SECURITIES CLASS ACTIONS IN CANADA

Misrepresentation in the Secondary Market: A Common Law and Statutory Comparative

INTRODUCTION

In December 2005, Ontario enacted a statutory right of action for misrepresentations disseminated in the secondary security markets. This right of action, which is contained in the new Part XXIII.1 of the Ontario *Securities Act*,[1] effectively eliminates the requirement of proving reliance in misrepresentation cases.

Canadian common law jurisprudence regarding negligent misrepresentation has traditionally required proof of reliance as a prerequisite for establishing causation. Attempts to import the American "fraud on the market" theory into Canadian securities law as an alternative to the requirement of proving reliance in a misrepresentation claim, have been largely unsuccessful in the common law provinces, as Canadian courts have tended to misunderstand the theory. Accordingly, the requirements in the United States for sustaining a claim of securities fraud differ significantly from those in Canada. The changes to Part XXIII.1 of the *Act* however, are expected to be *more* favourable to plaintiffs alleging misrepresentation in securities class actions, since the American fraud on the market theory creates a presumption of reliance, but does not eliminate the need of proving reliance as the changes to the *Act* appear to do. The changes to the *Act* therefore provide plaintiffs with a significantly more advantageous legislative regime for damages recovery in securities misrepresentation cases than was previously available.

Nonetheless, recent developments in the law of negligence as it is applied in the class action context, establish a movement, however reluctant, toward a more plaintiff friendly evolution of negligence law and therein a less stringent requirement for proving detrimental reliance in misrepresentation class actions.

I. MISREPRESENTATION AND RELIANCE: THE COMMON LAW PERSPECTIVE

1. The Common Law Elements of Negligent Misrepresentation

It is well established in Canadian law that reliance is a necessary element of the tort of negligent misrepresentation, and one of the reasons that the changes to the *Securities Act* are a welcome relief to plaintiffs who have suffered economic losses as a result of misrepresentations on the secondary market. Despite the long history of the reliance requirement however, Canadian jurisprudence suggests a shift toward a more plaintiff friendly application of the traditional legal principles surrounding negligent misrepresentation. The following cases exemplify this shift.

The decision of the Supreme Court of Canada in *The Queen* v. *Cognos*[2] is often cited as authority for the proposition that reliance is a necessary element of the tort of negligent misrepresentation. In *Cognos*, Iacobucci J., for the Court, stated that:

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1 *Securities Act*, R.S.O. 1990 c. S-5 [hereinafter the "*Act*"].

2 *The Queen* v. *Cognos* (1993), 99 D.L.R. (4th) 626, 1993 CarswellOnt 972 (S.C.C.) [hereinafter "*Cognos*" cited to CarswellOnt.].

> The required elements for a successful *Hedley Byrne*[3] claim have been stated in many authorities, sometimes in varying forms. The decisions of this court cited above suggest five general requirements:
>
> (1) there must be a duty of care based on a "special relationship" between the representor and the representee;
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> (2) the representation in question must be untrue, inaccurate, or misleading;
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> (3) the representor must have acted negligently in making said misrepresentation;
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> (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and
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> (5) the reliance must have been detrimental to the representee in the sense that damages resulted.
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> In the case at bar, the trial judge found that all elements were present and allowed the appellant's claim.

Strictly speaking, however, reliance was not in issue before the Supreme Court of Canada, as the trial judge had found that the plaintiff had detrimentally relied upon the defendant's misrepresentations. Subsequent case law however, has affirmed the reliance requirement as an element of the tort of negligent misrepresentation, and it has been held that a plaintiff cannot succeed in holding a defendant liable for his or her losses where reliance is absent.[4]

The reliance issue in turn, assists with informing the duty of care such as to establish liability. Since the House of Lords decision in *Hedley Byrne*, it has been recognized that liability for negligent statements can be established where it is reasonable to assume that a statement will be trusted by the plaintiff. Accordingly, in Canada, it has been held that sufficient proximity between a plaintiff and defendant such that a prima facie duty of care is found to exist, may be established when the defendant ought reasonably to foresee that the plaintiff will rely on a particular representation, and, reliance by the plaintiff, would, in the circumstances, be reasonable.[5] Accordingly, the existence of a duty of care in negligent misrepresentation cases does not depend upon whether the plaintiff actually relied, but whether reliance *ought to have been foreseen* and *would have been reasonable*. Under this analysis, the duty of care owed a plaintiff by a defendant, exists independently of whether there is *actual* reliance.

Overcoming the necessity of proving reliance has been the primary challenge in both Canadian and American securities class actions in which misrepresentations are made on the secondary market. Not surprisingly, the need to establish reliance on a class wide basis makes recovery difficult without engaging the inevitable defence argument that individual issues predominate over common issues, thus negating the appropriateness of a class action as the preferable procedure for recovery. Out of this challenge, evolved the American, "fraud-on-the-market theory."

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3 *Hedley Berne* v. *Heller* [1946] A.C. 465 (HL). [hereinafter *"Hedley Byrne"*.]

4 *Hercules Managements Ltd. v. Ernst & Young* [1997] 2 S.C.R. 165, 1997 CarswellMan 198 (S.C.C.) [hereinafter "*Hercules Management*" cited to CarswellOnt.].

5 *Ibid*, at paras. 18, 22-26.

2. United States Securities Class Actions: The Fraud on the Market Theory

In the United States, securities class actions for misrepresentations disseminated in the secondary markets are based upon Rule 10b-5, which was promulgated under the United States *Securities and Exchange Act of 1934*. That rule states:

> **Rule 10b-5 -- Employment of Manipulative and Deceptive Devices**
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> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> a. To employ any device, scheme, or artifice to defraud,
>
> b. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> c. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Initially, class actions based upon Rule 10b-5 met with mixed success, because some federal courts ruled that reliance was an essential element of the Rule 10b-5 cause of action, and that the individual issue of reliance predominated over the proposed common issues.[6] The predominance of individual issues in such a case accordingly presented a significant obstacle to certifying a class action. United States courts then began to apply a rebuttable presumption of reliance, which became known as the "fraud-on-the market" theory.

