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Securities Class Actions and Secondary Liability in Canada: A New Day Dawning?

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SECURITIES CLASS ACTIONS AND SECONDARY LIABILITY IN CANADA: A NEW DAY DAWNING?

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I. Introduction

Class actions provide a powerful tool to plaintiffs and their counsel. Actions that would previously not have been brought suddenly make sense when many small claims can be efficiently aggregated. With the passage of class action legislation, anyone with responsibilities to a diffuse group is now at greater risk. Issuers, directors, and officers of public companies are no exception.

II. The US Experience

Actions against issuers, their officers and directors are among the most popular areas for class actions in the US. Most common are claims of fraud under s. 10(b) of the *Securities Exchange Act of 1934*.[1]

If a director or officer fails to ensure that the company discloses adverse material information, they are likely to find themselves part of a class action lawsuit by shareholders who purchased in the secondary market during the period of the material non-disclosure. The action will claim the difference between the price at which the shares were purchased, and what the shares were actually worth.

These class actions are assisted by the "fraud on the market" theory, which essentially removes the necessity to establish reliance on any particular misrepresentation by the company, so long as the plaintiff can establish that the failure to disclose had an impact on the market price.[2] Further, courts may be willing to certify the class action even if the claim requires an assessment of documents produced over an extended period of time, so long as the documents were part of a common scheme to

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1 15 U.S.C. 78j(b).

2 *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

defraud shareholders.[3] Both these principles reduce the individuality associated with the claims, and keep the focus on the issuer's conduct. Certification is essentially automatic in such class actions.[4]

Defendants whose share price takes an unexpected dip will usually face a spate of actions by many different law firms. For example, Cendant Corp. alone was hit with 70 different lawsuits in 1998.

So many class actions were filed in the early 1990s that (Republican) legislators came to believe that remedial legislation was required. Congress passed the *Private Securities Litigation Reform Act* in 1995. This legislation:

(a) heightened the pleading requirement—more specificity was required in relation to the fraud allegation;

(b) created a presumption that the best representative plaintiff is the person with the largest financial interest in the case;

(c) required that each plaintiff seeking to serve as a representative party file a sworn certification that:

  (i) the plaintiff did not purchase the shares at the direction of counsel or in order to participate in a lawsuit;

  (ii) identifies any other action filed during the preceding three-year period in which the plaintiff sought to serve as a representative plaintiff; and

  (iii) the plaintiff will not accept payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as approved by the court;

(d) assigned joint and several liability for damages only if the trier of fact specifically determines that the defendant knowingly violated securities laws; otherwise, damages were restricted to that portion of the judgment that corresponds to the percentage of each individual defendant's responsibility for the plaintiffs' losses; and

(e) provided certain issuers a safe harbor from liability for forward-looking statements regarding a security's projected performance or operations, if: (1) the statement is immaterial or is identified as a forward-looking statement and accompanied by certain cautionary statements; or (2) the plaintiff fails to prove that the statement was made with either actual knowledge of its false or misleading nature by a natural person, or actual approval by an executive officer.

The desire to shift control of securities class action litigation from alleged "straw men" to institutional investors was a driving force behind the enactment of the legislation.[5]

Did the legislation succeed in deterring securities class actions? The answer was clear from the following headline at Stanford's *Securities Class Action Clearinghouse* website[6]:

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3 *Newberg on Class Actions* (West Publishing, 1992), para. 22.19.

4 *Newberg on Class Actions*, *supra*, para. 22.01.

5 *Lirette v. Shiva Corp.*, 1998 U.S. Dist. LEXIS 18525 (Mass. D.C.).

6 http://securities.stanford.edu. This website is an amazingly comprehensive site of cases, statutes, and academic material.

SECURITIES FRAUD LITIGATION SETS RECORD IN 1998 ---
Companies Sued at a Rate Close to One-A-Day

It is generally accepted that the legislation failed to achieve the purpose of reducing the number of cases.[7] Class actions continued unabated. While settlements slowed following the reforms, the absolute value has been larger. The settlements' percentage of the potential loss did not change significantly.[8]

Congress responded to this failure by passing the *Securities Litigation Uniform Act of 1998*. This legislation creates further restrictions by attempting to ensure that the US Federal Court is the exclusive jurisdiction for these types of actions. Evidence suggested that class counsel were seeking to circumvent the 1995 federal requirements by filing securities actions in state courts rather than federal court.

