THE UPDATE

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Corporate Securities

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Ontario Government Proposes Significant Amendments to the *Securities Act* (Ontario)

On October 30, 2002, the Government of Ontario introduced Bill 198, which includes significant amendments to the *Securities Act* (Ontario). These amendments form part of the response of the Government and the Ontario Securities Commission (OSC) to the passage in the United States of the *Sarbanes-Oxley Act* and are designed to restore what the Government and OSC perceive as lagging investor confidence in our capital markets. These amendments will impact virtually all participants in Ontario's capital markets, including issuers, investors, directors, officers and auditors.

The amendments, if enacted, will:

- give investors the benefits of a limited statutory civil liability regime for continuous disclosure;
- strengthen the enforcement capabilities of the OSC;
- create new offences for fraud, market manipulation and making misleading or untrue statements;
- authorize the OSC to conduct reviews of disclosures that have been made, or that ought to have been made, by reporting issuers; and
- empower the OSC to make rules: requiring the appointment of, and prescribing the requirement for, audit committees; mandating systems of internal controls; mandating disclosure controls and procedures; requiring chief executive officers and chief financial officers to provide certifications related to internal controls and to disclosure controls and procedures; and defining auditing standards for reporting on internal controls.

Set out below is a brief summary of the highlights of the proposed amendments to the *Securities Act*.

I. Civil Liability

General Right of Action

The proposed civil remedy regime will provide investors in the secondary market with a limited right of action to seek compensation for damages resulting from a misrepresentation in public disclosure or a failure to make disclosure of a material change. This right of action will exist regardless whether the investor actually relied upon the misrepresentation or the failure to make disclosure.

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 and insiders) and each director or officer thereof who knowingly influenced the misrepresentation;
- auditors; and
- other responsible experts.

Potential Liability

As illustrated on the next page, 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 a misrepresentation or the failure to make required disclosure. Defendants who "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" (in most cases, 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 or an officer of an issuer.

Defences

The proposed regime includes specific defences to such claims. The main defence that is available is that 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.

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.

II. Strengthening of Enforcement Capabilities

New Enforcement Powers

Under the proposed amendments, if a person or company fails to comply with Ontario securities laws, the OSC will be given the power to order the payment of an "administrative penalty" of up to $1 million. The OSC will also be granted the power to order the disgorgement of amounts obtained as a result of non-compliance with Ontario securities laws.

In addition, the maximum penalties that may be imposed by a Court for offences under the *Securities Act* will be increased from a fine of $1 million and imprisonment for two years to a fine of $5 million and imprisonment for five years less a day.

Creation of New Offences

The proposed amendments will create new offences of securities fraud, market manipulation and making misleading or untrue statements. In particular, the amendments prohibit:

- engaging in acts that a person or company knows or reasonably ought to know perpetrate a fraud or result in a misleading appearance of trading activity in, or an artificial price for, a security, and
- making statements that a person or company knows or reasonably ought to know are misleading or untrue and significantly affect, or would reasonably be expected to have a significant effect on, the market price or value of a security.

Directors and Officers

The proposed amendments also provide that, if a company has not complied with Ontario securities law, a director or officer of the company who authorized, permitted *or acquiesced* in the non-compliance will be deemed to also have not complied with Ontario securities laws.

III. Review of Continuous Disclosure

The proposed amendments empower the OSC to conduct a review of disclosures that have been made or ought to have been made by a reporting issuer. The basis for such review is to be determined at the discretion of the OSC or its director. A reporting issuer that is subject to such review must, at such time or times as required by the OSC or its director, deliver to the OSC or its director any information or documents relevant to the disclosures that have been made or ought to have been made by the issuer.

These amendments appear to have been proposed to bolster the OSC's ability to conduct continuous disclosure reviews of issuers. To date, these reviews have involved the OSC sending letters to various issuers requesting access to a wide range of corporate documents and requesting issuers to respond on a "voluntary" basis.

In a related development, on October 25, 2002, staff of the OSC published a notice indicating that if an issuer agrees to amend and refile a document previously filed with the OSC or implements an accounting change on a retroactive basis, the issuer:

- is acknowledging that its original filing was not prepared in accordance with Ontario securities laws;
- will be required to issue a press release and file a material change report in respect of the matter (even where the correction may not represent a material change); and
- may be added to a public Refiling and Errors list for a period of three years.

IV. New Rule-Making Power

The proposed amendments empower the OSC to enact rules in respect of the following:

- requiring reporting issuers to appoint audit committees and prescribing requirements relating to the functioning and responsibilities of audit committees;
- requiring reporting issuers to devise and maintain a system of internal controls related to the effectiveness and efficiency of their operations sufficient to provide reasonable assurances that transactions are recorded properly in order to provide for an accurate accounting and reporting of such transactions;
- requiring reporting issuers to devise and maintain disclosure controls and procedures sufficient to provide reasonable assurances that accurate and timely disclosure of information under securities legislation is completed within prescribed time frames and such information is communicated to

the reporting issuer's management, including the chief executive and financial officers, to allow timely decisions regarding disclosure;

- requiring chief executive and financial officers of reporting issuers, or persons performing similar functions, to provide certification as to the reporting issuer's internal controls which certifies the establishment, design and effectiveness of the internal controls; and
- requiring chief executive and financial officers of reporting issuers, or persons performing similar functions, to provide certification as to the reporting issuer's disclosure controls and procedures which certifies the establishment, design and effectiveness of the disclosure controls and procedures.

Please contact any member of the Goodmans securities team to discuss the legislation.

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