The fraud-on-the-market theory is based upon the notion that, in a modern, efficient capital market, the price of a publicly-traded security promptly incorporates all publicly available and material information. Therefore, even if an investor is unaware of a misrepresentation, the investor nevertheless sustains damage as a consequence of the misrepresentation because he pays more for the security than he would have paid had the issuer of the security made full and frank disclosure to the broader market. The requirement of causation is therefore satisfied, notwithstanding that the plaintiff did not rely directly upon the misrepresentation.

In 1988, in *Basic v. Levinson*[7], the United States Supreme Court approved the fraud-on-the-market theory:

> The fraud-on-the-market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material

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6 See *Levinson v. Basic Inc.* 786 F.2d 741 (6th Cir.: 1986) pp: 749-50. "Here the district court believe that if each of the members of this class, sellers of Basic shares between October 20, 1977 and December 15, 1978, were required to show reliance on the misrepresentations, questions affecting individual members probably would predominate over common questions such that the class certification would be improper. To circumvent what the district court perceived to be a barrier to class actions in 10b-5 cases, it applied a presumption of reliance so that common questions predominated and the class was appropriately certified. We agree."

7 *Basic v. Levinson* (1988) 485 U.S. 224. (U.S.S.C.)

> information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . . *The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.*"...
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> ...
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> *We agree that reliance is an element of a Rule 10b-5 cause of action. Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury. There is, however, more than one way to demonstrate the causal connection...*
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> The modern securities markets, literally involving millions of shares changing hands daily, differ from the face-to-face transactions contemplated by early fraud cases,...and our understanding of Rule 10b-5's reliance requirement must encompass these differences.
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> ...
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> The presumption [of reliance] is also supported by common sense and probability. Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations. It has been noted that "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" Indeed, nearly every court that has considered the proposition has concluded that where materially misleading statements have been disseminated into an impersonal, well-developed market for securities, the reliance of individual plaintiffs on the integrity of the market price may be presumed...
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> The Court of Appeals held that in order to invoke the presumption, a plaintiff must allege and prove: (1) that the defendant made public misrepresentations; (2) that the misrepresentations were material; (3) that the shares were traded on an efficient market; (4) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and (5) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.[8] [Emphasis added; citations omitted.]

As is apparent from the foregoing, the American fraud-on-the-market theory is *not* a creature of statute, but is a judicial creation. In espousing the theory, the Court was influenced by Congressional concern for the integrity of the capital markets, but Congress nowhere stipulated that courts were to apply a presumption of reliance in securities fraud class actions.

3. Importing the Fraud-on-the-Market Theory into Canadian Law

Shortly after the decision of the U.S. Supreme Court in *Basic v. Levinson*, the first direct attempt to invoke the fraud-on-the-market theory in Canada appears to have been made in British Columbia, on a motion to strike certain aspects of the pleadings, in a case called *Kripps v.*

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8 *Ibid* at pp: 241-243.

Touche Ross & Co.[9] In *Kripps* , the B.C. Court of Appeal affirmed the trial court's rejection of the fraud-on-the-market theory concluding that the "integrity of the market" and related theories, if capable of being imported into our law, could not assist the plaintiffs in that case.[10]

It would appear, however that the Court in *Kripps* misunderstood the fraud-on-the-market theory, supposing that the theory is founded upon investors' reliance upon the United States regulatory system. The character of American securities regulation, however, is fundamentally the same as that of Canadian securities regulation. Neither system of regulatory oversight is designed to assure that only securities of a particular quality will enter the market. Both systems are designed, rather, to ensure the accuracy and completeness of investment information. In both jurisdictions, if an investor has received full and accurate disclosure but nevertheless commits his capital to a poor investment, the legal regime provides him with no remedy.

Some years later, the *Kripps*[11] case came before the B.C. Court of Appeal again, this time on appeal from the judgment dismissing the plaintiffs action. This gave the Court the opportunity to further address the reliance issue as it relates to negligent misrepresentation claims. The B.C. Court of Appeal allowed an appeal from the judgment dismissing the action for failure to establish the necessary elements of negligent misrepresentation, particularly, reliance. The Court of Appeal held:

> It is sufficient...for the plaintiff in an action for negligent misrepresentation to prove that the misrepresentation was at least one factor which induced the plaintiff to act to his or her detriment. *I am also of the view that where the misrepresentation in question is one which was calculated or which would naturally tend to induce the plaintiff to act upon it, the plaintiff's reliance may be inferred.* The inference of reliance is one which may be reubutted but the onus of doing so rests on the representor.[12] [Emphasis addes].

Even an inference of reliance however, as contemplated in *Kripps* has been circumvented in subsequent case law where a causal link between the misrepresentation and the damages sustained by the class can be established. In *Collette v. Great Pacific Management Co.,*[13] the plaintiff brought a proposed class proceeding on behalf of investors in mortgage units. The action was brought against a financial adviser and investment broker who had marketed the units to the class members. In certifying the investors' claim of misrepresentation, the Court stated:

> The reason for insistence on reliance is to establish causation. If causation can be established otherwise, then reliance is not required: see Henderson, supra, per Lord Goff at 776, and Yorkshire Trust Co. v. Empire Acceptance Corp. Ltd. (1986), 24 D.L.R. (4th) 140 at 145-47, 69 B.C.L.R. 357 at 354-55, 22 E.T.R. 96 (S.C.) per McLachlin J. Here if the mortgage units had not passed the due diligence test they would not have been offered for sale by the respondents to any clients. *Causation is therefore established between a breach of due diligence duty and the investors' loss, independently of proof of individual reliance.* In my view, proof of reliance does not present an obstacle to the appellant's case

9 *Kripps* v. *Touche Ross & Co.* [1992] 69 B.C.L.R (2d) 62, 1992 CarswellBC 191 (C.A.) [hereinafter "*Kripps* " cited to CarswellBC] .