However, these changes still did not materially change the number of filings. The "Filings per Issuer Index" was 2.35 in 1998, 2.32 in 2007, and 2.23 in 2008.[9]

III. The Canadian Experience

Has the US experience been imported into Canada? Prior to recent statutory developments, Canada saw some securities class action activity, but there were limitations on how far the area could expand. This has begun to change with recent legislation in certain provinces that has provided specifically for statutory secondary market liability.

Before beginning a discussion of the impact of the more recent secondary liability statutory provisions, a review of prior case law is offered to provide some background for showing the opportunities and pitfalls associated with securities class action litigation, including a look at class actions based on primary market liability and corporate oppression.

A. Primary Market Liability

The Prototypes—Maxwell v. MLG Ventures and *Kerr v. Danier Leather Inc.*

In *Maxwell v. MLG Ventures Ltd.*, an action based on alleged misrepresentations in an offering circular was certified, and a settlement subsequently achieved on behalf of investors.[10] The class included all former shareholders of Maple Leaf Gardens Ltd. who had tendered their shares pursuant to the defendant's offer. The settlement required the offeror to substantially increase its initial offer. Class certification was assisted by the fact that the Ontario *Securities Act* already provided for deemed reliance on the contents of the primary market offering circular.[11] This provision removes one

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7 Tamara Loomis, "Securities Reform: What Went Wrong" (October 27, 2000), found at http://securities.stanford.edu/report

8 Bajaj, Mazumdar, and Sarin, "Securities Class Action Settlement: An Empirical Analysis" (Nov. 16, 2000), found at http://securities.stanford.edu/research/studies/20001116_SSRN_Bajaj.html

9 Indices of Securities Class Action Filings, Stanford Securities Class Action Clearinghouse, found at http://securities.stanford.edu/litigation_activity.html. A significant drop to 1.58 occurred in 2006 which was attributed largely to a strong stock market.

10 [1995] O.J. No. 2698 (Gen. Div.).

11 *Securities Act*, R.S.O. 1990, c.S.5, s. 131. The same rule applies to misrepresentations in a prospectus. Section 130 reads:

> 130(1) Liability for misrepresentation in prospectus - Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution

otherwise difficult individual issue, and will usually tip the balance in favour of class certification in cases involving primary market distributions (i.e., distributions direct from the issuer or purchases pursuant to a take-over bid circular).

In *Kerr v. Danier Leather Inc.*,[12] the Court again certified a class action alleging misrepresentation in a prospectus. Danier issued a prospectus May 6, 1998 in connection with the IPO of its shares. The public offering closed May 20, 1998. The price was $11.25 per share.

Notably, the allegation of misrepresentation was in relation to a forecast. In the prospectus, an increase in revenue of $5,000,000 was projected for the 1998 fourth quarter over that of the 1997 fourth quarter. Unfortunately, the actual sales in May and early June 1998 did not meet the expectations in the Forecast. This was attributed to a prolonged period of unseasonably warm weather. On June 4, 1998, Danier's Board of Directors issued a press release containing a "Revised Forecast" which anticipated that the warm weather trend would continue in June. Fourth quarter revenue projections were reduced from $17,410,000 to approximately $12,600,000, a decline of about 27.5%. A net loss of $1.15 million was now projected for the fourth quarter, an increase of about 196% over the projected loss of $384,000. The total projected net earnings of fiscal 1998 were restated and reduced from $4,500,000 to $3,700,000.

However, the unseasonably warm weather did not continue after the June 4, 1998 Revised Forecast. There was cooler weather for the balance of June 1998. Also, Danier made use of certain "reserves" in its manner of financial reporting. Hence, the actual results for the fourth quarter and overall fiscal 1998 were only marginally less than the projections in the Forecast. However, the share price remained depressed for some time.

The subsequent results for fiscal 1999 and 2000 demonstrated significant additional growth in sales, gross profits and net earnings, all of which were reflected favourably in the market price for the shares.

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to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages against,

(a) the issuer or a selling security holder on whose behalf the distribution is made;

(b) each underwriter of the securities who is required to sign the certificate required by section 59;

(c) every director of the issuer at the time the prospectus or the amendment to the prospectus was filed;

(d) every person or company whose consent has been filed pursuant to a requirement of the regulations but only with respect to reports, opinions or statements that have been made by them; and

(e) every person or company who signed the prospectus or the amendment to the prospectus other than the persons or companies included in clauses (a) to (d)

or, where the purchaser purchased the security from a person or company referred to in clause (a) or (b) or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter, in which case the purchaser shall have no right of action for damages against such person, company or underwriter.

