&O insurance policies typically protect directors and officers against losses,
defined as any amounts they are obligated to pay from claims made against them for
wrongful acts, including judgment, settlement amounts, and litigation costs. Wrongful acts
are defined in a number of insurance policies as including errors, misstatements, or
misleading statements or acts of omission or breach of duty, with some specified exemptions,
such as liability arising from corporate pension and benefit plans. Hence, where insurance
policies cover potential liability under securities law, insurers are likely to influence the
outcome of proceedings. Moreover, the new secondary market civil liability provisions are
likely to affect both the cost and coverage of D&O insurance.

We postulate that the premiums that insurers charge for D&O policies may be a barometer
of the expected cost of securities litigation. If the expected cost of securities litigation goes
up, D&O premiums should increase as well. A natural experiment arises from the fact that
for Canadian issuers listed in the U.S., the enactment of secondary market liability in Canada
was likely to have less marginal impact than it did for Canadian firms listed exclusively in
Canada. Only the latter group were likely to have been charged more for D&O insurance in
response to new secondary market legislation. To test this hypothesis, we compared the D&O
rates for Canadian companies listed in the U.S. with those listed only in Canada. We
speculated that the impact of the legislation will be more pronounced for firms listed only
in Canada because Canadian firms listed on U.S. exchanges already faced a substantial risk
of litigation.

194 Ibid. at 347.
366 at para. 2. Although the OSA, supra note 3, s. 128(3), and other statutes provide for restitution
orders, they have been rarely used to date in Canada, although they are frequently used in the U.S.
196 Mary Jane Stitt, “Insurance Claims for Ill-Gotten Gains: The Insurability of Restitutionary Damages”
(Paper presented to the Canadian Institute’s 6th Annual Conference on Managing & Resolving Insurance
Coverage Disputes, Toronto, 24 May 2006) [unpublished] at 5, citing Lazar Sarna, Directors & Officers:
To explore this question, we collected data on D&O premiums for 2004, 2005, and 2006 for the 250 largest firms on the TSX, as measured by market capitalization. We focused on the largest firms because prior research on U.S. firms has shown that the size of a company is an important determinant of suits. Smaller firms are unlikely to be sued because the potential damages available are unlikely to support an adequate fee recovery. Data on market capitalization were obtained from the TSX and data on D&O policies and premiums for the companies were obtained from the management’s information circular on the “System for Electronic Document Analysis Retrieval.” We were able to obtain D&O data for at least two consecutive years for 153 firms. All figures have been converted to Canadian dollars.

Table 4
DIRECTORS’ & OFFICERS’ INSURANCE POLICY LIMITS AND DEDUCTIBLES

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>U.S. Listed</th>
<th>Canada Only</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>n=153</td>
<td>n=71</td>
<td>n=82</td>
</tr>
<tr>
<td>Market Capitalization (2005)</td>
<td>7,140.57</td>
<td>11,549.01</td>
<td>3,377.26</td>
</tr>
<tr>
<td>Mean</td>
<td>Median</td>
<td>Mean</td>
<td>Median</td>
</tr>
<tr>
<td>Policy Limit</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>93.23</td>
<td>50.00</td>
<td>77.97</td>
</tr>
<tr>
<td></td>
<td>111.39</td>
<td>95.18</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>87.89</td>
<td>50.00</td>
<td>68.63</td>
</tr>
<tr>
<td></td>
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<tr>
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<td>-4.82</td>
<td>0.00</td>
<td>-8.49</td>
</tr>
<tr>
<td></td>
<td>-0.57</td>
<td>0.00</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>88.00</td>
<td>50.00</td>
<td>65.01</td>
</tr>
<tr>
<td></td>
<td>113.66</td>
<td>100.00</td>
<td></td>
</tr>
<tr>
<td>^2006</td>
<td>3.63</td>
<td>0.02</td>
<td>4.48</td>
</tr>
<tr>
<td></td>
<td>2.68</td>
<td>0.03</td>
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<tr>
<td>Deductible</td>
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<td></td>
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<tr>
<td>2004</td>
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<td>0.60</td>
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<td></td>
<td>2.84</td>
<td>1.00</td>
<td>0.30</td>
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<tr>
<td>2005</td>
<td>1.90</td>
<td>0.58</td>
<td>0.95</td>
</tr>
<tr>
<td></td>
<td>3.00</td>
<td>1.00</td>
<td>0.29</td>
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<td>2.09</td>
<td>0.58</td>
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<tr>
<td></td>
<td>3.28</td>
<td>1.00</td>
<td>0.29</td>
</tr>
<tr>
<td>Net Coverage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>91.53</td>
<td>49.50</td>
<td>76.67</td>
</tr>
<tr>
<td></td>
<td>108.72</td>
<td>92.38</td>
<td>34.50</td>
</tr>
<tr>
<td>2005</td>
<td>86.12</td>
<td>49.75</td>
<td>67.45</td>
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<td></td>
<td>107.99</td>
<td>95.00</td>
<td>36.61</td>
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<tr>
<td>^2005</td>
<td>-4.90</td>
<td>0.00</td>
<td>-8.52</td>
</tr>
<tr>
<td></td>
<td>-0.72</td>
<td>-0.58</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>85.93</td>
<td>49.93</td>
<td>64.17</td>
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<tr>
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<td>110.23</td>
<td>99.00</td>
<td>46.36</td>
</tr>
<tr>
<td>^2006</td>
<td>3.39</td>
<td>0.02</td>
<td>4.53</td>
</tr>
<tr>
<td></td>
<td>2.11</td>
<td>0.02</td>
<td>0.01</td>
</tr>
</tbody>
</table>