10 *Ibid.*, at p. 306.

11 *Kripps* v. *Touche Ross & Co.* (1997), 33 B.C.L.R. (3d) 254, 1997 CarswellBC 925 (C.A.) [hereinafter "*Kripps*" cited to CarsewellBC].

12 *Ibid.* at para. 103

13 *Collette v. Great Pacific Management Co.* [2004] 195 B.C.A.C. 79, 2004 CarswellBC 410 (B.C.C.A.) . [hereinafter "*Collette*" cited to CarsewellBC].

> as framed. The appellant's case adequately links a breach of duty causally to the investors' losses.[14] [Emphasis added].

Negligent and fraudulent misrepresentation claims were also certified in *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*[15] *Sharbern* arose out of alleged misrepresentations contained in an offering memorandum. In granting certification, Wedge J. was of the view that the common issues were fundamental to the resolution of the claims advanced, and were not overwhelmed by individual issues such as reliance.[16] *Sharbern* therefore introduced yet another possible argument for advancing a securities class action in the face of the reliance hurdle. *Sharbern* appears not to have turned upon the plaintiffs' ability to demonstrate causation by some means other than reliance (as was the case in *Collette*) but rather upon the fact that resolution of the common issues would move the litigation sufficiently forward notwithstanding the possible need to prove reliance on an individualized basis.

Ontario courts have been equally as reluctant as those in British Columbia to accept the American "fraud-on-the-market" theory. In *Carom v. Bre-X Minerals Ltd.*[17], Winkler J. decisively rejected that approach:

> The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance in either tort.[18]

Subsequently, in *Mondor v. Fisherman*,[19] the plaintiffs brought a class proceeding based in part upon claims of negligent and fraudulent misrepresentation. The representations related to the legitimacy of the business of a particular corporation whose shares were listed publicly. This allegedly affected the market price of the shares. Cumming J. denied a motion to strike on the basis that the plea effectively constituted a fraud-on-the-market claim, holding that the trier of fact might infer reliance on the basis of the facts alleged.

While this seemed to open the door to the application of at least an attenuated form of the fraud-on-the-market theory, shortly after the release of Cumming J.'s decision in *Mondor*, Nordheimer J. rejected an apparent attempt to apply the fraud-on-the-market theory in the products liability context in *Boulanger v. Johnson & Johnson Corp.*.[20] Quoting Winkler J.'s decision in *Bre-X*, Nordheimer J. held that "[t]here is no authority that has been presented to me that would justify the conclusion that the notion of indirect reliance should be imported into our law as the basis for

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14 *Ibid.*, at paras. 33-34.

15 *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.* [2005] B.C.W.L.D. 2966, 2005 CarswellBC 395 (B.C.S.C.) [herinaftter *"Sharbern"* cited to CarswellBC]]

16 *Ibid.*, paras. 153-171.

17 *Carom v. Bre-X Minerals Ltd.* (1998), 41 O.R. (3d) 780, 1998 CaswellOnt 4285 (S.C.J.).

18 *Ibid.*, at para. 40.

19 *Mondor v. Fisherman* [2001] 15 C.P.R. (4th) 289, 2001 CarswellOnt 4206 (S.C.J), [hereinafter *"Mondor"* cited to CarswellOnt]

20 *Boulanger v. Johnson & Johnson Corp.* [2002] 14 C.C.L.T. (3d) 233, 2002 CarswellOnt 1395 (S.C.J). [hereinafter *"Boulanger"* cited to CarswellOnt]

a claim for misrepresentation".[21] The plaintiff in Boulanger appealed the dismissal of his motion for certification.

While that appeal was pending, the Ontario Court of Appeal released its decision in *Haskett v. Equifax Canada Inc.*,[22] a claim that appears to have been framed exclusively in negligence. The motions judge denied certification on the basis that the plaintiff's claim was one for pure economic loss, that the only possible recognized category of economic loss that could be pertinent to the pleaded facts was negligent misrepresentation, and that that cause of action could not be advanced because the alleged misrepresentations had been made not to the class members but to third parties (in this case credit grantors). The Court of Appeal reversed and certified the claim of negligence, stating:

> On the issue of reliance, Dean Feldthusen, in his book Economic Negligence: The Recovery of Pure Economic Loss, 4th ed. (Scarborough: Carswell, 2000) at p. 131, makes the point that *reliance on the representation by the plaintiff is not a necessary factor per se, but is required in the analysis to demonstrate the causal sequence leading to liability, and the effective assumption of responsibility by the representor*.
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> ...
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> In this case we have the elements of negligent misrepresentation without reliance by the affected consumer, but where the representor has effectively assumed responsibility for the accuracy of the information because of the potential harm which could be caused to the consumer if the contents are inaccurate. This makes the case one that arguably does not fit exactly within negligent misrepresentation, but one that is analogous to it.
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> ...
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> [I]n this case, the relationship between the credit reporting agency and the consumer who is the subject of the report is one of proximity both in the relational and causal sense, if the facts alleged in the Statement of Claim are proved to be true.
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> ...
>
> In my view, whether as an analogous category to negligent misrepresentation or as a new category, on the proximity analysis there is the basis to find a duty of care owed in this case.[23] [Emphasis added.]

It is possible to read *Haskett v. Equifax Canada* as re-opening the door to a claim of negligent misrepresentation in the absence of detrimental reliance by the plaintiff as long as the plaintiff can demonstrate a causal link between the misrepresentation and the damage he has sustained. The difficulty with that interpretation is that the Court characterizes the plaintiff's claim not as one of negligent misrepresentation, but as one "analogous to" negligent misrepresentation or, alternatively, as a new category of negligence. This difficulty, however, was clarified in the

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21 *Boulanger v. Johnson & Johnson Corp.*, *supra*, at para. 13.