Similar provisions are found in BC's *Securities Act*.

12 [2001], O.J. No. 950 (S.C.), rev'd [2005] O.J. No. 5388 (C.A.), aff'd 2007 SCC 44.

The case is one of the few class actions to have proceeded through a full trial.[13] The class claim was successful at trial, but reversed on appeal. It was held on appeal that neither s. 130 nor the definition of misrepresentation in s. 1(1) imposed on an issuer an obligation to disclose material facts occurring after the date a receipt for a final prospectus is issued and before the end of the distribution period.

One of the interesting elements of the trial court's assessment was the consideration of damages (the Court of Appeal did not have to consider this issue given its finding on liability). The Court held that the *prima facie* measure of damages is the depreciation in the price of the security": i.e. (the offering price) – (post-disclosure of the misrepresentation price).

In terms of the relevant date for this calculation, the trial court concluded:

> The defendants' argument that the only evidence of the value of the shares at the time of purchase is the trading price and the evidence of their expert indicating that the intrinsic value of the shares was at least the trading price must be rejected. In this case, the misrepresentation was made to all purchasers of the shares. The trading price was not free of the misrepresentation before June 4, 1998, the date of the disclosure. The market reaction as of this date and following is the best evidence of the consensus of buying and selling opinion as to the real value of the shares absent the misrepresentation. With respect to the defendants' expert, it would be illogical to prefer the opinion of one expert to the consensus of the market, particularly when the market consensus was that the real value of the shares was below $11.25.
>
> Under s. 130(7), it is open to the defendants to rebut the depreciation in value evidenced by the market reaction to the disclosure, by proving that other factors caused the depreciation in price or that the market prices on June 4, 1998, and following did not represent value because they were affected by factors unrelated to value. (at paras. 338-339)

Given the eventual rebound of the shares, the trial court also considered whether class members must have sustained an actual loss; that is, must they have sold after the misrepresentation was disclosed, and are they only entitled to recover any actual loss flowing from such sale? The Court rejected this limitation stating:

> Neither s. 130 nor any of the authorities referred to suggest that the plaintiffs can recover only if they have sold and crystallized their loss. This follows from the premise that the appropriate measure of damages is the difference between the price paid and the then value of the securities. As indicated in *Pearson, supra*, if the plaintiff both buys and sells the securities when they are affected by the misrepresentation—i.e. sells before the disclosure of the misrepresentation—then he or she has not suffered any depreciation in value and cannot recover damages. Accordingly, purchasers who sold before June 4, 1998, may not recover, and, in fact, are not included in the class in this case. If a plaintiff makes a second investment decision and continues to hold the securities after the disclosure of the misrepresentation, then subsequent movements in the market price of the securities will not inure to the benefit of either the plaintiff or the defendant. This method of measuring damages does not risk awarding a windfall to the plaintiff. For example, assume Ms. X purchased shares at $30 per share on the understanding that the company had drilled for oil and had discovered a significant oil field and expected significant increases in production and cash flow. Thirty days after this purchase, the company discloses that its claim to have discovered a significant oil field was a misrepresentation. The market reacts to this disclosure and the price of the shares declines to $10 per share. Ms. X sues for damages, but continues to hold her shares because in her view, at $10 per share, the company is a good investment in light of the corrected information regarding its current prospects. Subsequently, the company's shares stagnate for two

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13 [2004] O.J. No. 1916 (S.C.).

> years and then appreciate to $50 per share on the basis of an even larger discovery. Ms. X sells her shares at $50 per share. Would awarding Ms. X damages at trial represent a windfall? In my view, absolutely not. Ms. X should have realized $40 per share based on the then value of the shares she purchased. Instead she only realized $20 per share. Awarding Ms. X damages of $20 per share, representing the difference between the price she paid and the then value of the shares, would only compensate Ms. X for the harm caused by the misrepresentation. (at para. 345).