All figures in millions of Canadian dollars.

Table 4, above, summarizes the characteristics of the sample firms and their D&O policies. The firms listed in the U.S. are substantially larger, with a mean (median) market capitalization of $11.5 billion ($4.1 billion), compared with $3.4 billion ($1.6 billion) for the firms listed only in Canada. Not surprisingly, the U.S. listed firms have correspondingly higher policy limits, although the discrepancy is not as great as it is for market capitalization, with the mean U.S. listed firm carrying slightly over $110 million (~$100 million) in

197 Johnson, Nelson & Pritchard, supra note 99.
199 The sample size is slightly smaller for 2006 – 138 firms – as a small number of firms were delisted after being acquired.
ANALYSIS OF SECURITIES CLASS ACTIONS IN CANADA

coverage over each of the three years in our sample period, while the mean for the Canadian only firms is between $65 and $78 million (median between $35 and $47 million). The policy limit and net coverage data reveal an important trend: firms listed only in Canada faced a substantial reduction in policy limits between 2004 and 2005 (− $8.5 million), while the U.S. listed firms stayed relatively stable (− $0.6 million). This finding suggests that insurers negotiated more conservative policy limits in response to the new legislation. This relation holds after adjusting for deductibles (Net Coverage).

Table 5, Panel A, below, presents descriptive statistics on the premiums charged for D&O insurance. Panel A shows an overall picture of easing in D&O rates, with the average premium paid declining over the sample period for the overall sample. For issuers listed only in Canada, however, the average premium was unchanged from 2004 to 2005, at both the mean and the median. In 2006, the premiums paid by the Canadian listed issuers declines at the mean, but not as sharply as the reduction enjoyed by the U.S. listed issuers. This overall stability for the Canadian only issuers appears to be driven by steep declines for a handful of the issuers, with the medians largely unchanged from year to year.

**Table 5**

DIRECTORS' & OFFICERS' INSURANCE POLICY PREMIUMS

### PANEL A: PREMIUMS

<table>
<thead>
<tr>
<th></th>
<th>Total n=153</th>
<th>U.S. Listed n=71</th>
<th>Canada Only n=82</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean Median</td>
<td>Mean Median</td>
<td>Mean Median</td>
</tr>
<tr>
<td>2004</td>
<td>1.08 0.53</td>
<td>1.75 1.00</td>
<td>0.49 0.26</td>
</tr>
<tr>
<td>2005</td>
<td>1.06 0.57</td>
<td>1.73 1.01</td>
<td>0.49 0.27</td>
</tr>
<tr>
<td>^2005</td>
<td>−0.01 0.00</td>
<td>−0.03 −0.03</td>
<td>0.00 0.00</td>
</tr>
<tr>
<td>2006</td>
<td>1.02 0.57</td>
<td>1.64 1.21</td>
<td>0.44 0.27</td>
</tr>
<tr>
<td>^2006</td>
<td>−0.07 0.00</td>
<td>−0.08 0.00</td>
<td>−0.05 0.00</td>
</tr>
</tbody>
</table>

All figures in millions of Canadian dollars.