22 *Haskett v. Equifax Canada Inc.* (2003) 63 O.R. (3d) 577, 2003 CarswellOnt 692 (C.A.) [hereinafter "*Haskett*" cited to CarswellOnt].

23 *Ibid.*, at paras. 31-41.

appeal from Nordheimer J.'s decision in *Boulanger*, where the Court of Appeal left little doubt that its decision in *Haskett* was not intended to alter the requirements of negligent misrepresentation *per se*. In affirming Nordheimer J.'s refusal to certify the negligent misrepresentation claim, the Court of Appeal stated:

> It is clear that in Canada, actual reliance is a necessary element of an action in negligent misrepresentation and its absence will mean that the action cannot succeed. See *Hercules Management Ltd.* v. *Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18. Here there is absolutely no assertion of reliance by the appellant (or by anyone on her behalf) on the representations of the respondents to Health Canada. Indeed there is no pleading of reliance on the fact of regulatory approval. This complete absence of reliance is fatal to a negligent misrepresentation claim.[24]

Nevertheless, the Court reversed Nordheimer J.'s refusal to certify the negligence claim, stating that:

> These filings are pleaded as an aspect of the respondents' conduct which caused the appellant harm and which fell below the standard required of a reasonable drug manufacturer. They are one of the ways in which the appellant says the respondents were negligent. Framed this way, I cannot say that it is plain and obvious that such a claim will fail. *Indeed, the claim could appropriately be viewed as one of negligent misstatement.* See Haskett v. Equifax Canada Inc., [2003] O.J. No. 771 (C.A.), leave to appeal to the S.C.C. denied.[25] [Emphasis added.]

The Court of Appeal's decision in *Boulanger* was followed by the decision of Carnwarth J. in *Trizec Properties Inc. v. Citigroup Global Markets Inc.*[26]

The most recent Ontario class action decision to address the reliance issue squarely is *Serhan v. Johnson and Johnson,*[27] a class proceeding arising from allegedly defective products to be used by diabetics to monitor their blood glucose levels. The plaintiff alleged that the products were defective in that they frequently failed to indicate correct glucose levels, and brought claims in negligence and negligent and fraudulent misrepresentation. Cullity J. certified the case under "waiver of tort" principles but declined to certify the negligent and fraudulent misrepresentation claims, stating:

> In Mondor, Cumming J. did not suggest that an inference of reliance drawn from the conduct of class members in purchasing shares after the representations were made could not be rebutted by evidence that there was, in fact, no causal connection between the representation and the decision to purchase. The possibility of such a rebuttal was recognized explicitly in a passage he quoted from the reasons delivered by Finch J.A. in the Court of Appeal for British Columbia in Kripps v. Touche Ross & Co. (1997), 33 B.C.L.R. (3d) 254, [1997] B.C.J. No. 968, at para. 103. *Given the test applicable to motions to strike under rule 21.01(1)(b), this possibility was not material to the*

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24 *Boulanger v. Johnson & Johnson Corp.*, [2003] 174 O.A.C. 44, 2003 CarswellOnt 2129, (C.A.) at para. 11.

25 *Ibid* at para. 14

26 *Tizec Properties Inc. v. Citigroup Global Markets Inc.*, [2004] 72 O.R. (3d) 265, 2004 CarswellOnt 2817(S.C.J.)

27 *Serhan v. Johnson and Johnson* [2004] 72 O.R. (3d) 296, 2004 CarswellOnt 2809 (Ont. Div. Ct.) Leave to appeal this decision to the Divisional Court has been granted on other grounds. *Serhan Estate v. Johnson & Johnson*, [2004].WL 2426515, 2004 CarswellOnt 4511 (Ont. Div. Ct.)

> *resolution of the issue in Mondor. Here, however, the question is significantly different. It relates to the commonality of the issue of reliance and not to whether the plaintiffs have any chance of success on that issue.* In determining whether any inference of reliance arising simply from the conduct of class members in purchasing, or using, the devices was rebutted, the defendants would be entitled to inquire into the motivation of, and examine, every member of the class. As Winkler J. stated in Carom v. Bre-X Minerals Ltd. [(1999), 44 O.R. (3d) 173, 46 B.C.L.R. (2d) 247 (Gen. Div.)], at p. 241 O.R.:
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>> Reliance is not established by a mere showing that a plaintiff was a recipient of a representation. Rather the representation must have caused the recipient to act in a certain manner.
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> Whether reliance should be inferred is a question of fact and the answer may differ from individual to individual. *Mondor* was distinguished on this ground by Nordheimer J. in *Pearson* v. *Inco Ltd.*[28] The defendants may, or may not, have difficulty in rebutting any inference, or presumption, of reliance that is found to arise but the possibility should not be foreclosed on this motion.
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> As the most that a court could find on the basis of the conduct of class members is that a rebuttable inference of reliance arose, I do not believe this can be included as a common issue whose resolution would significantly advance the proceeding. Nor can the resolution of the issue be considered to be necessary for the determination of each class member's claims as the authorities require: Western Canadian Shopping Centres Inc. v. Dutton, [2001] 2 S.C.R. 534, 201 D.L.R. (4th) 385, at p. 554 S.C.R.; Hollick v. Metropolitan Toronto (Municipality), [2001] 3 S.C.R. 158, 205 D.L.R. (4th) 19, at p. 171 S.C.R. The plaintiffs have pleaded reliance simpliciter, as well as reliance inferred from their conduct. The issue of reliance would remain open whether or not the court found for, or against, the plaintiffs on the question whether a rebuttable inference of reliance should be drawn. [Emphasis added.]