Finally, the trial court considered the precise calculation of damages:

> The closing price of Danier shares on June 4, 1998, was $10.25, which suggests damages of $1.00 per share.
>
> The plaintiffs do not use this price to calculate damages. Instead the plaintiffs base their measurement of $2.40 per share on calculations performed by their expert, Professor Giammarino. Using a statistical model that he constructed, Professor Giammarino estimated the statistical relationship between the change in Danier's share price, the proportional change in the TSE 300 index, the proportional change in the TSE Consumer Discretionary Spending sub-index and the changes in the share prices of comparable companies. The plaintiffs also note that their expert, Alan Stewart, calculated damages using the ten and twenty-day average of the closing prices of Danier shares, of $2.28 and $2.21 respectively, or $2.52 and $2.24 when the ten and twenty-day averages are calculated excluding the closing prices on June 4 and 5. Alan Stewart's approach essentially mirrors the calculation of damages under s. 134(6). As discussed above, the measure of damages under s. 134(6) may inform measurement of damages under s. 130.
>
> There is no reason to depart from the prima facie measure and adopt either the measure of damages under s. 134(6) or Professor Giammarino's statistical model.
>
> Professor Giammarino's evidence, however, is helpful in determining whether the market price on June 4, 1998, is the appropriate post-misrepresentation price. It is Professor Giammarino's opinion that the implications of the forecast revision were not fully absorbed by the market until June 10, 1998. Professor Giammarino supports his opinion with statistical analysis indicating that the price swings for the trading days June 4, 5, 8, and 9 were abnormal price movements and reflect a continued response to the June 4, 1998, announcement. Further, that price stabilization activities such as those undertaken by the lead underwriter, CIBC, have the effect of mitigating price movements, which means that the market price may not reflect the consensus of buying and selling opinion. Professor Giammarino indicates that CIBC was on the buying side of 60%, 97% and 39% of the total volume of shares traded on June 4, 5, and 8 respectively. It is the evidence of Earl Rotman of CIBC that they purchased, at market, $10 million of Danier shares on June 4th and June 5th for the purposes of price stabilization.
>
> The plaintiffs' argument on this point is persuasive. The post-misrepresentation price should be adjusted to eliminate the effects of the price stabilization and any abnormal price movements, similar to the adjustment made in *Beecher v. Able, supra*, to eliminate the effects of panic selling. In the circumstances of this case, the appropriate post-misrepresentation price is the closing price of $8.90 on June 10, 1998, the date that the forecast revision had been fully absorbed by the market and the market price was no longer affected by price stabilization activities.
>
> Thus, the plaintiffs are entitled to damages of $2.35 per share ($11.25-$8.90) subject to any negative causation defence proven by the defendants under s. 130(7) of the Act. (at paras. 356-361).

B. Secondary Market Liability Prior to the Legislative Amendments

The Glass is Half-Full (or All Empty)—Carom v. Bre-X Minerals Ltd.

This action included pleas of misrepresentation and conspiracy against Bre-X, a sister company, its insiders and engineer, and several brokers who recommended Bre-X stock. These were "secondary market" allegations, not based on a particular prospectus or circular. All Canadian shareholders who purchased shares of Bre-X on various stock exchanges over the course of the alleged fraud were included within the proposed class.

In an earlier pleadings motion, the Court specifically declined to import the US "fraud on the market" concept into such secondary market claims.[14] The Court held that the Supreme Court of Canada's judgment in *Hercules Management* meant that reliance must be established in every case alleging negligent misrepresentation.

Without the benefit of the "fraud on the market" concept, the negligent misrepresentation tort is usually quite personal - it begins with an analysis of exactly what was said to each individual, and it ends by requiring confirmation that each person relied on the particular statement challenged.

At the certification stage, the trial court in *Carom* refused to certify the negligent misrepresentation claims, based in large measure on the complexity created by the need to establish reliance in each case.[15] However, the court did certify the fraudulent misrepresentation claim against the company and its insiders given that the focus of this claim was an overarching fraud permeating every statement rather than a series of individual representations. The Court also certified the conspiracy and *Competition Act* claims against the same parties. The Ontario Court of Appeal subsequently found that the negligent misrepresentation claims could proceed against the insiders and Bre-X, given that the fraudulent misrepresentation claim had already been certified against these parties, and there was insufficient legal distinction between the nature of the two claims to justify different treatment.

Therefore, in relation to secondary market claims, unless you have a strong case of fraud against the issuer itself, it will be difficult to achieve certification based on common law causes of action alone. The problem facing the class in *Carom*, which will not be infrequent, is that the issuer is left with little in the way of exigible assets once a fraud is uncovered. Further, the extent of insurance coverage for fraud is likely to be limited or non-existent.