### PANEL B: RATIO OF COVERAGE TO PREMIUMS

<table>
<thead>
<tr>
<th></th>
<th>Total n=153</th>
<th>U.S. Listed n=71</th>
<th>Canada Only n=82</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean Median</td>
<td>Mean Median</td>
<td>Mean Median</td>
</tr>
<tr>
<td>2004</td>
<td>166.59 102.52</td>
<td>93.52 72.23</td>
<td>230.52 128.70</td>
</tr>
<tr>
<td>2005</td>
<td>143.51 101.77</td>
<td>86.53 72.10</td>
<td>192.16 127.59</td>
</tr>
<tr>
<td>^2005</td>
<td>−26.27 0.00</td>
<td>−7.00 0.00</td>
<td>−43.13 0.00</td>
</tr>
<tr>
<td>2006</td>
<td>143.20 103.01</td>
<td>86.52 70.09</td>
<td>194.66 149.85</td>
</tr>
<tr>
<td>^2006</td>
<td>5.09 2.99</td>
<td>−0.08 0.69</td>
<td>9.78 4.74</td>
</tr>
</tbody>
</table>

To get a better sense for the experience of the typical company in our sample, we calculate the ratio of net coverage to premium paid. Panel B, above, shows that Canadian listed issuers
get substantially more coverage for their premium dollar relative to their U.S. listed counterparts, suggesting that insurers calculate the probability of having to pay as being higher in the U.S.. This ratio took a precipitous decline in 2005, however, as Canadian listed issuers lost an average of $43 dollars in coverage for every premium dollar paid (22 percent), while U.S. listed issuers had a much less substantial decline of $7 in coverage per premium dollar paid (7 percent). Simply put, firms listed in Canada were paying more and getting less in 2005 than they did in 2004. This pattern does not carry over to 2006; the ratio bounces back somewhat for Canadian listed issuers in 2006, but the 2005 decline does not reverse itself.

The pattern may mirror some of the complexities involved in the underwriting and pricing of insurance for directors, rather than simply the introduction of the new liability provisions, and hence only a portion is likely attributable to the introduction of a new liability regime. In Canada, the risk of director liability to date has been more pronounced in respect of environmental liability and pension liability, as these are two areas in which remedies have been successfully sought. Premiums are priced through a complex formula. Although the publicly reported amounts indicate global shifts in premiums and total coverage that could be compared to market cap, the data do not disclose the contours of the policy. Traditional D&O policies did not contain many exclusions, and the exclusions that did exist, such as the misconduct exclusion, the improper profit exclusion, and claims for return of remuneration for which approval was not obtained, essentially mirrored the limits to indemnification of directors and officers under corporations statutes. Mary Jane Stitt, a leading Canadian insurance lawyer, has observed that the market for insurers was quite limited until recently, and now a number of new entrants to the Canadian insurance market are competing for the same business with a consequent reduction in premiums and the offering of new products. She observes that part of directors’ risk management strategy is to demand higher policy limits, written indemnity agreements, and more effective coverage to backstop corporate indemnities and maximize personal asset protection through coverage that does not show up on the public disclosures of insurance coverage. Stitt notes, however, that common contractual limitations in D&O insurance still exempt fraudulent acts or wilful violation of statutes and hence aligns with the type of conduct causing loss that is most likely to attract class action suits. An important policy question is thus whether the availability of D&O insurance is aligned with the policy objectives of civil liability provisions, and whether the availability of insurance serves as an incentive, or not, in encouraging director and officer compliance with securities law requirements. However, the answer to this question is beyond the scope of this article, but warrants further study.

In Canada, both the cost and the availability of D&O insurance will depend on both the kinds of cases that are brought, and the remedies sought under the new securities law provisions, as well as under other remedial legislation, including the issue of whether the courts will allow officers to be indemnified by the company. Stitt observes that Canadian courts have historically distinguished between acts that are deliberate or performed

200 Stitt, supra note 196 at 6; there have also been exclusions for pollution related claims: see Gordon Hilliker, Liability Insurance in Canada, 3d ed. (Vancouver, Butterworths, 2001) at 219. Generally, directors and officers may be indemnified if they "acted honestly and in good faith, with a view to the best interests of the corporation and in the case of administrative or criminal action had reasonable grounds for believing that the ... conduct was lawful."

201 Telephone interview of Mary Jane Stitt, Partner, Blake, Cassels and Graydon LLP (March 2008).

202 Ibid.
recks and any unintended results. She suggests that it is generally accepted in Canada, absent express policy wording stating otherwise, that an accident arises when the result is unintended, even if it might have been foreseen or even if it is the adverse outcome of a calculated risk. Stitt observes that in Canada, D&O policies now exclude more types of claims because of increased litigation against directors and officers, including: (1) the “insured versus insured” exclusion; (2) the 10 percent principal shareholder exclusion; (3) the fiduciary liability exclusion; (4) matters covered under a commercial general liability (CGL) policy; and (5) claims for an accounting of profits made from the purchase or sale by an insured person of securities of the insured organization.