Accordingly, Ontario law currently rejects the fraud-on-the-market theory and ultimately appears to require that the plaintiff's detrimental reliance be demonstrated in a claim of fraudulent and negligent misrepresentation. This need to prove reliance will pose a significant obstacle to the certification of claims in fraudulent and negligent misrepresentation. Recent Ontario jurisprudence nevertheless recognizes that there may be a tort analogous to negligent misrepresentation, or an entirely new category of negligence, neither of which requires proof of detrimental reliance by the plaintiff.[29]

1. Civil Law

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28 *Pearson v. Inco Ltd.* [2002] 33 C.P.C. (5th) 264, 2002 CarswellOnt 2446 (S.C.J.). See, in particular paras. 112-13. [hereinafter "*Pearson*" cited to CarswellOnt].

29 There appears to be only one case outside of British Columbia and Ontario which directly assesses the fraud-on-the-market theory, *First Choice Capital Fund Ltd. v. First Canadian Capital Corp.*, (1999) 33 C.P.C. (4th) 191, [1999] S.J. No.163 (Q.B.) [hereinafter "*First Canadian*"] a decision of the Saskatchewan Queen's Bench. The action was brought by preferred shareholders in investment funds. The plaintiffs sought leave to amend their pleading in order, inter alia, to advance the fraud-on-the-market theory. The Court denied leave to amend on the basis that an assertion of fraud must be pled with particularity and the plaintiffs' amended pleading was not sufficiently particular. Although the Court expressly declined to rule on the validity of the fraud-on-the-market theory, it expressed some sympathy for the defendants' assertion that the theory was not recognized in Canada and would entail a redefinition of the torts of fraudulent and negligent misrepresentation *First Canadian*, at paras. 22 and 28.

The Supreme Court of Canada has held that the *Civil Code* does not preclude liability in negligence for pure economic loss, nor does it impose a requirement of detrimental reliance in cases of pure economic loss. As stated by the McLachlin J. (as she then was) in *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*:

> The civil law jurisdictions of France and Québec make no distinction between physical and economic damage. Nor do they base liability on concepts of reliance. Loss of any type is recoverable wherever fault, damage and a direct and immediate causal connection between the two are established. Thus pure economic loss is recoverable.[30]

In *Léveillé c. Avantage Link Inc.*, a class action based in part upon alleged misrepresentations disseminated in the secondary market, the defendants sought to have the case de-certified on the basis that the representative plaintiff had not purchased the subject shares in reliance upon the defendants' misrepresentations, but because his son had urged him to do so. Despite the apparent absence of reliance, the Court denied the defendants' motion to have the case de-certified.[31]

2. Certification of a Class Action

(a) Reliance is not a Necessary Element of a Claim under ss. 36 and 52 of the *Competition Act*

Claims for negligent misrepresentation may benefit from concurrent alternative claims under the *Competition Act*[32] where plaintiffs are concerned about issues surrounding detrimental reliance. Subsections (1) and (1.1) of s. 52 of the *Competition Act*, which are contained in Part VI of the Act, state:

> **52.** (1) No person shall, for the purpose of promoting, directly or indirectly, the supply or use of a product or for the purpose of promoting, directly or indirectly, any business interest, by any means whatever, knowingly or recklessly make a representation to the public that is false or misleading in a material respect.
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> Proof of deception not required
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> (1.1) For greater certainty, in establishing that subsection (1) was contravened, it is not necessary to prove that any person was deceived or misled.

Section 36(1) of the Act states:

> **36.** (1) Any person who has suffered loss or damage *as a result of*
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> > (a) conduct that is contrary to any provision of Part VI, or
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> > (b) the failure of any person to comply with an order of the Tribunal or another court under this Act,

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30 *Canadian National Railway Co. v. Norsk Pacific Steamship Co.* (1992) 91 D.L.R. (4th) 289 1992 CarswellNat 168 (S.C.C.), at para. 236.

31 *Léveillé c. Avantage Link Inc.*, [2004] J.Q. no 8383 (C.S.),.

32 *Competition Act*, R.S.C. 1985 c.C-34.

> may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section. [Emphasis added.]

Section 36(1) contains no reference to reliance, and states simply that the loss or damage must have been "a result of" conduct contrary to Part VI. The notion that s. 36 of the Act does not require proof of reliance arguably finds support in s. 52 which, as stated above, imposes criminal liability without proof of deception. Presumably, if Parliament was prepared to impose criminal liability in the absence of such proof, it was prepared to impose civil liability in such circumstances.

In *Carom v. Bre-X Minerals Ltd.*,[33] the plaintiff argued that the *Act* "provides a statutory framework similar to the rule 10b-5 context within which the fraud on the market theory was developed".[34] Winkler J. rejected this argument, stating:

> In my view, the analogy between the *Act* and the rule 10b-5 cause of action is flawed. The *Competition Act* is not specific securities legislation, nor is it restricted to claims based in fraud. Rather it requires a false or misleading representation to the public that is made negligently but need not be made fraudulently: see *R.* v. *Wholesale Travel Group Inc.*, [1991] 3 S.C.R. 154, 84 D.L.R. (4th) 161.
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> By way of further comparison, as discussed in detail above, the predominance of common issues requirement, which was significant in furthering the acceptance of the fraud in the market theory in the United States is not present here as an obstacle to a class proceeding. I note also that the position of the plaintiffs in argument on the prior pleadings motions, and in their pleadings, has been that reliance is not an element of an action under s. 36. The argument relying on the *Competition Act* fails.[35]

Nevertheless, Winkler J. certified numerous questions pertaining to the *Act*, and held that the proposed common issues were of mixed fact and law, arising from a common factual background. Though a resolution of the issues was held not be dispositive of the claims, it was determined that such a resolution would be capable of advancing the litigation.[36]

Accordingly, Winkler J.'s decisions in *Bre-X* appear to have foreclosed the argument in Ontario that the *Competition Act* contemplates application of the fraud-on-the-market theory to claims under s. 36. This interpretation of the *Competition Act* does not appear, however, to be foreclosed in British Columbia, a consideration for plaintiffs seeking to certify a class action in that jurisdiction.[37] Moreover, whether or not the *Competition Act* can be said to contemplate application of that theory to claims under s. 36, *Bre-X* is authority for the proposition that purchasers of securities in the secondary securities markets can bring claims for misrepresentation under the *Competition Act*, and also supports the proposition that certain issues

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33 *Carom v. Bre-X Minerals Ltd.*, (1998) 41 O.R. (3d) 780, 1998 CarswellOnt 4285 (Ont. Gen. Div.). [hereinafter "*Bre-X*" cited to CarswellOnt]]

34 *Ibid.* at para. 41.

