BEARS V. BULLS: SECONDARY MARKET SECURITIES CLASS ACTIONS IN ONTARIO

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The impact of the COVID-19 pandemic on equity markets has been a topic of endless speculation and debate. Following steep sell-offs in late February and March of 2020, stock prices have come roaring back, fueled by unprecedented liquidity action by central banks and fiscal stimulus. Given the uncertain trajectory of markets, it is wise for companies in Ontario and their stakeholders to understand certain aspects of the province's liability regime for secondary securities market misrepresentation.

Amendments to *Ontario's Securities Act*[1] (the "**Act**") in 2005 created statutory causes of action for secondary market losses. Similar changes were adopted in other provinces. Since addition of the statutory cause of action, the number of securities law class actions has increased. 2019 saw the largest number of Canadian securities class actions filed in any year since the creation of the statutory regimes.[2]

This bulletin provides a high-level overview of secondary market class actions in Ontario brought under the statutory regime.

The Statutory Regime

Liability under the Act may attach to Ontario reporting issuers or other publicly traded securities of an issuer with a real and substantial connection to Ontario ("**Responsible Issuers**"). It may also attach to a Responsible Issuer's directors, officers and other parties responsible for their public representations.

Separate causes of action exist for misrepresentations resulting in losses in the 'primary market' (related to security trades offered by the company in a prospectus or offering memorandum) and the 'secondary market' (related to security trades in the public market after the initial offering, including trades on an exchange). The Act rigidly separates liability in the two markets - secondary market claims cannot 'piggyback' onto claims for prospectus misrepresentation.[3] The distinction between primary and secondary markets can pose difficulties for claims related to complex securities instruments, including exchange-traded funds (ETFs), whose trades will sometimes have characteristics of both primary and secondary market transactions.[4]

Secondary market claims arise under Section 138.3 of the Act include where:

- a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation;[5]
- a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation;[6] and
- a responsible issuer fails to make a timely disclosure of a material change;[7]

Similar provisions exist in securities legislation across the country.

Damages are measured between the time of the misstatement or failure to make timely disclosure and the time of its public correction. A public correction can come from the issuer corporation directly or from other sources, such as market analysts, short-sellers, news articles or credit rating agencies.[8] There must be some connection and shared subject matter between the alleged misrepresentation and the public correction. The correction must be reasonably capable of revealing the existence of the untrue statement or omission of material fact.[9] The public correction requirement provides a safeguard against frivolous and unmeritorious claims.[10]

The statutory causes of action under the Act do not require claimants to prove that they relied upon the relevant misrepresentation or omission. This makes the statutory causes of action much more amenable to class proceedings than traditional claims for common law misrepresentation. At common law, the claimant must prove their reliance on the misrepresentation, which is typically considered an individual issue incapable of being resolved on a common basis. Amendments to Ontario's Class Proceedings Act (the "**CPA**"), discussed below, could make common law misrepresentation claims even more challenging to advance on a class basis.

The Act provides statutory defences and other protections for defendants to secondary market claims, including a leave requirement to prevent frivolous strike suits. Where the alleged misrepresentation was not made in a 'core document', the plaintiff must prove that the defendant knew about the misrepresentation, deliberately avoided knowledge or was guilty of gross misconduct. A defendant can avoid liability by proving that the plaintiff knew about the misrepresentation or omission when they bought or sold the company's security. Another statutory defence is available where a reasonable investigation was conducted and the defendant did not believe there was a misrepresentation or omission. The Act also provides statutory defences in respect of information confidentially disclosed to the provincial securities regulator or in respect of forward-looking information qualified by suitable cautionary language. Finally, the Act prescribes formulas for the assessment of damages in various situations, the apportionment of liability and limits on liability for the different categories of defendant.

Special Considerations

a. Gatekeeping Motions

There are two preliminary gatekeeping motions that must be granted for a securities class action to proceed: (1) a motion for leave to commence the claim under the Act; and (2) a motion to certify the class action under the CPA.

Section 138.8 of the Act requires that leave be granted by the Court before a secondary market claim under Section 138.3 can be commenced. Leave will be granted where the Court is satisfied that (a) the action is being brought in good faith, and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

The Supreme Court of Canada has provided some guidance as to the standard that must be met for leave. The leave test requires a "reasonable or realistic chance that the action will succeed" based on "a plausible analysis of the applicable legislative provisions, and some credible evidence".[11] The meaning of "some credible evidence" has been a source of debate among practitioners and commentators.