Without the assistance of the statutory provisions on secondary market liability, it may be possible to justify certification of secondary market claims if there is one single key press release or written statement that will obviously have been heard or relied upon by all shareholders, but such situations will be rare.

Misrepresentation Difficulties, What Misrepresentation Difficulties?—Menegon v. Philip Services Corp.

A settlement class was certified against the issuer in *Menegon v. Philip Services Corp.*[16] in which secondary market misrepresentation claims were advanced by the shareholder class. However, there was little analysis of the concerns raised in *Carom*. The certification seemed to be driven by the particular circumstances of that case. The issuer required class settlement approval in order to achieve a restructuring under the *Companies' Creditors Arrangement Act*. The Court specifically held that certification against the issuer was without prejudice to any arguments the remaining defendants might wish to make in opposition to certification at some later date.

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14 (November 4, 1999) 97-GD-39574 (Ont. Ct. Gen. Div.).

15 44 O.R. (3d) 173 (Gen. Div.), aff'd (1999), 46 O.R. (3d) 315 (Div. Ct), appeal allowed (October 31, 2000) C33905 (C.A.).

16 [1999] O.J. No. 4080 (S.C.).

C. Oppression Class Actions

Oppression Class Actions: The Form is Fine, but what about the Content?—Stern v. Imasco Ltd. and *Joncas v. Spruce Falls Power and Paper Co.*

There is a variety of corporate activity that takes place outside the framework of prospectuses or takeover bids. The oppression remedy is meant to provide a remedy for all situations in which shareholders have been unduly prejudiced. Can the class action vehicle be used effectively to advance such claims?

In *Joncas v. Spruce Falls Power and Paper Co.*,[17] the Court approved an oppression claim relating to a share issuance by the company to employees. Certification was not actively contested by the defendant however, only the existence of a cause of action.

In *Stern v. Imasco Ltd.*,[18] the plaintiff sought to bring an oppression-based class action alleging that the issuer, its directors, and de facto controlling shareholder were entering into an improvident transaction which had the effect of "freezing out" minority shareholders at a price that did not properly reflect the value of the shares. All shares were to be transferred to the de facto controlling shareholder, BAT plc.

The defendants argued that oppression-based class actions are barred through the operation of s. 37(a) of the Ontario *Class Proceedings Act*.

Section 37(a) provides that the Act does not apply to a proceeding that may be brought in a representative capacity under another act. The defendants argued that an oppression action could be brought in a representative capacity under the applicable corporate statute, and therefore certification under the Ontario Act was not appropriate. The Court rejected this argument stating that although an oppression proceeding can sometimes have the characteristics of a representative action in its effect, it is not "brought in a representative capacity." The Court found that use of the class proceedings legislation can be complementary to the objectives of the oppression remedy.

When it came to assessing the merits, however,[19] the Court adopted the traditional business judgment rule and held that: "The directors of Imasco have an arguable basis for facilitating a decision by Imasco's public shareholders on BAT's proposal." The business judgment rule as interpreted to date by Ontario and BC court's have provided officers and directors with a great deal of latitude in terms of structuring transactions.[20] As a general matter, it would appear that US courts are more inclined to adopt a degree of healthy skepticism when considering the motives of a corporation's principals.

The Court in *Stern* also struck the personal claims against the directors, and those against the de facto controlling shareholders. This left only the issuer as subject to the oppression action. These findings illustrate two points: (1) the broad scope of the business judgment rule in Canada, and (2) the need to carefully assess the scope of any securities claim to ensure that only the bare minimum of parties necessary to assure full recovery at the end of the day are joined. This is particularly true in Ontario, where costs can be awarded against representative plaintiffs within a class proceeding.

On this latter point, it is notable that the Supreme Court of Canada in *Kerr*, *supra*, declined to relieve the representative plaintiff from his *prima facie* liability for costs. The Court stated:

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17 (April 13, 1999) No.97-CV138924 (Ont. Ct. Gen. Div.).

18 (1999), 38 C.P.C. 4th 347 (Ont. S.C.J.).

19 The plaintiff had asked for interim disclosure orders, which required the court to consider the merits of the plaintiff's position generally.