Stitt suggests that the misconduct exclusion in a D&O policy excludes coverage for any claim based on allegations of any deliberately fraudulent act or omission, or any wilful violation of any statute or regulation, if a judgment adverse to the insured person establishes such deliberately fraudulent act or omission or wilful violation. This misconduct exclusion is a powerful incentive for directors and officers to settle claims rather than trying them to a judgment. In response to claims being made against directors and officers, insurers in North America have introduced further exclusions where they perceive increased risk in order to limit their exposure, and the contours of those exclusions do not show up in public disclosures. Hence, intentional misconduct is not covered by insurance.

203 Stitt, supra, note 196 at 25, citing Canadian Indemnity Co. v. Walkem Machinery & Equipment Ltd., [1976] 1 S.C.R. 309. In U.S. securities law cases, a number of courts have held that disgorgement is not an insurable loss, based on either interpretation of the specific insurance policy or public policy grounds. It is not clear if Canadian courts will follow suit: Stitt at 27. Stitt reports that the three major policy interpretation cases are: Reliance Group Holdings, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 594 N.Y.S.2d 20 (A.D. 1993), leave to appeal dismissed in part, denied in part, 601 N.Y.S.2d 578 (N.Y. 1993), in which the New York Appellate Division found that there was no coverage available under a D&O Policy where the insured had settled a series of derivative actions brought by shareholders alleging that various directors and officers had breached fiduciary duties by abandoning a hostile takeover in exchange for “greenmail” payments; Level 3 Communications, Inc. v. Federal Ins. Co., 272 F.3d 908 (7th Cir. 2001), in which the 7th Circuit refused coverage under a D&O Policy in respect of the settlement of a securities fraud suit based on allegations of fraudulent misrepresentations where the D&O policy defined “loss,” in part, as including: damages, judgments, settlements, and defense costs. Stitt observes that the 7th Circuit found there was no coverage for the settlement payments made because the relief sought in the suit against Level 3 and for which indemnification was sought was restitutionary in nature” (at 16); Conseco, Inc. v. National Union Fire Ins. Co. of Pittsburgh, Pa. (31 December 2002), Marion County 49D130202CP00348594 (Ind. Cir. Ct.), in which the Indiana Circuit Court held, in an unpublished opinion, that restitutionary damages assessed and/or paid pursuant to § 77k of the Securities Act, supra note 18, did not constitute “loss” under the relevant D&O policies of insurance as the § 77k portion of a settlement, which also involved claims under Rule 10b-5, supra note 11, represented “restitutionary damages” that corresponded to consideration that was wrongfully taken from the investing public. Thus, the Court found that “it was the restitutory nature of the claim and the character of the settlement that controlled whether coverage was available, not the intent of the party forced to disgorge ill-gotten gains” (at 18).

204 Stitt, ibid. This exclusion excludes “liability for loss on account of any claim made against any insured person brought or maintained on behalf of any insured (except derivative actions)” (at 6).

205 Ibid.

206 Ibid.at 7-8.

207 Ibid.

208 See Stitt, ibid.
Tom Baker and Sean Griffith suggest that liability insurers may play a part in the failings of the liability system by keeping the costs of shareholder litigation artificially low, given the high settlement rate within the limits of available insurance. The relationship between insurance and director and officer conduct is under-developed in the Canadian context, but should be an important policy consideration as the new civil liability regime is developed. It will be interesting to see if Canadian D&O insurers begin taking the active role in governance, as described by U.S. scholars. Insurers in Canada are clearly already heavily involved in decisions in respect of settlement of class action suits against directors and officers in the non-securities law context.

A related issue is one of indemnification by the company itself, and who has the onus of establishing whether or not there was honesty, good faith, and belief in lawful conduct — the criteria to be met for indemnification under Canadian corporate law. The Ontario Superior Court of Justice allowed a claim for indemnification by a CEO and president of a company, John Anthony Bennett, with respect to expenses incurred in civil and administrative proceedings pursuant to the CBCA. The expenses were incurred as a result of the officer defending himself in a consolidated class action in the U.S., and securities regulatory proceedings in Canada and the U.S. in respect of allegations of failure to disclose material change on a timely basis. All the proceedings resulted in settlement. The class actions settled for a cash payment of US$9.75 million, of which the company paid $0.75 million and the insurer paid the rest. The securities proceedings were settled by agreement that Bennett was prohibited from acting as a director for ten years, fined $250,000 as an administrative fine, and ordered to pay $50,000 towards the commission’s investigation costs. Bennett admitted, subject to certain caveats, to violations of the OSA in failing to disclose material information on a timely basis. The board of directors made a decision that Bennett had not complied with the good faith or lawful conduct requirements for indemnification and sought repayment of all the funds advanced in the proceedings. The Court, following the Supreme Court of Canada in Blair v. Consolidated Enfield, held that the burden lies on the company.