35 *Ibid.*

36 *Ibid*

37 See for example, *Bouchanskaia v. Bayer Inc* [2003] B.C.S.C. 1306, 2003 CarswellBC 2059 (B.C.S.C.).

raised under the *Competition Act* can be common issues the resolution of which will significantly advance the litigation.

(b) Resolution of the Common Issues will advance the Litigation even if each Class Member must prove Individual Reliance

Sharbern was certified on the basis that, despite the possible need to prove individual reliance, the common issues would advance the litigation. It also appears to have been the basis upon which *Bre-X* was certified. Plaintiffs lawyers attempting to bring a class action for negligent misrepresentation on the foundation of *Sharbern* and *Bre-X* will be faced with the challenge identifying and articulating the common issues such as to establish that their resolution will substantially advance the litigation despite the possible need to prove individual reliance.

II. PRINCIPAL FEATURES OF THE REVISED ONTARIO SECURITIES ACT

Clearly, the common law approach to a claim for damages arising from misrepresentation disseminated on the secondary market is not a fail safe approach for a successful class action, given the different approaches the courts have taken with respect to the reliance issue. This issue is largely resolved through the changes to the *Act,* since under the new legislative regime, the basic right of action essentially eliminates the need to prove reliance in misrepresentation cases, and accordingly adds an element of confidence to those who have suffered damages as a result of such misrepresentations.

Section 138.3(1) provides:

> Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document[38] that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, ***without regard to whether the person or company relied on the misrepresentation***,[39] a right of action for damages against,
>
> (a) the responsible issuer;
>
> (b) each director of the responsible issuer at the time the document was released;
>
> (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document;
>
> (d) each influential person, and each director and officer of an influential person, who knowingly influenced,

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38 Section 138.3(2) creates a distinct right of action for oral misrepresentations. As most actionable misrepresentations are contained in documentary disclosures, this section is likely to be of limited importance and is not examined in this memorandum.

39 Although s. 138.3(1) eliminates the requirement of proving reliance, s. 138.4(5) affords a defence to those defendants who demonstrate that the plaintiff *actually* knew of the misrepresentation. The fact that the plaintiff ought to have known of the misrepresentation is no defence.

(i) the responsible issuer or any person or company acting on behalf of the responsible issuer to release the document, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and

(e) each expert where,

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document.

Section 138.3(4) creates a separate right of action in respect of failures to make "timely disclosure"[40] of material facts. Thus, a defendant need not make a positive misrepresentation in order to incur liability – the mere omission to disclose a material fact on a timely basis can give rise to liability. Generally, the s. 138.3(4) right of action is available against the same categories of defendants as the s. 138.3(1) right of action.

Defences

The *Act* lists a variety of defences, the scope of which vary largely according to two factors: (1) whether the misrepresentation is contained in a "core document"; and (2) the identity of the defendant.[41]

"Core document" is defined to include a prospectus, a management's discussion and analysis (generally found in annual and quarterly reports), annual and interim financial statements and annual reports.[42] Where the defendant is the issuer or an officer of the issuer, a "core document" includes a material change report required to be filed with the OSC pursuant to s. 74(2) of the Act.

The most notable omission from the list of "core" documents are press releases other than those filed as "material change reports" under the *Act*. Pursuant to sub section (c) of the definition of "core document", however, other categories of documents may be added to the definition pursuant to regulation. It remains to be seen whether Regulation 1015 promulgated under the Act ("Reg. 1015") will be amended to incorporate all press releases into the definition of "core document".

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40 Under s. 75(2) of the Act, reporting issuers are required to file with the OSC reports of material changes in the issuer's business or affairs. These reports must be filed as soon as practicable and in any event not more than 10 days after the occurrence of the material change.

41 Section 138.4.

42 Section 138.1.

The scope of the definition of a "core document" is important for the following reason. Under section 138.4(1), a misrepresentation in a non-core document is generally[43] actionable only if the plaintiff proves that the defendant knew of the misrepresentation, deliberately avoided acquiring knowledge as to the misrepresentation or was "guilty of gross misconduct" in connection with the release of the misrepresentation.

The plaintiff is subject to these same requirements in respect of an action arising from a failure to make timely disclosure under s. 138.3(4). With respect to the s.138.3(4) right of action, however, that defence is not available to issuers and their officers.

The most important of the defences to the rights of action under s. 138.3 however is set out in Section 138.4(6)– the due diligence defence. The importance of this defence stems from the breadth of its availability. It applies in respect of misrepresentations contained in "core documents". It also applies to officers and issuers who fail to make "timely disclosure". This defence requires that the defendant (1) conducted or caused to be conducted a "reasonable investigation" and (2) had "no reasonable grounds" to believe that the relevant document contained a misrepresentation or that the failure to make timely disclosure would occur. It is important to note that these requirements are conjunctive. Accordingly, the absence of reasonable grounds to apprehend the misrepresentation will constitute a defence only where a reasonable investigation was made or caused to be made.

The *Act* further sets out a non-exhaustive list of factors to be considered by the Court in determining whether an investigation was reasonable or whether a defendant is guilty of "gross misconduct".[44] These include the knowledge, experience and function of the defendant and the existence of an effective compliance system.