Section 5(1) of the CPA sets out the requirements for the Court to certify a class proceeding. Where the standard for leave under section 138.8 requires the court to give consideration to the strength of a case, the requirements for certification do not generally involve evaluation of the merits. First, the pleadings must disclose a reasonable cause of action. This is satisfied unless it is plain and obvious that the plaintiff's claim cannot succeed assuming all of the facts pleaded are true.[12]

Section 5(1) also requires that: (a) an identifiable class exist; (b) the claims raise common issues of law or fact; (c) a class proceeding is the preferable procedure to resolve the common issues; and (d) there is a suitable class representative. These requirements are satisfied where there is "some basis in fact" to support each of them.[13]

Extensive amendments to the CPA came into force on October 1, 2020. These amendments changed the standards applied to certification. The amendments to the CPA are also believed to increase the likelihood of motions that dispose of a proceeding in whole or in part or that narrow the issues or evidence for the proceeding. The effect of the amendments to the CPA on shareholder class actions and the interaction with the leave motion remains to be seen.

b. Special Limitation Period Applicable to Claims Under the Act

Section 138.14 of the Act imposes a special limitation period for secondary market claims. An action must be commenced by the earlier of: (a) three years after the alleged misrepresentation was made or timely disclosure of a material change was required to be made, or (b) six months after a news release disclosing that leave has been granted to commence a secondary market action. This is a departure from the usual limitation period that applies to civil claims in Ontario, which runs for two years from the date a claim is discoverable.

The special limitation period under the Act is suspended from the time a motion for leave is filed with the Court until the motion is finally resolved or abandoned. This 'pause button' was introduced to the Act following a surprise decision of the Ontario Court of Appeal in 2012 that held that a suspension provision in section 28 the CPA does not apply to statutory secondary market claims before the leave motion is granted. (The Supreme Court of Canada split three ways on the same issue in a subsequent trilogy of cases).

Section 28 of the CPA provides a blanket suspension of the applicable limitation period for all class members from the time a class proceeding is commenced until certain prescribed events occur (including an abandonment or dismissal of the class proceeding). Section 138.14(2) of the Act, on the other hand, merely pauses the special limitation period "in respect of an action". If class certification or leave motion of a securities class action ultimately fails, it is not clear that anyone other than the class plaintiff who brought the claim will have the benefit of the pause afforded by section 138.14(2).

c. Jurisdiction

As discussed above, the statutory secondary market liability regime applies to a "responsible issuer". This term includes both Ontario reporting issuers and any other issuer with a real and substantial connection to Ontario whose securities are publicly traded. To determine if a 'real and substantial connection' exists, the Court will consider whether a sufficient connection exists between the province and the subject matter of the dispute. A real and substantial connection is presumed where, among other things, the defendant 'carries on business' in Ontario or is alleged to have committed a tort in the province. That presumption can be rebutted, including where the presumptive connection is weak. Where a real and substantial connection exists, the Court may still decline jurisdiction under the principle of forum non conveniens if it finds that another venue is "clearly more appropriate".

In Yip v. HSBC Holdings plc, the Ontario Court of Appeal attempted to clarify the proper application of the "real and substantial connection" test and the doctrine of forum non conveniens for the purposes of statutory secondary market claims.[14] To establish a real and substantial connection, it is not sufficient that a foreign issuer knew or ought to have known that its investor information was being made available to Canadian investors.[15] Also, the fact that information was accessed from Ontario is not sufficient to find that a foreign issuer is 'carrying on business' in the province for the purposes of the jurisdiction analysis. Regarding forum non conveniens, the Court of Appeal appeared to endorse the view that "in secondary market claims, courts should generally favour the forum where the trade took place."[16]

d. Universe of Potential Defendants

As noted above, section 138.3 of the Act sets out classes of persons who may attract statutory liability. Depending on the circumstances, the targets of a claim can include: the responsible issuer, its directors and

officers, and any 'influential person' and related parties who made, influenced or acquiesced in the release or statement, and any 'expert' whose report, statement or opinion contained the misrepresentation. Both experts and influential persons are defined and their scope circumscribed in the Act. For example, ratings agencies are expressly omitted from the definition of "expert".