20 *Brant Investments Ltd. v. KeepRite Inc. et al.* (1991), 3 O.R. (3d) 289 (C.A.) at 320; *Brio v. Clearly Canadian Beverage Corp* (1995), 8 C.C.L.S. 1 (B.C.S.C.) at para. 17; *CW Shareholdings Inc. v. WIC Western International Communications Ltd. et al.* (1998), 160 D.L.R. (4th) 131 (Ont. Gen. Div.) at 150 to 153.

> It has not been established that this is a "test case" in the conventional sense of a case selected to resolve a legal issue applicable to other pending or anticipated litigation. Nor have the appellants raised a "novel point of law." As we have seen, the heart of the case is simply a shareholder dispute over a lot of money requiring the application of well-settled principles of statutory interpretation to particular legislative provisions. This is the usual fodder of commercial litigation ... We are certainly not dealing with people on either side who are historically disadvantaged. Nor, as the Court of Appeal noted, "is it a contest characterized by significant power imbalance" ... Though many Canadians are investors and the resolution of the present dispute will affect future actions for prospectus misrepresentation, the Court of Appeal rightly concluded that this is, in essence, "a commercial dispute between sophisticated commercial actors who are well resourced" (para. 6). If anything, 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. Be that as it may, Mr. Durst was well aware that as a representative plaintiff he ran the risk of being held solely responsible for the defendants' costs if the action failed. He gambled on his interpretation of s. 130(1) and lost. (paras. 65-68).

This is a relatively unforgiving approach to costs, and will mean that representative plaintiffs in securities class actions will be well advised to immunize themselves from an adverse costs award by (1) seeking an indemnity from class counsel, (2) obtaining costs protection from the provincial class proceedings funds in jurisdictions where such funds exist, or (3) suing in a jurisdiction that generally deprives parties of costs in class actions.[21] For example, costs are generally not available in class actions in BC.[22]

D. Other Cases

Preventing Abuse—Epstein v. First Marathon Inc.

Epstein v. First Marathon Inc.[23] illustrates the care courts will take to ensure that securities class proceedings are not used improperly to prevent commercial transactions from proceeding smoothly.

In Ontario, any discontinuance of a class action must obtain court approval, whether or not the action has been certified.[24] In *Epstein*, the plaintiff sought to discontinue a proposed securities class action. The action was sought in order to challenge the corporation's decision to enter into a statutory arrangement. Prior to any challenge being advanced however, the plaintiff agreed to discontinue the action in return for a sum of money on account of fees. No funds were going to be paid to the class, and the agreement was not generally disclosed.

The Court refused to approve the fee, concerned that the action had the characteristics of a "strike suit" advanced solely to obtain the payment of fees rather than in the best interest of shareholders. The Court noted that the case on the merits was never advanced by the plaintiff, and counsel was the only person benefiting from the settlement.

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21 On class action costs generally, see Branch, *Class Actions in Canada* (Canada Law Book, looseleaf) at chapter 19.

22 BC *Class Proceedings Act*, s. 37.

23 (2000), 41 C.P.C. (4th) 159 (Ont. S.C.).

24 Note: This is not the case in BC where court approval for a discontinuance is only required if the case reaches certification.

IV. Statutory Secondary Market Liability

Many years after the Canadian Securities Administrators published proposed draft legislative changes, Ontario finally brought in a form of "fraud on the market" for secondary market claims, which came into effect on December 31, 2005. BC (July 4, 2008), Alberta (December 31, 2006), and Quebec (November 9, 2007) are other provinces that have followed suit.

The main benefit of the new legislation for class actions is clear: by removing the reliance element, the major hurdle established by the courts to class certification has been removed. This key complicating individual element is removed, transferring the weight towards the common issues side of the ledger.

But there are serious limitations within the legislation which restrict its benefit for investors. We discuss the key control mechanisms below.

First, the issuer's damages exposure is limited to the greater of $1 million or 5% of its market capitalization notwithstanding that a secondary market misrepresentation may have caused far greater losses. As such, the secondary market liability provisions serve a purpose that appears to be guided more by deterrence than comprehensive compensation. There is an issue as whether the liability limits are sufficiently high to motivate class counsel to bring such difficult and challenging secondary market claims. It may be necessary for class counsel to "double up": invoke the statutory remedies to ensure certification, while maintaining the common law claims to ensure that the company continues to face exposure for the entire loss suffered by shareholders. The cases filed to date under the new legislation have generally advanced both the statutory and common law claims.

