IN FACT AND IN LAW

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# The Application of Ontario's Bill 198 to Securities Class Actions in Quebec

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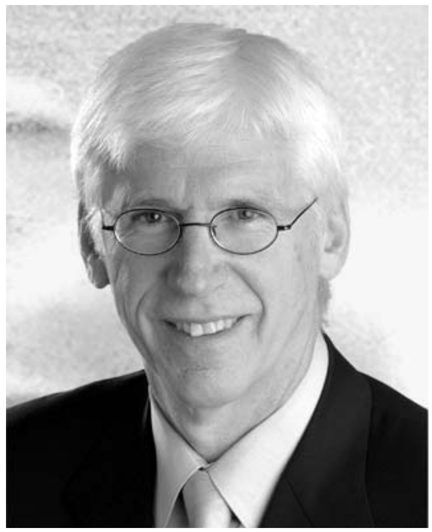

On December 31, 2005, amendments to Ontario's *Securities Act* will come into effect to provide investors with a new recourse against companies and their directors, officers, employees and consultants for any misrepresentation in their public documents or public oral statements, or for failure to make timely disclosure of material changes in the company's circumstances. This legislation creates a powerful new right of action which arises whether or not there was actual reliance by the investor on the issuer having complied with its disclosure requirements, and it is widely believed that it will give rise to a significant increase in securities class action lawsuits in Ontario.

What is not generally being addressed by commentators is the potential application of this legislation to Quebec shareholders who avail themselves of the legislation to launch a class action in Quebec, particularly against a company having its head office or principal place of business in Quebec.

The consequences of the application of this legislation are far-reaching, and as it appears likely that a Quebec court would accept jurisdiction when both Plaintiffs and Defendants reside in Quebec, as long as similar proceedings have not already been commenced in Ontario invoking the same right of action between the same parties, we consider that it is important to be aware of it.

Article 3115 of the *Quebec Civil Code* reads:

> **Art. 3115. Failing any designation by the parties, a sale by auction or on a stock exchange is governed by the law of the country where the auction takes place or the exchange is situated.**

In other words, it appears likely that Ontario law, including this new legislation, would apply to any sale of shares that takes place on an Ontario stock exchange, including those of any Quebec based company whose shares are publicly traded on the Toronto Stock Exchange. Accordingly, if a lawsuit is filed in Quebec invoking the *Ontario Securities Act*, it appears likely that a Quebec court would apply at least the substantive portions of these new provisions.

Interestingly, some of the key safeguards that the supporters of this legislation claim to be deterrents to strike suits[1] may not apply in Quebec.

For example:

- the requirement to receive the Court's leave to proceed, which a Court grants only if it is satisfied that the action is being brought in good faith and that there is a reasonable possibility that the action will be resolved at trial in favour of the Plaintiffs (Section 138.8(1));
- the requirement for approval of the Court before any suit is discontinued, abandoned or settled (Section 138.10); and
- the stipulation that the prevailing party is entitled to costs (Section 138.11),

are all essentially procedural in nature. As such, they may not necessarily be applicable in Quebec because, generally speaking, procedure is governed by the law of the Court before which the action is taken (Article 3132 C.C.Q.).

However, even if these purported safeguards against strike suits may not be applicable in Quebec, it nevertheless appears likely that the principal substantive provisions of the legislation will be, including the key feature regarding reliance. It is thus important that Quebec based companies and their directors, officers, employees and experts be aware of this legislation.

Much has been written about the nature and impact of the legislation, and the following comments are meant only to be a very brief overview of some of its key features.

[1] This term is commonly used to refer to very large claims filed within days or even hours of a drop in share price even when little, if any, evidence of corporate wrongdoing exists, in an attempt to force a lucrative early settlement.

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## Who Does the Legislation Apply To?

This legislation will apply to any company that is a reporting issuer under the terms of the *Ontario Securities Act*, as well as to any company having a real and substantial connection to Ontario whose shares are publicly traded. This would probably include any Quebec company whose shares are publicly traded in Ontario.

## What Does the Legislation Apply To?

With the exception of securities that have been offered by a prospectus or by an exempt distribution, most transactions involving securities publicly traded in Ontario (estimated to be more than 85% of transactions on the Toronto Stock Exchange) are covered by this legislation.

## What Does It Require?

The legislation requires that those companies to whom the legislation applies not make misrepresentations in the documents they release or in the public oral statements their representatives make. It also requires these companies to make timely disclosure of any material changes in the companies' circumstances. Any document or public oral statement containing a misrepresentation or any failure to make timely disclosure may give rise to a right of action for damages against the company. Its directors and officers, the various influential persons as defined in the legislation (including their directors and officers), as well as the experts who have provided reports statements or opinions containing misrepresentations, may also be held liable under these provisions.

## Who Has a Right of Action?

Any person or company who has acquired or disposed of the issuer's securities during the period between the time the document was released, the public oral statement made, or the material change was required to be disclosed, and the time when the misrepresentation was publicly corrected or the material change disclosed, has a recourse under the provisions of the legislation.