Forward-looking Information

The *Act* contains a "safe harbour" for "forward-looking information".[45] This safe harbour is quite similar to that established in the United States under the *Private Securities Litigation Reform Act* of 1995 ("*PLSRA*"), which was enacted by Congress to curb perceived abuses in the securities class actions. This is therefore one area in respect of which American jurisprudence is likely to provide some interpretive assistance with regard to the new legislation.

The safe harbour is available (*i.e.* the defendant does not incur liability) if various requirements are met, including the insertion of (1) "reasonable cautionary language"[46] identifying the forward-looking information as such and identifying the material factors that could cause actual results to differ from predictions, and (2) a statement of the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection. The defendant must also have a reasonable basis for drawing the impugned conclusions or making the impugned

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43 Under s. 138.4(2), these requirements do not apply if the defendant is an expert.

44 Section. 138.4(7).

45 Section 138.4(9). Note: Section 138.3(1) defines "forward-looking information" to mean "all disclosure regarding possible events, conditions or results (including future-oriented financial information with respect to prospective results of operations, a prospective financial position or prospective changes in financial position that is based on assumptions about future economic conditions and courses of action) that is presented as either a forecast or a projection".

46 The *PLSRA* uses the same phrase.

forecast. As a result of these requirements, actions based purely upon misrepresentations in "forward-looking information" will be difficult, but not impossible, to sustain.

Damages

Detailed rules for computing damages are also provided by the changes to the legislation.[47] While these sections codify many rules that have been developed gradually through the case-law in American securities litigation, and eliminate a considerable amount of uncertainty, they also impose arbitrary limits on the liability of various defendants. In extreme cases, these limits may render the prosecution of legal proceedings uneconomical.

Who is Eligible for Damages?

Investors who *continue to hold* the issuer's securities are provided with a method for computing damages under the *Act*, and therefore need not crystallize a loss in order to be eligible for damages.[48] The *Act* further provides a methodology for computing the damages of persons who *sell* securities in the case of a misrepresentation or a failure of timely disclosure.[49] Therefore, the dissemination of unduly negative information, or the failure to disclose positive information on a timely basis, also gives rise to liability.

The language of s. 138.5 suggests that only persons who both acquire the issuer's securities after the first publication of the misrepresentation and who do so prior to the first publication of a correction or a material change that was not disclosed on a timely basis, are eligible to claim damages.

It sometimes happens that an issuer will disseminate a misrepresentation but refuse to acknowledge that the representation was materially false or misleading. In other words, the issuer fails to publish a "correction". In light of the wording of s. 138.5, we can anticipate that such issuers will deny that the plaintiff is entitled to any damages whatsoever.

The Basic Method of Measuring Damages

In the case of investors who *acquire* securities during the period of the misrepresentation or the failure to disclose information on a timely basis, s. 138.5(1) sets forth a basic methodology for computing damages in three different situations:

(1) the plaintiff disposes of the securities less than 10 days after the public correction or the first publication of material information that was not disclosed on a timely basis: the measure of damages per share is the difference between (a) the average price paid for the securities (including commissions) and (b) the price received upon disposition (without deducting commissions);

(2) the plaintiff disposes of the securities on or after the 10th day following the public correction or the first publication of material information that was not disclosed on a timely basis: the measure of damages per share is the lesser of (a) the difference between (i) the average price paid for the securities (including commissions) and (ii) the price received upon disposition

47 Sections 138.5, 138.6 and 138.7.

48 Section 138.5(1)

49 Section 138.5(1)

(without deducting commissions); and (b) the difference between (i) the average price paid for the securities (including commissions) and (ii) the average price of the securities for the 10 days following the public correction or the first publication of material information that was not disclosed on a timely basis (without deducting commissions); and

(3) the plaintiff continues to hold the securities: the correct measure of damages per share is the difference between (a) the average price paid for the securities (including commissions) and (b) the average price of the securities for the 10 days following the public correction or the first publication of material information that was not disclosed on a timely basis (without deducting commissions).

The effect of these provisions is to codify the obligation to mitigate one's damages, and to impose a universal (and somewhat arbitrary) standard of reasonableness on the conduct of the plaintiff. The legislature has effectively assumed that a reasonable purchaser would in all circumstances dispose of his securities within ten days of the public correction or first publication of material information that was not disclosed on a timely basis.

Section 138.5 establishes a comparable methodology for computing damages in the case of investors who *dispose of* securities during the period of the misrepresentation or the failure to disclose information on a timely basis.

Use of the foregoing methodology is subject to an important proviso, which is set forth in s. 138.5(3). According to that section, assessed damages do not include a fluctuation in the price of the stock which was due to factors other than the misrepresentation or the failure to make timely disclosure. The defendant bears the burden of proving that the fluctuation in stock price resulted from factors extraneous to its breach of duty. The discharge of this burden is likely to require expert testimony from a forensic economist or other qualified expert.

Proportionate Liability

The principle of joint and several liability is rejected under the *Act,* and a defendant is liable only for that portion of the aggregate amount of damages "that corresponds to that defendant's responsibility for the damages".[50] However, a defendant who knew of the misrepresentation or the failure to make timely disclosure is liable for the full amount of the aggregate damages assessed, and is jointly and severally liable with all other defendants who are found to have had such knowledge.

Damages Cap – The Issuer

Each defendant's liability is generally subject to a limit. In the case of the issuer of the security, that limit is 5% of "market capitalization". [51]

The theory behind the liability limit is explained in Canadian Securities Administrators ("CSA") Notice 53-302 (the "Notice"), wherein certain members of the CSA proposed to their respective provincial governments that securities legislation be amended to provide a private right of action for secondary market misrepresentations. It states that:

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50 Section 138.6(1).

51 Sections 138.1 and 138.7.

> The proposal is primarily directed to providing an effective deterrent to misrepresentations and failures to make timely disclosure. Providing compensation for investor damages is a secondary objective, which should be balanced against the interests of long term security holders of the issuer, who effectively pay the cost of any damages awards. In order to achieve this balance, the proposed legislation would limit the potential exposure of issuers and other potential defendants.[52]

The CSA states that its primary objective in proposing the private right of action is to enhance deterrence. It is at least plausible, however, that exposing actors in the securities markets to full liability for their misconduct is a more effective deterrent than limited liability.