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210 Baker and Griffith have suggested that in the U.S., the D&O insurer serves as an important intermediary between injured shareholders and the managers who harmed them, as they tend to screen their risk pools, rejecting firms with the worst corporate governance practices and increasing the insurance premiums of firms with higher liability risk: Tom Baker & Sean J. Griffith, “Risk: Evidence from the Directors’ & Officers’ Liability Insurance Market” (2007) 74 U. Chicago L. Rev. 487 at 489. Financial health and governance practices are two important determining factors in respect of insurance premia, and Baker and Griffith found that what matters to insurers are “deep governance” variables such as “culture,” which is the system of incentives and constraints operating within the organization, including both formal rules and informal norms, and “character,” which they define as the likelihood that top managers would defect from corporate interests when given an opportunity to do so, rather than formal governance structures (at 516-25). Second, they argue that D&O insurers “may monitor the governance practices of their corporate insured and seek to improve them by recommending changes, either as a condition to receiving a policy or in exchange for a reduction in premiums” (at 489). Third, they suggest that D&O insurers may manage the defence and settlement of shareholder claims by “fighting frivolous claims, managing defence costs, and withholding insurance benefits from directors or officers who have engaged in actual fraud,” and in this respect play a role in deterrence through the pricing and availability of insurance (at 489). They also suggest that insurance underwriters take capital structure into account, suggesting, for example, that a controlling shareholder may be a substitute for the governance constraints and significant insider share ownership may indicate an alignment of shareholder and management interests (at 522).

211 Stitt, supra note 196.

212 See e.g. Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 124 [CBCA].


214 Ibid. at para. 18.

215 Ibid. at para. 17.

to prove bad faith. The Court also held that bad faith is not restricted to intentional fault, but can include wanton or reckless conduct.\textsuperscript{218} The Court held that while Bennett, at the time, had a reasonable basis for his belief, it was to be distinguished from understanding in retrospect that his conduct fell below the statutory standard.\textsuperscript{219}

The judgment finds that although the officer admitted in the settlement to violating the statute, that is not, in itself, sufficient to bar indemnification. In dismissing an appeal in this case, the Ontario Court of Appeal affirmed that the onus is on the corporation to demonstrate that the director did not act honestly and in good faith with a view to the best interests of the corporation, and that the director did not have reasonable grounds for believing that his conduct was lawful, finding that the imposition of the burden on the corporation best balances the promotion of strong director decision-making while discouraging irresponsible behaviour.\textsuperscript{220} The Court held that the officer's belief was an informed one, the honesty in his belief was supported by the absence of any motive to withhold disclosure, and the corporation failed to establish that the stated belief was either opportunistic or amounted to a reckless disregard of his obligations. The Court rejected the argument that the court of first instance had improperly imported a subjective element into the objective test of director obligations.\textsuperscript{221} The Court further held that implicit in the wording of the statute is that the conduct or belief at issue must have been reasonable when considered in context.\textsuperscript{222} The appellate court also found that admission of violation of statutory requirements was not sufficient for a company to refuse to indemnify its officers.\textsuperscript{223} The decision is likely to increase the scope of protection against potential personal liability for directors and officers for securities law violations, as well as an impact on settlement negotiations.

V. CONCLUSION

Canadian securities markets have entered a new era with the introduction of private causes of action. The legislation reflects a careful consideration of the costs and benefits of such actions. In this, it stands in sharp contrast to the parallel cause of action in the U.S.: Rule 10b-5 is an awkward amalgamation of a judicially created cause of action with legislative limits subsequently imposed to rein in what was perceived to be abusive litigation. In particular, by eliminating the reliance requirement, the Canadian legislation avoids the unintended consequences of the "fraud on the market" theory of reliance used in the U.S., which tends to skew private enforcement toward the largest companies with the most actively traded shares. Active trading is likely to correlate with widespread analyst coverage, one check against fraud.

A critical factor likely to affect the usage of the new class action legislation will be the jurisdiction in which the suit is filed, and judicial decisions relating to costs. The Supreme

\textsuperscript{218} Bennett I, supra note 213 at para. 41.

\textsuperscript{219} Ibid. at para. 51. Here, the Court found no expert evidence or other evidence that would lead to a conclusion that Bennett's beliefs were unfounded or totally unreasonable and hence the Court held that the company failed to discharge the burden of establishing that Bennett acted in bad faith or unlawfully (at paras. 52-53).

\textsuperscript{220} Bennett v. Bennett Environmental Inc. (2009), 94 O.R. (3d) 481 (C.A.) [Bennett II].

\textsuperscript{221} The Superior Court had held that "a director will be held to an objective standard of care in carrying out his duties but there is as well a subjective element that takes into account the individual skill and training and the circumstances surrounding his or her action": Bennett I, supra note 213 at para. 47, citing Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68, [2004] 3 S.C.R. 461 at paras. 62-63.