## Reliance

One of the most important features of this legislation is that this right of action exists whether or not the person or company relied upon the misrepresentation or the fact that there was compliance with the disclosure requirements.

## Damages

Damages are defined in the legislation as generally being equal to the difference between the average price paid for the securities and the price received upon disposition within the ten days following the public correction of the misrepresentation or disclosure of the material change (or a variant thereof in the event the shares are not disposed of within that time frame).

## Proportionate Liability

The legislation provides for proportionate liability, which effectively limits the damages assessed against each party found liable to only that portion of the damages corresponding to that party's share of the responsibility for the damages.

## Limits on Damages

The legislation provides for limits on the amount of damages that can be claimed. These limits have been described as providing an additional safeguard against strike suits.

These limits are:

- for a company, the greater of 5% of its market capitalization, or $1,000,000;
- for directors, officers, and influential persons (including their directors and officers), the greater of $25,000, or 50% of their aggregate compensation from the issuer and its affiliates; and
- for experts, the greater of $1,000,000, or the total revenue of the expert and its affiliates from the issuer and its affiliates for the twelve months preceding the misrepresentation.

These limits will be reduced by damage awards in other jurisdictions in Canada resulting from the same misrepresentation or failure to make timely disclosure.

It is important to note, however, that these limits **do not apply** to anyone, other than the responsible issuer, if it is proven that he, she or it **knowingly** "authorized, permitted or acquiesced in the making of the misrepresentations or the failure to make timely disclosure while knowing it was a misrepresentation or failure to make timely disclosure, or influenced the making of the misrepresentation or the failure to make timely disclosure". Although proof of such knowledge may eventually prove difficult, allegations of such knowledge will be relatively simple to make, and will thus permit claims to be made for amounts far in excess of the limits provided for in the legislation.

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## Defences

While there are a number of defences and provisions in the legislation regarding burden of proof that will provide those sued with significant means of exoneration, unfortunately, to have any effect, most of these will require the case to have reached a stage where evidence is to be heard and will thus not provide much solace at the early stages of litigation. By the time these defences can be given effect in a judgment, considerable damage may already have been done to both the reputation and the financial well-being of those sued.

The following are some of the key provisions regarding defences and burden of proof:

i) There is no liability unless the Plaintiff proves that the person or company accused of misrepresentation in a non-core document or a public oral statement knew or deliberately avoided acquiring knowledge that it contained the misrepresentation (or was guilty of gross misconduct in connection with its making or release). This provision does not apply with regard to an expert. (Sections 138.4(1) and (2)).

ii) Similarly, there is no liability for failure to make timely disclosure unless the Plaintiff proves the person or company knew - or deliberately avoided knowing - of the change in circumstances and that the change was material at the time the failure to make timely disclosure first occurred (or was guilty of gross misconduct in connection with the failure to make the timely disclosure). This provision is not applicable to the company (the responsible issuer) its officers, an investment fund manager or its officers. (Sections 138.4(3) and (4)).

iii) There is no liability if the Plaintiff acquired or disposed of the securities knowing the document or statement contained a misrepresentation or had knowledge of the material change. The Defendant has the burden of proof. (Section 138.4(5)).

iv) There is no liability if the person or company proves he, she or it made a reasonable investigation before the release of the document or public oral statement, and that at that time, he, she or it had no reasonable grounds to believe the document or statement contained the misrepresentation. Similarly, regarding a failure to make timely disclosure, no liability lies if a reasonable investigation had been conducted and the person or company proves he, she or it had no reasonable grounds to believe that the failure to make timely disclosure would occur. Once again, the burden of proof of this reasonable diligence defence lies with the Defendant. (Section 138.4(6)).

v) There is no liability for misrepresentations in forward looking information if the Defendant person or company proves the document or public oral statement contained reasonable cautionary language and a statement of the material factors or assumptions that were applied in making the forecast or projection, and also that it had a reasonable basis for drawing the conclusions it did. Once again, the Defendant has the burden of proof of this safe harbour Defence. (Section 138.4(9)).

vi) There is no liability when a Defendant proves that it had no knowledge and no reasonable grounds to believe at the time a document was released that it would in fact be released (except with respect to a document that is required to be filed with the Securities Commission). (Section 138.4(13)).

vii) A person or company is not liable when the misrepresentation or failure to make timely disclosure occurred without his, her or its knowledge or consent as long as he, she or it promptly notifies the Board of Directors, and if no correction is made within two days after such notice, he, she or it advises promptly and in writing the Securities Commission. (Section 138.4(15).

## Conclusion

Any Quebec based company that is publicly traded in Ontario - as well as its directors, officers, influential persons and experts - would therefore be wise to be vigilant in ensuring that all publicly released documents and public oral statements are free of misrepresentations, and that material changes are promptly disclosed when required. Failure to do so may lead to unpleasant surprises as a result of this legislation, not only in Ontario, but also in Quebec.

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