BY NEILL MAY

Growing up different

In some ways Canadian securities regulation sometimes reminds me of a classic after-school special, where a younger teen patterns his or her behaviour after that of an older kid. The younger child (Canadian securities laws in this analogy) mimics the speech patterns, behaviour, or preferences of the bigger teen (U.S. securities laws), only to find out the older teen has moved on and the copied choices are not cool anymore.

Part of this is inevitable, as the sheer size of the U.S. market generates a volume of experience that would be ridiculous to ignore in shaping Canadian securities regulation, and at a pace difficult to match. What is gratifying is the classic bang-you-in-the-skull moral of many of those after-school specials, with the younger teen benefiting from the experience of the older kid but recognizing and focusing on his or her own strengths and preferences, seems also to be reflected in the evolution of Canadian securities laws.

The Canadian market is a different place, in terms of its nature and size, which often requires a different approach. Canadians are often quick to point out the differences, such as the relative litigiousness of Americans, but whether this is simple observation, motivated in part by jealousies, or putting the other down to lift oneself up is the subject of an entirely different series of after-school TV.

I refer to dynamics between the countries because the U.S. Supreme Court is poised to reconsider a basic building block of the contemporary legal framework, its own 1988 decision in *Basic Inc. v. Levinson*. That case is considered the foundation of the "fraud-on-the-market" doctrine, which has been called "the most powerful engine of civil liability ever established in American law."

The power of the fraud-on-the-market doctrine is clear when one considers the normal requirements for a claim based on misrepresentation. To begin with, the plaintiffs have to prove both they relied on the representation (challenging to do in the context of any investment decision, which may be based on many factors not always documented) and the misrepresentation resulted in the damage suffered. As difficult as these hurdles might be for an individual plaintiff, or a small group of plaintiffs, they represent a potentially insurmountable obstacle for class actions. If each plaintiff is required to prove reliance, certification of a class action becomes unwieldy.

The fraud-on-the-market presumption effectively eliminates the need for plaintiffs to individually prove reliance on alleged misstatements in cases involving securities that trade on "efficient" markets. The doctrine is based on efficient market theory: If a security is publicly traded in a liquid market then the price will reflect the information publicly available, and investors rely on that price and need not prove reliance on the alleged misrepresentation. Bottom line: The doctrine significantly greases the wheel of securities litigation in the U.S. In November, the U.S. Supreme Court agreed to hear an appeal by Halliburton Co. that will test the fraud-on-the-market doctrine and possibly poke a big stick in the spokes of that wheel.

The Canadian landscape is very different. Our securities laws presume reliance, and causation, and measure the damages from misrepresentations based on market price movements. But our laws impose limits on securities class actions, with a requirement for leave from the court, and limitations generally on remedies against issuers and their principals. Due to those limitations, plaintiffs' counsel in Canada typically plead common law claims in addition to statutory claims. The status of the fraud-on-the-market doctrine is uncertain here, but the recent trend of court decisions appears to generally facilitate securities class actions (perhaps on the basis the threat of viable securities litigation may provide a useful discipline on public disclosures). At this point in the after-school special, it looks like we are moving to embrace a phenomenon in which the bigger kid might be losing interest.

Where does this leave us? The reality is Canada is a terrific environment to test the efficient-market theory that underpins the fraud-on-the-market doctrine. We have a full spectrum, from senior-listed issuers whose securities trade with a high degree of liquidity to much smaller public issuers whose securities trade far more infrequently. The logic of the fraud-on-the-market doctrine for those more senior issuers starts to erode where the market is not so efficient. And there is plenty of skepticism about just how efficient markets are. Space limitations prevent me from providing examples of the many arguments against and exceptions to it but think about it in these terms: many people trade in securities precisely because they think the market price is wrong.

In Canada, as mentioned, we already have a process (the leave requirement) for courts to consider claims to assess which actions warrant the courts' time and attention, perhaps whether or not the efficient market hypothesis (and its progeny, the fraud-on-the-market doctrine) apply in a given context. Securities laws would be a challenging subject for an after-school special, but this might be a neat, fulfilling, and educational ending, which may even generate tears with the right music. It might need a catchy (though misleading) title: I'm thinking *Me and My Hormones — How I Really Feel about Fraud on the Market*.

Neill May is a partner at Goodmans LLP in Toronto focusing on securities law, with an emphasis on M&A and corporate finance. E-mail him at nmay@goodmans.ca. *The opinions expressed in this article are those of the author alone.*