\textsuperscript{222} Bennett II, supra note 220 at para. 38.

\textsuperscript{223} Ibid. at para. 47.
Court’s recent decision in *Kerr* is sure to be a caution to plaintiffs and their lawyers who are considering the possibility of suit in a jurisdiction that has not adopted the no-cost regime for class action proceedings.

The overall litigation exposure for Canadian companies remains relatively low when compared to their American counterparts. Canadian issuers that have listed their shares in the U.S. face the greatest litigation exposure, and such lawsuits are substantially more costly to resolve. Larger companies are more likely to be sued even under the Canadian legislation because they promise larger damage awards, a key factor explaining the incidence of suit. The Canadian legislation limits liability for garden variety misrepresentations to 5 percent of market capitalization, so no company is likely to face bankrupting liability for an innocent mistake. The liability cap is lifted against individuals, however, for cases of intentional fraud; we see the effects of this exception in the high percentage of cases against issuers and officers that have been subjected to a government investigation or had to restate their earnings. Clearly, these are the frauds that policymakers should be most anxious to deter, so this targeting is somewhat reassuring. On the other hand, these factors are also the most public indications of fraud, so these companies have already been subject to a stiff sanction in the stock market when the restatement or government investigation was first revealed.

One potential effect of the new secondary market legislation is that it might tend to equalize the burden of class actions between Canadian firms that are listed only in Canada and those that are listed in the U.S. The shift in D&O rates that we document from 2004 to 2005 tends to support this view, although, as noted above, the complex factors that determine insurance rates do not allow us to establish direct causation. The equalization is unlikely to be complete, however, because Canadian firms listed in the U.S. now face litigation exposure in both jurisdictions. Although the number of such cases remains relatively small, the cross-border suits do appear to be very expensive to resolve, with mean settlements considerably greater than settlement amounts for suits brought only in one jurisdiction or the other.

As the foregoing discussion illustrates, a number of factors are exerting contrary influences over the level of litigation and subject matter, including the expanded pool of potential defendants in secondary market civil liability actions, the availability of class action proceedings, Canada’s loser-pays costs regime, requirements for leave, liability caps, and the availability of insurance and indemnity. Future research will need to analyze the forthcoming decisions of the courts in certification and leave proceedings. For the time being, Canadian issuers face considerable uncertainty over the extent of their exposure to securities class actions.
**APPENDIX A**

**COMPARATIVE SUMMARY OF PRIMARY MARKET CIVIL LIABILITY PROVISIONS**

<table>
<thead>
<tr>
<th>Primary Market</th>
<th>Canada</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Those with cause of action</td>
<td>-Purchaser of securities during the period of distribution where a prospectus, amendment to prospectus, or offering memorandum contains a misrepresentation. -Security holder where takeover bid or notice of change or variation contains a misrepresentation.</td>
<td>-Purchaser of securities traceable to a registration statement, recipients of the prospectus if either contains a misrepresentation. -Security holder for misrepresentation made in connection with a tender offer.</td>
</tr>
<tr>
<td>Class of defendants</td>
<td>-The issuer, or, in the case of a sale by a control person, against the selling security holder. -Directors of the issuer at the time the prospectus or amendment to a prospectus was filed. -Underwriter. -Any expert who gave her or his consent to the use of all or part of her or his opinion or report. -Every person who signed the prospectus.</td>
<td>-The issuer. -Directors of the issuer at the time the registration statement or amendment was filed. -Underwriter. -Any expert who gave her or his consent to the use of all or part of her or his opinion or report. -Every person who signed the registration statement (includes CEO and CFO).</td>
</tr>
<tr>
<td>Burden of Proof</td>
<td>-Deemed reliance: the plaintiff does not have to establish either the existence of a duty of care or reliance on the misrepresentation if it was a misrepresentation at the time the security was purchased. -The plaintiff must demonstrate that he or she purchased the security offered under the prospectus, that the purchase was made during the period of distribution, and that there was a misrepresentation in the prospectus.</td>
<td>-No reliance requirement. -The plaintiff must demonstrate that he or she purchased securities traceable to the registration statement, or received a prospectus that contained a misrepresentation.</td>
</tr>
<tr>
<td>Remedy/Damages (limits on liability)</td>
<td>-Rescission or damages. -No underwriter is liable for more than the total public offering price underwritten by it. -Amount recoverable is not to exceed the price at which the securities were offered to the public.</td>
<td>-Rescission or damages. -No underwriter is liable for more than the total public offering price underwritten by it. -Amount recoverable is not to exceed the price at which the securities were offered to the public.</td>
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</table>
### Remedy/ Damages (limits on liability) (con’t.)