Subject to the limitation above, secondary market liability legislation generally provides for calculating damages based on whether plaintiffs acquired or disposed of their shares during the period of time which is 10 trading days after the misrepresentation or failure to disclose is publicly corrected.[25] If a plaintiff bought shares after the misrepresentation and sold them within 10 days after the public correction, damages are the difference between the average purchase and selling prices of the shares. If the plaintiff sold the shares after the 10-day period, damages are the lesser of the difference between the average purchase and selling prices of the shares or the weighted average trading price of the shares over the 10-day period. For plaintiffs still holding their shares, damages would be based on the latter scenario. This general calculation of damages is then subject to reduction based on losses that are attributable to a change in the market price of the shares which is unrelated to the misrepresentation or failure to disclose, as proven by the defendant.

Second, the removal of the joint and several liability (except in instances of non-issuer liability for those defendants who authorize, permit, or acquiesce with knowledge of the disclosure violation) further increases the risk for class counsel in commencing such litigation. Unless a deep pocket defendant is allocated a major share of responsibility, all efforts made to establish liability could be for naught.

Third, there is a "gatekeeper" leave requirement forcing proposed class counsel to invest substantial time and effort on the merits without knowing whether or not he will be granted the status of class counsel at all. The concern for class counsel regarding the leave element may be reduced once the courts determine the practical requirements of obtaining leave. In order to obtain leave, the plaintiff must show that the claim has been brought in good faith and that there is a "reasonable chance" the claim will be resolved in favour of the plaintiff at trial.[26] So far, there has not been a single decision by a Canadian court that sets out the practical requirements for satisfying this leave test nor applied them to the facts of a particular case. Pending Ontario cases are close to rendering decisions on the leave test, however. The closest to doing so is *Silver v. IMAX Corp.*, where the leave application was heard in December 2008. A decision in *IMAX* is not expected before March 2009.

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25 See, e.g., Ontario's *Securities Act*, s. 138.5; BC's *Securities Act*, s. 140.5.

26 See, e.g., Ontario's *Securities Act*, s. 138.8; BC's *Securities Act*, s. 140.8.

Initial indications are that securities class actions based on the secondary market liability provisions is a steady growth industry. Only one case (*IMAX*) was filed in 2006, four cases were filed in 2007,[27] and eight cases filed were in 2008 (all in Ontario).[28] 2008 still represents a significant increase, however, in the number of securities class actions based on the new secondary market liability legislation. These cases often involve allegations of accounting errors in some form, sometimes resulting in restated financial statements.

Leading the charge in these cases is the Siskinds law firm, who are plaintiff's counsel in seven of the eight actions filed in 2008, and either plaintiff's counsel or co-counsel (mainly with Stutts Strosberg) in the five actions filed in 2006 and 2007.

Of particular note on the settlement front, the *Southwestern Resources* case was settled for $15.5 million and was approved in November 2008.[29] There also have been some recent evidentiary decisions in the *IMAX* and *CV Technologies* cases that have shed some light on the leave application process. In *IMAX*, a broad relevance test was adopted for the scope of cross-examination of defendant affidavits filed in opposition to a leave application.[30] In *CV Technologies*, the trial court decided defendants were not required to file any affidavits in opposition to the leave application (which had the result of preventing the plaintiff from examining the defendants).[31] Leave to appeal was recently granted on that decision in the *CV Technologies* case.

Jurisdictionally, there is likely be a continued bias towards Ontario as (1) most defendants will be located and/or listed there, which will generally negate expensive jurisdictional battles, and (2) Ontario is willing to certify national opt-out class actions, which creates the largest pool against which class counsel can apply their contingency fee. By contrast, BC's *Class Proceedings Act* only certifies national classes on an "opt in" basis, making it more difficult to secure control of a large class against which to apply class counsel's fee.

Whether this industry will take off on a long-term basis will depend on actual results (either at trial or through settlement). Specifically, will the risk/reward equation be beneficial enough to keep Siskinds in the game, and also attract other law firms to the area? It is still too early to opine on this issue.

V. Settlement Statistics

The resources required to defend the lawsuit and the negative impact on the company's ability to raise capital, coupled with certain class counsel's willingness to resolve claims for cents on the dollar, create an environment that is very conducive to settlement. Thus, in general, the settlement figure in any given securities class action will depend on a number of factors, including:

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27 Three of the cases involve Celestica Inc. (Ontario), CV Technologies Inc. (ColdFX) (Ontario), and Southwestern Resources Corp. (Ontario, BC and Quebec), PetroKazakhstan Inc. (Alberta) was the fourth class action filed in 2007 but it has limited application with respect to the secondary market liability provisions.

