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*A Report on Recent
Developments in Canadian
Securities Law*

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BRITISH COLUMBIA COURT OF APPEAL RULES ON PURCHASERS ENTITLED TO STATUTORY CAUSE OF ACTION FOR PROSPECTUS MISREPRESENTATION

On November 21, 2002, the British Columbia Court of Appeal released a ruling dealing with fundamental aspects of Canadian securities law. The ruling can be accessed at <http://www.courts.gov.bc.ca/jdb-txt/ca/02/06/2002BCCA0624.htm>.

THE CASE

Pearson v. Boliden Limited is a British Columbia class action on behalf of everyone, anywhere, who purchased instalment receipts issued pursuant to the Boliden IPO in June 1997. The plaintiffs seek damages under the statutory cause of action for prospectus misrepresentation contained in Canadian provincial securities acts. Damages were said to arise when a tailings dam at Boliden's Spanish subsidiary failed in April 1998, releasing millions of litres of tailings into the Spanish countryside, and allegedly caused Boliden's share price to drop. The plaintiffs allege that the IPO prospectus contained misrepresentations in that it failed to disclose structural problems with the dam which are said to have been known to Boliden at the time.

THE ISSUES

The plaintiffs and the defendants agreed that the case should be certified as a class action. They disagreed, however, on the plaintiff classes which should be certified. In particular, they disagreed about whether the following purchasers were entitled to the statutory cause of action and should be included in the plaintiff classes:

- purchasers in provinces where the relevant securities acts either provided no statutory cause of action or set a limitation period which had already expired;
- purchasers outside Canada;
- purchasers who sold their shares before the Spanish dam failed; and
- purchasers who purchased during the period of distribution but in the secondary market.

THE DECISION

In 2001, a British Columbia lower court ruled that all of the disputed purchasers should be included in the plaintiff classes for the time being, with the matter to be finally settled by the trial judge. But, in its ruling, the British Columbia Court of Appeal disagreed. In doing so, it decided three issues on which there was little or no Canadian jurisprudence (while leaving a fourth novel issue open for the time being).

WHICH LAW APPLIES?

The plaintiffs argued that the question of which provincial securities act governed any particular purchaser could have a number of answers. For example, they suggested that Ontario’s *Securities Act* might govern a transaction involving a New Brunswick resident who acquired instalment receipts from a New Brunswick broker because the issuer was in Ontario and the prospectus was signed there.

The Court of Appeal rejected the plaintiffs’ approach. In a judgement which reflects the way in which securities practitioners have always assumed the system worked, the Court confirmed that every “trade” constituting a “distribution” within a province is governed by that province’s legislation. By way of example, the Court noted that an investor in New Brunswick who placed an order with a broker in Toronto will have acquired securities pursuant to a distribution in Ontario since the “trade” (ie, the broker’s receipt of the buy order) and the “distribution” will have taken place in Ontario. While there may be some factual ambiguity at the margins about whether a given transaction constitutes a trade in one province or another, the applicable law will almost always be self-evident. The place of the head office of the issuer or the place where the prospectus was prepared or signed is irrelevant.

As a result, the Court excluded from the plaintiff classes:

- purchasers of securities through trades constituting distributions in provinces where the relevant securities acts provided no statutory cause of action or where the limitation period had already expired; and
- purchasers of securities through trades constituting distributions outside Canada, as none of these trades was governed by the provincial securities acts on which the plaintiffs relied.

EARLY SELLERS

The plaintiffs argued that purchasers who sold their shares before the Spanish dam failed might have been prejudiced by the alleged misrepresentations in that, for example, they may have paid “too much” for their shares

in the first place rather than having sold them for “too little” later.

The Court of Appeal rejected the plaintiffs’ approach and followed an Ontario lower court decision arising out of the Bre-X litigation.

The provincial securities acts provide that defendants are not liable for damages which do not represent the depreciation in value of the security which occurs as a result of the alleged misrepresentation.¹ The Court held that a loss suffered by a shareholder who sold before the dam failed, and thus before the alleged misrepresentations became apparent, could not constitute “depreciation” which “resulted from” the misrepresentation. So long as the misrepresentation remained unknown, any shareholder loss must by definition have occurred for other reasons.

As a result, the Court also excluded from the plaintiff classes purchasers who sold their shares before the dam failed.

SECONDARY MARKET PURCHASERS

Finally, the Court of Appeal made an important ruling with respect to the scope of the statutory cause of action. In particular, the Court addressed the question of whether “a purchaser who purchases a security offered [by a prospectus] during the period of distribution or distribution to the public” (the Ontario language²) includes someone who purchased during the period of distribution but in the secondary market. The provincial securities acts are not as clear as they might be, and there is conflicting commentary in the doctrine.

The Court had no difficulty concluding that secondary market purchasers were not entitled to the statutory cause of action and should be excluded from the plaintiff classes. The connection between a distribution and the obligation to deliver a prospectus, and between a prospectus-based misrepresentation and the statutory cause of action, led the Court to the conclusion that the provinces had chosen to “draw a line” between purchasers of securities offered by the prospectus and all other purchasers so far as the statutory cause of action was concerned.³

¹ See, for example, Ontario’s *Securities Act*, s. 130(7).

² Section 130(1)

³ One exception is Manitoba, where the statute is more ambiguous and was said to leave open the possibility that even secondary market purchasers were covered.

It is interesting to note that the Ontario Government has recently proposed amendments to Ontario's *Securities Act* that contemplate civil liability for secondary market disclosure in certain documents (including a prospectus).

GREENSHOES AND OVERALLOTMENTS

Under the plan of distribution set out in the prospectus (and in the underwriting agreement), the underwriters agreed to purchase approximately 51 million instalment receipts and had the right to purchase approximately five million additional instalment receipts to cover overallocments (the overallocation option or "greenshoe"). The underwriters sold approximately 61 million instalment receipts, approximately 10 million more than they agreed to purchase and five million more than contemplated by the "greenshoe" (ie, they were "short above the shoe"). To satisfy their overallocments, the underwriters acquired approximately four million instalment receipts pursuant to the "greenshoe" and approximately six million instalment receipts in the secondary market.

The use of the six million instalment receipts acquired in the secondary market to satisfy the underwriters' overallocments raises two interesting questions.

The first question is whether purchasers of the secondary receipts are entitled to the statutory cause of action. On one hand, the underwriters acquired only 55 million

instalment receipts pursuant to the plan of distribution. It may, therefore, be hard to say that the sale of the secondary receipts constituted "trades" within the definition of a "distribution" or transactions "in the course of or incidental to" a distribution as described in the provincial securities acts.⁴ On the other hand, the purchasers of the secondary receipts presumably received a prospectus, whether they were entitled to one or not, and their trades were likely indistinguishable from those of other purchasers. The Court of Appeal decided to include the purchasers of the secondary receipts in the plaintiff classes (except to the extent excluded for the reasons described above) for the time being, with the matter to be finally decided by the trial judge.

The second question (which was not before the Court of Appeal) is whether underwriting agreements permit underwriters to sell more securities than contemplated by the plan of distribution, particularly since the seller may be exposed to liability and does not receive any proceeds from the sale.

CONCLUSION

The decision in *Pearson v. Boliden* is now the leading Canadian case on these important issues. The British Columbia Court of Appeal has performed a valuable service in articulating and clarifying a number of important legal principles affecting securities law across the country.

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The foregoing is a summary only. Readers should refer to the British Columbia Court of Appeal ruling for complete details.

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⁴ See, for example, the Ontario *Securities Act*, s. 1(1) "distribution"

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