<table>
<thead>
<tr>
<th>Primary Market</th>
<th>Canada</th>
<th>United States</th>
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<tbody>
<tr>
<td>Remedy/</td>
<td>-In action for damages, the defendant is not</td>
<td>-In action for damages, the defendant is not</td>
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<td>Damages</td>
<td>liable for any portion of the damages that the defendant proves does</td>
<td>liable for any portion of the</td>
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<td>(limits on</td>
<td>not represent the depreciation in value of the security as a result of</td>
<td>does not represent the depreciation in value of the security as a result of</td>
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<td>liability)</td>
<td>the misrepresentation.</td>
<td>the misrepresentation.</td>
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<td>(con’t.)</td>
<td>-Joint and several liability.</td>
<td>-Joint and several liability;</td>
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<td></td>
<td></td>
<td>proportionate liability for outside directors.</td>
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### Defences

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<tr>
<th>Primary Market</th>
<th>Canada</th>
<th>United States</th>
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<tbody>
<tr>
<td>Defences</td>
<td>-Plaintiff had knowledge of the misrepresentation and the misrepresentation did not cause the loss.</td>
<td>-Plaintiff had knowledge of the misrepresentation and the misrepresentation did not cause the loss.</td>
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<td></td>
<td>-Due diligence defence: defendant must show that he or she conducted a reasonable investigation to provide reasonable grounds for a belief that there was no misrepresentation and that he or she did not believe that there was misrepresentation.</td>
<td>-Due diligence defence: defendant must show that he or she conducted a reasonable investigation to provide reasonable grounds for a belief that there was no misrepresentation, and that he or she did not believe that there was a misrepresentation.</td>
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<tr>
<td></td>
<td>-Defendant is not liable for any part of a prospectus or amendment to a prospectus based on a report, opinion, or statement of an expert where the defendant had no reasonable grounds to believe, and did not believe, that there had been a misrepresentation.</td>
<td>-Defendant is not liable for any part of a registration statement or amendment based on a report, opinion, or statement of an expert where the defendant had no reasonable grounds to believe, and did not believe, that there had been a misrepresentation.</td>
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<tr>
<td></td>
<td>-Defendant either did not consent to the filing of prospectus or withdrew consent prior to the purchase of the securities by the purchaser and gave reasonable general notice of, and reasons for, such withdrawal.</td>
<td>-Defendant either did not consent to the filing of registration statement or withdrew consent prior to the purchase of the securities by the purchaser and gave reasonable general notice of, and reasons for, such withdrawal.</td>
</tr>
<tr>
<td></td>
<td>-Experts: duty of reasonable investigation with respect to that part of the prospectus prepared on their own authority as experts.</td>
<td>-Experts: duty of reasonable investigation with respect to that part of the registration statement prepared on their own authority as experts.</td>
</tr>
<tr>
<td></td>
<td>-Issuer of the securities or selling security holder strictly liable for misrepresentations in a prospectus.</td>
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<td>Primary Market</td>
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<td>United States</td>
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<tr>
<td>Defences (con’t.)</td>
<td>- Where the defendant is a person in a special relationship, the person has a defence where he proves that the person reasonably believed that the material fact or change had generally been disclosed or the material fact or change was known, or ought reasonably to have been known, by the seller or purchaser.</td>
<td>- Issuer of the securities or selling security holder strictly liable for misrepresentations in a registration statement. - All defendants have a defence of reasonable care for misstatements in a prospectus.</td>
</tr>
<tr>
<td>Limitation Period</td>
<td>- Action for rescission must be brought within 180 days from the date of the transaction that gave rise to the cause of action. - Action for damages must be brought from the earlier of 180 days from the date the plaintiff had knowledge of the facts giving rise to the cause of action and three years from the date of the transaction.</td>
<td>- Action must be brought from the earlier of one year from the date the plaintiff had knowledge of the facts giving rise to the cause of action and three years from the date of the transaction.</td>
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## Appendix B
### Comparative Summary of Secondary Market Civil Liability Provisions