In LBP Holdings Ltd. v. Allied Nevada Gold Corp.,[17] the plaintiff alleged that a company at the centre of a bought deal financing made prospectus misrepresentations. The plaintiff sought to add the bought deal underwriters as defendants following the company's bankruptcy. The Court held that an underwriter is not an "expert" for the purposes of the Act and the underwriters were therefore not susceptible to secondary market misrepresentation claims.[18]

e. Intersection of Class Actions and Insolvency Proceedings

Companies that become the target of secondary market misrepresentation claims can face economic hardship and insolvency. Canada's two principal insolvency statutes are the Bankruptcy and Insolvency Act ("**BIA**") and the Companies' Creditors Arrangement Act ("**CCAA**"). The CCAA permits the reorganization of insolvent companies with liabilities over $5,000,000 and the compromise of creditors' claims through a plan of compromise or arrangement.

As with insolvency proceedings in other jurisdictions, the hallmark of proceedings under the BIA and CCAA is a 'stay of proceedings', preventing creditors from pursuing claims or enforcing their debts while the company attempts a restructuring or orderly liquidation. When the debtor company is a defendant in a class action, the class plaintiff may ask the Court to 'lift' the stay of proceedings to permit the class action to proceed in the normal course rather than within the CCAA proceeding.

The question as to whether claims against solvent defendants should proceed within a CCAA proceeding for an insolvent defendant sometimes arises. Resolving all claims in the same process permits related claims, including claims for contribution and indemnity, to be heard together within the CCAA proceeding.

In Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp., investors in a Canadian-listed corporation with timber operations in China brought a class action against the company as well as its auditors. The company was also subject to a CCAA proceeding. The CCAA Court approved a settlement and release of the auditors that was binding on all class members.[19] Several institutional investors opposed the CCAA settlement. The CCAA Court held that it had jurisdiction to approve the settlement under both the CCAA and the CPA.[20] It had the power to resolve the claims against a third party in addition to the claims against the debtor, as the matters were intertwined.

Secondary Market Liability Today

Issuers with connections to Ontario should seek legal advice prior to the commencement of secondary market claims against them. Online forums and investor activity can sound a clarion call for informed management. Many aspects of the secondary securities market liability regime in Ontario and other provinces require careful navigation, both before and during litigation.

Regulators have provided guidance on their views on proper disclosure of COVID-related information and regulatory-required revisions to public disclosure, demonstrating a heightened need for issuers to be attentive to COVID-related disclosure issues.[21] Issuers should re-evaluate the adequacy of forward looking statements, risk factor disclosure and cautionary language, which can in some instances provide defences to secondary market liability claims.

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[1] 2016 ONSC 1629 [LBP Holdings].

[2] While over 100 secondary market claims have been launched in Canada, there have been no trial decisions. See NERA Economic Consulting, Trends in Canadian Securities Class Actions: 2019 Update (19 March 2020).

[3] Rooney v. ArcelorMittal SA, 2016 ONCA 630.

[4] Wright v. Horizon, 2020 ONCA 337 involved alleged losses to investors in ETFs designed to provide a hedge against volatility. The prospectus under which the ETFs were issued was subject to constant updating and ongoing reliance by investors as the composition of the ETF portfolio continuously changed. However, investors purchased the funds exclusively on the secondary market.

[5] OSA, s. 138.3(1).

[6] OSA, s. 138.3(2).

[7] OSA, s. 138.3(4).

[8] DALI, Local 675 Pension Fund (Trustees of) v. SNC-Lavalin Group Inc., 2016 ONSC 5784 at para. 143.

[9] DALI Local 675 Pension Fund (Trustees) v. Barrick Gold, 2019 ONSC 4160 [Barrick] at para. 17.

[10] Barrick at 24.

[11] Theratechnologies inc. v. 121851 Canada inc, 2015 SCC 18 at paras. 38-39; CIBC v. Green, 2015 SCC 60 at para. 121.

[12] Pioneer Corp. v. Godfrey, 2019 SCC 42 at para. 27; Hollick v. Toronto (City), 2001 SCC 68 at para. 25.

[13] Pioneer Corp. v. Godfrey, 2019 SCC 42 at para. 27; Hollick v. Toronto (City), 2001 SCC 68 at para. 25.

[14] Yip at paras 31-34.

[15] Yip at para 41.

[16] Yip at para 54.

[17] 2016 ONSC 1629 [LBP Holdings].

[18] LBP Holdings at paras 46-63.

[19] Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp., 2013 ONSC 1078 [Sino-Forest].

[20] Sino-Forest, at paras. 31 and 42.

[21] COVID-19: Continuous Disclosure Obligations and Considerations for Issuers', May 6, 2020.

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A Cautionary Note