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Death to Coffin

By Neill May

If you have ever been involved in teaching a law school course and setting an exam, you'll know that there are many roles to play. Those new to the process might assume that to avoid the research and balancing act of setting the test questions, the tedium of invigilating the exam, and the drudgery (interrupted by occasional unintended humour) involved in marking exams, the best role is to practise-take the exam. Take a moment to consider the limited upside of performing well, and the enduring consequence of not doing so, and then volunteer to do the marking. Trust me.

The recent decision of the Ontario Superior Court in *Coffin v. Atlantic Power Corp.* reads like a law school exam response in the number of issues that it raises, and it is also at its core about foresight. Atlantic Power (ATP) is a publicly traded, dividend-paying company that owns and operates power projects. In late February 2013, the company announced a significant reduction in its dividend rate, and the market prices of ATP's shares and debentures dropped. The essence of the plaintiffs' complaint was that ATP had, in the period leading up to that announcement, misrepresented its circumstances by assertion and by omission.

By way of background, in 2012, ATP was facing the pending expiry of power purchase agreements for two of its larger facilities. The company had disclosed that the expiry of those agreements would significantly reduce cash flows from those facilities. ATP was, therefore, focused on completing accretive acquisitions (as it had done previously when faced with expiring agreements) in order to sustain cash flows and the dividend level going forward. During its regularly scheduled quarterly call with analysts in November 2012, the company's CEO advised that the company was confident in its ability to sustain its dividend level.

After the call, analysts questioned the long-term sustainability of ATP's dividend rate, though ATP itself apparently did not. In fact, in an e-mail exchange between two non-executive ATP employees concerning the analyst predictions of a dividend cut, one commented "everyone see's [sic] it but our management."

ATP then completed an acquisition late in 2012. But early in January 2013, the company's financial adviser cautioned that ATP's growth targets would be challenging, and the company and board continued to consider alternative scenarios until a decision was made and disclosed in late February to cut the dividend.

The ruling got some attention because it arose in a series of decisions considering the standard for leave for an action for secondary market misrepresentation under applicable securities laws. As a non-litigator, my understanding on this issue is limited to the notion that the "reasonable possibility" of success of the action standard is more than a mere speed bump and requires the court to undertake a reasonable consideration of the evidence to determine whether there is merit. The decision, however, is notable, too, for the number of issues that it addresses that arise in the normal course for a public company.

Every publicly traded company includes risk factors in its disclosure documents. They're required, and it's in their interest, to do so. Executives' and their advisers' eyes may glaze over when reviewing risk factors (not mine, just saying that it's theoretically possible), but *Atlantic Power* underscores how important those disclosures are (the company's disclosures cautioned, for example, that dividends were not guaranteed, and that they were tied to cash flows).

Publicly traded companies also regularly deal with the question of when a disclosable "material change" has occurred. The *Atlantic Power* decision provides important guidance on this point. As noted, the court determined that ATP management maintained the subjective belief that dividends were sustainable in the long term (it was accepted that the company had enough cash to continue the dividends for up to three years even without acquisitions). It is significant that even where the "street" believed that a cut was coming, the relevant standard is the company's own sincere belief.

As to what type of developments might constitute a "material change" in the business, operations, or capital of the issuer, the court made conclusions of particular relevance to issuers in the yield space (i.e., paying regular distributions). Specifically, though it was a primary corporate objective to increase the value of the company and to focus on the dividend payout to shareholders, the "business of the company" was not paying dividends but was the ownership and operation of power plants.

Finally, the decision reflects the view that issuers' disclosure obligations do not arise when issuers and their boards first consider a possibility. How this plays out will depend on the circumstances, of course, but it would change board processes fundamentally if there were to be an automatic disclosure obligation on initial or preliminary consideration of a possible path or outcome.

Material change cases sometimes have an element of hindsight. As a general rule, I try to limit recourse to hindsight. On reflection, I might have proposed to my wife earlier than I did when it became clear she was the love of my life. Not that it didn't work out extremely well, or that I mind at all hearing the story of how long I unnecessarily delayed, but just to avoid her the task of telling it. And retelling it. **CL**

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