

Corporate Securities

FEBRUARY 20, 2001

CIVIL REMEDY FOR MISREPRESENTATION IN THE SECONDARY MARKET

The Canadian Securities Administrators have proposed amendments to Canadian securities legislation that would give investors in the secondary market an enhanced statutory right to sue public companies and certain related persons for public misrepresentations or deficiencies in timely disclosure.

General Right of Action

The proposed civil remedy will give investors in the secondary market a limited right of action to seek compensation for damages resulting from incorrect statements in public disclosure of material facts or a failure to make required material disclosure. This right of action will exist regardless whether the investor actually relied on the information or lack of disclosure: in contrast to common law claims, a plaintiff will not be required to prove reliance to be successful.

Potential Defendants

The right of action will exist against:

- an issuer of securities,
- directors of the issuer,
- responsible senior officers of the issuer,
- “influential persons” (i.e., control persons, promoters, insiders or investment fund managers),
- auditors, and
- other responsible experts.

Potential Liability

As illustrated below, liability will differ for the various categories of defendants.

Defendant	Liability Limit will be the Greater of:	
Responsible Issuer	5% of market capitalization	\$1,000,000
Director or officer of issuer	\$25,000	50% of individual's compensation from the issuer and its affiliates
Influential person (that is not an individual)	5% of market capitalization	\$1,000,000
Influential person (who is an individual)	\$25,000	50% of individual's compensation from the issuer and its affiliates
Director or officer of influential person	\$25,000	50% of such individual's compensation from the Influential Person and its affiliates
Expert	\$1,000,000	12 month revenues earned from issuer and its affiliates
Any other person that makes a public oral statement	\$25,000	50% of such individual's compensation from the issuer and its affiliates

These liability limits will not apply to persons who “knowingly” make misrepresentations or fail to make timely disclosure.

The liability of each defendant will be assessed proportionately to that defendant's relative responsibility for making, and not correcting, public disclosure that contained an untrue statement of a material fact or the failure to make required disclosure. Defendants that “knowingly” make misrepresentations or fail to make timely disclosure will be jointly and severally liable for the whole amount of the damages assessed in the action.

Proof of Claims

Plaintiffs alleging misrepresentation will be required to prove that the defendant:

- knew of the misrepresentation;
- deliberately avoided acquiring knowledge of the misrepresentation; or
- was, through action or failure to act, guilty of gross misconduct in connection with the making of the misrepresentation

where the document in question is not a “core document” (prospectuses, take-over bid circulars, issuer bid circulars, directors’ circulars, rights offering circulars, MD&A, annual information forms, information circulars and annual financial statements).

A plaintiff would not be required to prove any of the matters set out above in respect of claims relating to core documents or to prove such matters in an action against an expert.

Plaintiffs alleging failure to make timely disclosure will be required to prove that the defendant:

- knew that a material change had occurred;
- deliberately avoided acquiring knowledge of the material change; or
- was, through action or failure to act, guilty of gross misconduct in connection with the failure to make timely disclosure.

A plaintiff would not be required to prove any of the matters set out above in an action against an issuer, an officer of an issuer, an investment fund manager or an officer of an investment fund manager.

Defenses

The proposed regime includes specific defences to such claims. Defences would be available if:

- the plaintiff acquired or disposed of the securities with knowledge of the misrepresentation or undisclosed material change,
- the defendant that made the misrepresentation (or failed to make the disclosure) did so following a reasonable investigation and had no reasonable grounds to believe that there was a misrepresentation or failure to make timely disclosure,
- with respect to an action for failure to make timely disclosure, the defendant did make timely disclosure using the confidential filing provisions of applicable securities legislation, or
- with respect to defendants other than an issuer, the defendant promptly notified the board of directors

of the issuer of the misrepresentation or the failure to make timely disclosure and a correction of the misrepresentation or subsequent disclosure of the material change was not made within two business days.

Leave of Court Required

Leave of the court, after notice to each defendant, would be required to commence an action. The court could grant leave only where it was satisfied that:

- the action is being brought in good faith, and
- there was a reasonable possibility that the action would be resolved at trial in favour of the plaintiff.

No action could be stayed, discontinued, settled or dismissed for delay without the approval of the court.

Please contact any of the lawyers below if you wish to discuss the implications of these proposed amendments.

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