<table>
<thead>
<tr>
<th>Secondary Market</th>
<th>Canada</th>
<th>United States</th>
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<tbody>
<tr>
<td>Those with cause of action</td>
<td>- Person or company who acquires or disposes of the issuer’s securities between the time the document was released or public oral statement was made that contained the misrepresentation, and the time the misrepresentation was publicly corrected. - For failure to make timely disclosure: a person or company who acquired or disposed of the securities between the time the material change was required to be disclosed and its disclosure.</td>
<td>- Person or company who acquires or disposes of the issuer’s securities between the time the document was released or public oral statement was made that contained the misrepresentation, and the time the misrepresentation was publicly corrected.</td>
</tr>
<tr>
<td>Class of defendants</td>
<td>- The responsible issuer, directors and officers, “influential persons,” and, in the case of written documents or oral statements, experts where misrepresentation was made in their report or opinion. - Influential person includes control persons, promoters, and insiders who are not directors or senior officers. However, unless the influential person released the impugned document or made the public oral statement, knowing influence on the part of the issuer is required to ground an action. - If the person who made the public oral statement that is impugned had apparent authority, but not implied or actual authority, then others are not liable.</td>
<td>- Anyone who makes a misstatement or commits a manipulative act. - Control persons, unless they can show that they acted in good faith and did not induce the violation.</td>
</tr>
<tr>
<td>Burden of Proof</td>
<td>- Deemed reliance: no requirement for the plaintiff to demonstrate reliance on the misrepresentation, or on the issuer having complied with timely disclosure requirements. - Distinction between core and non-core documents.</td>
<td>- Presumption of reliance: for omissions in breach of a duty to disclose the plaintiff must show materiality. For affirmative misstatements, the plaintiff must demonstrate that the stock traded in a liquid capital market that rapidly incorporates information.</td>
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<tr>
<td>Secondary Market</td>
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<td>United States</td>
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<tr>
<td><strong>Burden of Proof (con't.)</strong></td>
<td>-Requires a higher burden of proof on the plaintiff where non-officer directors and influential persons are being sued with respect to non-core documents or public oral statements; must prove that they knew at the time the statement was made that it contained misrepresentation or deliberately avoided acquiring the knowledge, or that they were guilty of gross misconduct. &lt;br&gt;-Elevated burden of proof also required where directors and influential persons are sued for failure to make timely disclosure, or for knowing that a change was material, or deliberately avoided acquiring knowledge or gross misconduct. &lt;br&gt;-Higher burden with respect to timely disclosure does not apply to issuer or officers. &lt;br&gt;-Liability limits inapplicable (except for the responsible issuer) where the plaintiff can prove that the defendant authorized, influenced, permitted, or acquiesced in making the misrepresentation; where there is a failure to make timely disclosure while knowing of misrepresentation; where there is a failure to make timely disclosure, or the failure to make timely disclosure while knowing it was a misrepresentation or failure to make timely disclosure.</td>
<td>-Plaintiff must plead and prove recklessness for misstatement of historical fact, and knowledge for false forward-looking statements. &lt;br&gt;-Plaintiff must plead and prove that misrepresentation was the cause of the loss.</td>
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<tr>
<td><strong>Damages (limits on liability)</strong></td>
<td>-Limits the damages for issuer or non-individual influential person to the greater of $1 million or 5 percent of the issuer’s market capitalization. &lt;br&gt;-Limits damages payable by individual influential person, officer or director of the issuer, or of the influential person to the greater of $25,000 or 50 percent of aggregate compensation from issuer. &lt;br&gt;-Expert liability is limited to the greater of $1 million and revenue earned from the issuer and its affiliates in 12 months prior.</td>
<td>-No damages limit. &lt;br&gt;-Proportionate liability for reckless misstatements. &lt;br&gt;-Joint and several liability for knowing misstatements.</td>
</tr>
<tr>
<td>Secondary Market</td>
<td>Canada</td>
<td>United States</td>
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</table>
| **Damages (limits on liability) (con’t.)** | - Person making oral public statement: $25,000 or 50 percent of aggregate compensation from issuer.  
- Liability is also to be proportionate with respect to each defendant’s responsibility for the damages assessed.  
- Joint and several liability. | |
| **Defences** | - Plaintiff knew of the misrepresentation or material change.  
- Reliance on experts.  
- Reasonable investigation, no reasonable ground to believe a misrepresentation.  
- Making confidential disclosure to regulator, if reasonable basis.  
- Future-Oriented Financial Information: if reasonable cautionary language and a reasonable basis for drawing the conclusions existed.  
- Due diligence defence: burden of proof on defendant. Legislative provisions enumerate a variety of factors that should be considered by a court in determining whether the defendant undertook a reasonable investigation or is guilty of gross misconduct.  
- Existence and nature of any system designed to ensure that the issuer meets its continuous disclosure obligations.  
- If defendant proves it did not know and had no reasonable grounds to believe the document would be released.  
- Derivative information and where corrective action taken. | - Forward-looking information if accompanied by meaningful cautionary language. |
| **Limitation Period** | - No later than the earlier of three years after the document containing misrepresentation was released, or the public oral statement was made, or failure to make timely disclosure and six months after the news release that leave was granted to commence an action. | - No later than the earlier of five years after the misrepresentation and two years after the fraud was discovered. |