# Preparing for Secondary Market Civil Liability

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Dialogue with the OSC 2005

# Secondary Market Civil Liability Background

- Part of Ontario Government's Investor Confidence Initiative
  - Bill 198 passed December 9, 2002
  - Bill 149 passed December 16, 2004
  - Part XXIII.1 of the Securities Act
  - Regime coming into force on December 31, 2005
  - Legislation based on Allen Committee's recommendations and CSA's Draft Legislation

- Deterrence model versus compensatory model

# Secondary Market Civil Liability
# On what basis can you be sued?

- Misrepresentation in a written document
  - "Document" that is "released"

- Misrepresentation in public oral statement
  - Statement must be made by a person with "actual, implied or apparent authority" and must relate to the business and affairs of the issuers

- Failure to make timely disclosure of a "material change"

# Secondary Market Civil Liability
# Who can sue?

- Any person or company who buys or sells securities of the responsible issuer during a disclosure violation period
  - Begins when:
    - Misleading disclosure made, or
    - Failure to make timely disclosure
  - Ends when:
    - Disclosure is corrected or made

- No need to prove reliance

# Secondary Market Civil Liability
# Who can be sued?

- Responsible issuer
  - Ontario reporting issuers
  - Any issuer with a real and substantial connection to Ontario with publicly traded securities
- Directors
- Officers
- Influential Persons
  - Control Persons, Promoters, Insiders, Investment Fund Managers
- Experts (includes auditors)
- Spokespersons

# Secondary Market Civil Liability
# Establishing Liability

- Two liability standards, which vary according to the type of disclosure at issue and who is the defendant:
  - Core Documents
    - Prospectuses, take-over/issuer bid circulars, rights offering circulars, MD&A, AIFs, directors' circular, financial statements and (for responsible issuer and officers only) material change reports
    - If misrepresentation proved, onus shifts to Defendant (strict liability)
    - All defendants have a due diligence defence

# Secondary Market Civil Liability
# Establishing Liability

- Two liability standards, which vary according to the type of disclosure at issue and who is the defendant:
  - Non-Core Documents/Public Oral Statements/Failure to make timely disclosure
    - Press releases, material change reports (for directors)
    - In addition to proving there was a misrepresentation or failure to make timely disclosure, plaintiff must also prove knowledge, deliberate avoidance or gross misconduct

# Secondary Market Civil Liability Defences

- Plaintiff Had Knowledge (s.138.4(5))
- Reasonable Investigation (Due Diligence) (s.138.3(6))
- No Authority Defence (public oral statements) (s.138.3(7))
- Confidential Disclosure (s.138.4(8))
- Safe harbour for forward-looking information (s.138.4(9))
- Expertized Statements (reliance on experts) (s.138.4(11))
- Defence for Experts (No consent or withdrawal of consent) (s.138.4(12))
- Release of Documents – No knowledge or reasonable grounds to believe that documents would be released (s.138.4(13))
- Derivative Information (s.138.4(14))
- Corrective Action (s.138.4(15))

# Secondary Market Civil Liability Defences

- Reasonable Investigation (Due Diligence)
  - Knowledge, experience and function of person
  - Office held, role and responsibility of person
  - Existence, if any, and nature of any disclosure compliance system
  - Reasonableness of reliance on disclosure compliance system
  - Professional standards applicable to expert
  - Period of time within which disclosure was required

# Secondary Market Civil Liability Safeguards Against Strike Suits

- Screening Mechanism – Plaintiff to obtain leave of the court
  - Action brought in good faith
  - Reasonable possibility of success
- Court Approval of Settlements
  - No proceedings can be discontinued, abandoned or settled without approval of the court
- "Loser" Pays Cost Rules

# Secondary Market Civil Liability Damages

- Difference between average price paid and average price during ten days after breach corrected
- No need to crystallize a loss
- No damages for price changes that defendant proves are not related to the misrepresentation or failure to make timely disclosure

# Secondary Market Civil Liability Damages

- Liability Limits
  - Issuer: > of 5% market capitalization or $1 million
  - Individuals: > of $25,000 or 50% of 12 months' compensation
    - "compensation" = cash compensation +FMV of all "deferred compensation" (e.g. options)
  - Experts: > of $1million or 12 months' compensation

# Secondary Market Civil Liability Damages

- Liability limits don’t apply to defendant, other than responsible issuer, if
  - Plaintiff proves person or company “authorized, permitted or acquiesced” in making the misrepresentation or failure to make timely disclosure while **knowing** it was misrepresentation or failure to make timely disclosure

# Secondary Market Civil Liability Damages – Allocation of Liability

- Proportionate Liability (contrast with primary market civil liability regime)
  - Safeguard against targeting “deep pocket” defendants
  - Exception:
    - Defendant “authorized, permitted or acquiesced” in making misrepresentation or failure to make timely disclosure while **knowing** it to be a misrepresentation or failure to make timely disclosure
    - If so, joint and several

# Secondary Market Civil Liability

# Panel Q&A