28 The eight cases involve European Minerals Corp./Orsu Metals Corp. (of which the authors are defence counsel), Gammon Gold Inc., TVI Pacific Inc., SunOpta Inc., Gildan Activewear Inc., Arctic Glacier Income Fund, AIG Financial Products, and Canadian Imperial Bank of Commerce. The latter two cases appear to be prompted by the latest financial credit crisis. NERA Economic Consulting, *Trends in Canadian Securities Class Actions: 1997-2008* (2009), p.6 at http://www.nera.com/publication.asp?p_ID=3704.

29 At the approval hearing in BC, class counsel indicated that the settlement terms (reached several months previous) likely would not have occurred under the present economic climate.

30 *Silver v. IMAX Corp.*, [2008] O.J. No. 1844 (leave to appeal denied, [2008] O.J. No. 2751 (Sup. Ct. Jus.)).

31 *Ainslie v. CV Technologies Inc.*, [2008] O.J. No. 4891.

(1) strength (or perceived strength) of the defences to liability and damages;

(2) the company's cash position;

(3) willingness of any Directors & Officers insurer to fund all or part of any settlement;

(4) the "passion" that class counsel have for the case; and

(5) timing of settlement (it can be somewhat easier to settle a class action early, particularly before class counsel have devoted substantial time to a case for which they will feel the need to be compensated).

Regarding what to expect to pay in a securities class action settlement, some guidance can be obtained from US studies of settlements in securities class actions. One recent US study by Cornerstone Research indicates certain trends in recent years for median settlements.[32] According to the study, the median settlement for 1996-2006, and for 2007 alone, as a percentage of estimated damages was 3.6% and 2.9%, respectively. Settlement percentages decrease as the estimated damages increase. For instance, the median percentages for cases involving estimated damages of less than $50 million were significantly greater than the overall median percentages (10.2% to 3.6% and 12.1% to 2.9%, respectively for 1996-2006 and 2007).

In Canada, according to a study by NERA Economic Consulting,[33] there have been 20 securities class action settlements since the enactment of class action legislation, but only one has involved the new provisions on secondary market liability—that being the *Southwestern Resources* case discussed above. Of the 20 combined class action settlements identified by NERA Economic Consulting, the average and median settlement value as a percent of claim amount in cross-border cases was 12.6% and 11.2%, respectively. In purely Canadian cases, it was 18.0% and 7.2%, respectively.[34]

The value of the *Southwestern Resources* settlement was 5.2% of the claim amount. Also, although it is a pre-secondary market liability legislation case filed in 2004, a recent settlement was approved in *Lawrence v. Atlas Cold Storage Holdings Inc.*, in which the defendants settled class action claims for $40 million (involving a class counsel fee of $6.3 million). The Court determined that on a net recovery basis, based on certain assumptions, the class would recover 21.55% of its loss, which was in line with the very few securities class actions that had been settled in Canada.

VI. Conclusion

The *Class Proceedings Act*, along with the recent provisions on secondary market liability, does partially even the playing field between issuers and wronged shareholders. Canadian class counsels are learning from their American counterparts.

Launching a securities class action is not for the faint of heart however. Issuers will retain top-flight counsel, and will confront class counsel with a full array of procedural objections. The speed at which securities transactions and its associated litigation occur requires enormous resources and devotion. The issue of costs for cases brought in Ontario can be daunting. On the merits, the courts will generally grant the corporation reasonably wide latitude in relation to its decision-making.

Nonetheless, at the end of the day, class actions have increased exposure for securities issuers. This will likely improve both the conduct of issuers, and the lot of shareholders wronged by improper activities. The level of improvement will depend on the courage (or foolhardiness) of class counsel.

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32 Cornerstone Research, *Securities Class Action: 2007 Review and Analysis* (2008) (Stanford Law School) at 6-7, at http://securities.stanford.edu/settle.html

33 NERA Economic Consulting, *Trends in Canadian Securities Class Actions: 1997-2008* (2009) at 10 at http://www.nera.com/publication.asp?p_ID=3704

34 *Ibid.* at Tables 1 and 2.