BANKING ON CORPORATE

THE POPULATION OF MISREPRESENTATION

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We live in a time where the U.S. president's lawyer says that "truth is not truth" and where in public discourse accuracy has dropped further in importance relative to the virtues of repetition, spin and decibels. At the same time, the thirst for comprehensive and immediate information is only intensifying. These dynamics are in the background as publicly traded issuers continue to deal with their disclosure obligations and why there continue to be cases exploring just what constitutes a "misrepresentation."

The word "misrepresentation" can be pronounced to sound like an award won by a female lawyer for best command of the representations parts of legal agreements. I flatter myself that on that theme I might have contended for "Mr. Condition," though that could be interpreted as a comment on my gym attendance record and there is sad evidence to the contrary these days.

"Part of what confuses the definition of misrepresentation is the different contexts in which it is considered . . . "

The Ontario Superior Court of Justice motion for leave decision this summer in *Paniccia v. MDC Partners Inc.* is one of the more recent decisions illustrating the complexity of the concept. MDC is a publicly traded company that in the spring of 2014 got a letter from the SEC asking that it add the qualifier "adjusted" to its EBITDA disclosures and then in the fall of that year got an SEC subpoena requiring production of documents relating to various matters, including executive compensation and certain accounting practices. The initial SEC request was publicly filed, but MDC did not immediately publicly disclose the subpoena. When in the following spring the company publicly reported on the SEC review, the internal special committee process implemented by the company and the CEO's reimbursement of prior reimbursement for expenses, the stock dropped.

Part of what confuses the definition of misrepresentation is the different contexts in which it is considered — certifications for class actions, leave motions under the secondary market civil liability provisions of securities laws and actual cases on the meaning of the word all have different standards. This is compounded by the other standards and indicia of materiality floating around in the space. For example, MDC's auditor issued "clean" audit opinions and positive reports on the company's internal financial controls throughout the period and did not withdraw them. These are interesting data points, but they obviously turn on different questions than the statutory definitions that underlie the concept of a "misrepresentation." MDC did not amend and restate its financials; the court in *Paniccia* noted that a restatement would constitute an acknowledgment in leave motion of a material misstatement. A classic conundrum: Not amending may leave incorrect statements out there, but restating them may be treated as an admission of a material misrepresentation.

The court lists some of the leading decisions, which illustrates how fact specific material change determinations can be: Drilling results for a mining company and the inability of an active capital markets company to issue commercial paper were held to be material changes, but intra-quarterly off-forecast results for a leather fashion retailer and regulatory correspondence for a pharmaceutical company about side effects were not.

In *Paniccia,* the court concluded that each of the misrepresentation claims failed for lack of materiality. Notable among the findings was a determination that the service of a subpoena was not considered to constitute a material change — the court's conclusion is framed in terms of what a reasonable investor would expect the issuer to disclose; in this case, that the company take reasonable steps and to then determine if there is some material information to disclose. The court also notes that a disclosable weakness in internal reporting cannot be inferred from the company's determination to improve its internal controls.

Disclosure decisions are clearly difficult, and when scrutinized, they are considered in hindsight. In *MDC*, where the CEO's compensation was concerned, the court noted that the compensation was disclosed, it was just a question of characterization and although the amounts were not small they were not significant relative to the scale of MDC's operations. But three months after the company's reporting on the SEC process and outcome, the CEO left the company.

The ultimate irony is that materiality is defined by reference to effect on market price, which means the market's reaction was the relevant information to be shared. It's tempting to advise clients that "materiality" is not defined by the degree of prurient human curiosity, but it may be. In this context, a complex accounting problem that is costly may be less likely to influence market price than the ripples of news of an extraordinarily opulent executive lavatory. With these challenges, if I'm going to be announced with some title involving typical agreements, maybe I should aim for "Mr. Survival Clause," though I'm concerned that sounds too much like a bad reality series with a group of holiday symbols stranded on an island. CL

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