March 2013

mcmillan litigation bulletin

"round two" for secondary market liability jurisprudence in BC: the Court of Appeal issues its decision in *Round v Macdonald, Dettwiler and Associates Ltd.*

On November 2, 2012, the BC Court of Appeal issued its decision in the case of *Round v MacDonald, Dettwiler and Associates Ltd*.[1] In upholding the decision of the chambers judge, the Court of Appeal declined to grapple with the issue of central interest to potential litigants and offered no analysis or commentary regarding the leave test that potential plaintiffs are required to satisfy in order to advance a secondary market liability claim.

background

The secondary market liability provisions (found in Part 16.1 of the British Columbia *Securities Act*[2]) create causes of action in relation to misrepresentations of material facts and the failures of public companies and others to disclose material changes that affect the price at which shares are traded on the market.

The statutory causes of action were created in favour of persons who acquire or dispose of shares during the period between the breach and its correction. Affected individuals are no longer

[1] 2012 BCCA 456.

[2] RSBC 1996, c 418.

required to prove reliance on the misrepresentation or a failure to disclose in order to maintain an action.

The legislation imports a leave requirement into the new causes of action in order to prevent frivolous suits and so-called "strike suits" from being pursued. The test at the leave stage requires a would-be plaintiff to prove that: (1) the action is brought in good faith, and (2) there is a reasonable possibility that his or her claim will be successful at trial.

facts

The Appellant, Lesley Round, was an employee of the Defendant, MacDonald, Dettwiler and Associates ("MDA"), from 2002 to 2008. During her employment, she received an entitlement to common shares of MDA through her employee share purchase plan. Under the plan, employees made contributions via automatic payroll deductions. Funds accumulated in each employee's plan account and, periodically, the plan administrator would purchase shares from MDA's treasury and hold them until the employee elected to withdraw, which Ms. Round did in December 2008.

Round complained that MDA and its named officers and directors failed to disclose that MDA began negotiating the sale of one of its divisions in October 2007, and that the proposed sale was subject to approval of the Minister responsible for administering the *Investment Canada Act* ("ICA").

the decision of the lower court

The decision issued by Mr. Justice Harris of the BC Supreme Court, as he then was, disposed of Ms. Round's claim on two substantive bases: firstly, that the material facts upon which Round relied all occurred before the statutory cause of action existed, and the legislation was not intended to apply retrospectively; and, secondly, Ms. Round did not acquire or dispose of her shares on the secondary market and therefore was not a proper plaintiff.

In his decision, Justice Harris also offered some helpful comments on the proper test to be applied at the leave stage. The judge's *obiter dicta* commentary can be summarized as follows:

- The determination of whether the applicant's evidence meets the "reasonable possibility" threshold is different than the test involved in certification of class actions, or the test for summary judgment.
- The leave test is intended to do more than simply screen out potential actions that are frivolous, vexatious or scandalous, and the test requires an applicant to do more than merely identify a triable issue. An action might have some merit, and not be frivolous, scandalous or vexatious, and yet it may not rise to the level of demonstrating that the proposed plaintiff has a "reasonable possibility of success."
- The analysis at the leave stage requires a "reasoned and significant assessment of the existing evidentiary record," and that this analysis necessarily occurs before any discovery has taken place. However, the leave application is intended to be, and should remain, an initial hurdle and not a substitute for trial.
- The leave application necessarily involves a review, weighing and balancing of the material facts upon which each side intends to rely, and requires the parties to submit their evidence in affidavit form. The court must then assess the merits of the proposed action on the evidence available.

The court's comments concerning what constitutes a reasonable possibility of success were of particular interest in light of the jurisprudence that has developed in Ontario. The decisions coming out of Ontario have described the leave test as "a relatively low threshold" which "is meant to screen out cases that, even though possibly brought in good faith, are so weak they cannot possibly succeed".[3] The leave requirement has also been described by an Ontario judge as requiring "something more than a de minimus

[3] Green v CIBC, 2012 ONSC 3637 at para 373.

possibility or chance that the plaintiff will succeed at trial,"[4] a phrase which Ontario courts have subsequently struggled to apply. These characterizations clearly differ from the BC Supreme Court's comments that an action might have some merit, and not be frivolous, scandalous or vexatious, and yet still might not rise to the level of demonstrating a reasonable possibility of success.

The divergence in the way the leave test has been characterized by the Ontario and BC courts is an issue that has yet to be considered and determined by any Court of Appeal in the country.

the BC Court of Appeal decision

Unfortunately for issuers, the Court of Appeal did not in this decision sanctify the lower court's *obiter* analysis regarding the "reasonable prospect of success" analysis, nor did it offer any commentary on the issue of the leave threshold for potential secondary market liability claims.

The Court of Appeal grappled with the two substantive points at issue in the appeal, which attacked the findings of the chambers judge on retroactive applicability of the legislation, and whether the *Securities Act* applied to Ms. Round given that she acquired her shares from treasury and not from the secondary market.

Speaking for the Court, Madam Justice McKenzie declined to accede to Round's arguments on the issue of the retroactive applicability of the legislation, indicating that the chambers judge's decision on this point was supported by authority and did not reveal any error.

With respect to the issue of how Ms. Round acquired her shares, the Court noted that the Appellant's position had changed somewhat from her original position in chambers, and the focus on appeal became whether Ms. Round's shares constituted a

---

[4] Silver v IMAX, 2009 CarswellOnt 7874, 66 BLR (4th) 222, at para 324.

distribution within the meaning of the Securities Act. Ms. Round failed to convince the Court of Appeal that the chambers judge made any error in his reasoning as to whether the secondary market liability provisions applied to Ms. Rounds' shares; the judge in chambers correctly held that the shares were a distribution within the meaning of the *Securities Act*.

The Court concluded its analysis by holding that the chambers judge was correct in finding there was no reasonable possibility of Ms. Round succeeding at trial because the legislation did not apply retroactively to the relevant events and Ms. Round accordingly had no cause of action. The Court of Appeal went on to state that, "[t]his conclusion is sufficient to dispose of the appeal. It is therefore unnecessary to address the arguments that [Ms. Round's] intended action has a reasonable prospect of success on the merits."

While the Court offered no commentary or analysis on the leave test, it went on to comment on a procedural issue regarding affidavit evidence on leave applications. The Court noted that Ms. Round's argument that each named defendant was required under the provisions of the *Securities Act* to file affidavit evidence was without merit. The legislation requires each party to file evidence, in affidavit form, of material facts on which it intends to rely; however, it does not require each defendant to swear his or her own affidavit.

significance of the Round appeal decision

The notable silence from the BC Court of Appeal on the leave test means a lack of clarity for issuers and potential litigants, and leaves more questions than answers about how the test might be applied on the future. With the BC Court of Appeal having passed up its opportunity to weigh in on the test, the focus now shifts to the upcoming cases before the appeal courts of Ontario and Quebec to see whether and how those courts may shape the jurisprudence in this area and whether the less stringent threshold

espoused by the courts of Ontario thus far will become the dominant iteration of the leave test.

The BC Court of Appeal decision does, however, clarify two other points which are notable and which will help guide litigants' conduct in this area.

Firstly, the Court upheld the finding of Justice Harris that the provisions of the legislation were clear that an action can only be brought by a person who has a cause of action and is, thereby, properly a plaintiff. The chambers judge held that, since Ms. Round did not *personally* have a cause of action, leave could not be granted to start the action. It is significant that the Court of Appeal upheld this finding given the class action context of these type of claims, where proposed representative plaintiffs are sometimes permitted to be replaced by another person who has a cause of action if the proposed representative plaintiff does not.

Secondly, the Court of Appeal approved of the chambers judge's award of costs against Ms. Round for the leave hearing. The Court confirmed that the no-costs regime of the *Class Proceedings Act* was not engaged at the application for leave, given that no certification application hearing had taken place. Accordingly, we can expect in the future to see would-be plaintiffs bringing their leave application concurrently with their motion to certify a class in order to avail themselves of the Class Proceedings Act no-costs regime.

by Katherine Reilly

For more information on this topic, please contact:

Vancouver Katherine Reilly 604.691.6847 katherine.reilly@mcmillan.ca