There is nothing exceptional about "long term security holders" bearing the brunt of the cost of corporate misconduct. This occurs in a vast array of corporate liability situations, such as contract breaches and patent infringements, yet no suggestion is made in these contexts that corporate liability should be capped arbitrarily.

The theory of corporate liability is simple yet compelling, and one that applies with equal force to liability for misrepresentations in the secondary market: shareholders elect the directors of the corporation, and there is, therefore, no injustice in imposing upon them the costs of managerial misconduct. Doing so, in fact enhances their incentive to elect directors who will behave responsibly and ethically, and to supervise the conduct of corporate management more effectively.

Although the liability limits are likely to remain in place for the time being, the foregoing considerations have not lost their relevance. As explained more fully below, these considerations can influence the manner in which courts interpret an important ambiguity in the definition of "market capitalization".

Generally, the size of the issuer's liability limit will vary greatly depending on the point in time at which the issuer's market capitalization is to be determined. It is clearly in the plaintiff's interests that that point in time occur during the period where the market price of the issuer's security is inflated by reason of unduly positive news or the failure to disclose negative news.

"Market capitalization" is not defined in Part XXIII.1 but is to be defined by the amended Reg. 1015. Although Reg. 1015 has not yet been amended, the Notice proposed a definition of "market capitalization" that is likely to be incorporated into Reg. 1015. That definition directs the court to calculate the issuer's market capitalization by reference to the market price of the security "during the ten days before the day on which the misrepresentation was made or there was a failure to make timely disclosure".

The difficulty with this definition exists in the phrase "*the* day on which *the* misrepresentation was made". In most cases of secondary market misrepresentation, the issuer disseminates *multiple* misrepresentations. Even when the substance of those various misrepresentations is the same, the issuer often repeats the misrepresentation. In such cases, there will be a question as to which misrepresentation is the operative misrepresentation for purposes of calculating market capitalization. In cases of multiple misrepresentations, plaintiff's counsel should argue that the

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52 CSA Notice 53-302, para. (2)(d).

operative misrepresentation is the one that was disseminated at or nearest to the time at which the issuer's stock price peaked. Defendant's counsel of course will oppose this interpretation, and is likely to rely upon the CSA's stated objective of balancing deterrence with compensation. It is in this context that the arguments articulated above regarding the theory of corporate liability become relevant. Plaintiff's counsel should also invoke s. 138.3(6) of the Act, which states:

> (6) In an action under this section,
>
> (a) multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation; and
>
> (b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common subject matter may, in the discretion of the court, be treated as a single failure to make timely disclosure.[53]

This section accords to the court an open-ended discretion as to how to deal with situations of multiple misrepresentations, and plaintiff's counsel should urge the court to employ that discretion in such a manner as to afford to the class the greatest possible compensation. Plaintiff's counsel should also point out that, had the drafters of the legislation wanted to oblige the court to evaluate the issuer's market capitalization outside of the class period, the drafters could easily have directed the court to calculate the issuer's market capitalization by reference to the market price of the security "during the ten days before the *first* day on which the misrepresentation was made". The absence of the word "first", combined with the discretion conferred by s. 136.3(6), suggest that the drafters intended to grant the court wide latitude in determining the operative date for calculating market capitalization.

Damages Cap – Individual Defendants

Individual defendants are also shielded by arbitrary limits on their liability. In general, that limit is equivalent to 50% of the individual's compensation from the issuer "during the 12 month period immediately preceding the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred".[54]

The liability limit raises several points worth considering. First, for purposes of the liability limit, s. 138.1 defines "compensation" to include deferred compensation, such as stock options. This is important given the prevalence and value of stock options awarded to senior officers of public companies.

Second, the word "first" does appear in this definition, which supports the interpretation of "market capitalization" articulated above. Specifically, a widely accepted rule of statutory interpretation is that Parliament is presumed to use words for a reason. The corollary of this is that Parliament is presumed to omit words for a reason as well. In other words, courts should assume that the legislature's decision to exclude the word "first" from the definition of "market capitalization" was intentional.

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53 The CSA revised this provision following a comment from the Canadian Bankers' Association. Neither the revisions nor that comment have any bearing on the application of this provision to the concept of "market capitalization".

54 Section 138.1 "compensation."

Third, although the word "first" appears in the definition of compensation, it only appears in the second clause of that definition, which relates to failures to make timely disclosure. This raises the question of whether the court enjoys a discretion to select a date within the class period as the operative date for calculating the individual defendant's compensation. This question is of considerable importance, since the compensation of many directors and officers is tied to the issuer's stock price and/or financial performance, and such individuals frequently receive inflated compensation during the pendency of material misrepresentations.

National Cap

Section 138.7 of the Act states:

> (1) Despite section 138.5, the damages payable by a person or company in an action under section 138.5 is the lesser of,
>
> > (a) the aggregate damages assessed against the person or company in the action, and
> >
> > (b) the liability limit for the person or company less the aggregate of all damages assessed after appeals, if any, against the person or company *in all other actions brought under section 138.3, and under comparable legislation in other provinces or territories in Canada* in respect of that misrepresentation or failure to make timely disclosure, and less any amount paid in settlement of any such actions. [Emphasis added.]

Thus, the liability limit is of quasi-national scope, since ss. (1)(b) requires deduction only of amounts assessed against the defendants, or paid in settlement, in actions brought "under comparable legislation". This wording suggests that amounts assessed or paid in settlement in any actions brought under the common law would not be deducted from the liability limit. It is also clear that any amounts assessed or paid in settlement in parallel litigation pursued in the United States would not be deductible from the liability limit.

It is possible that this section will generate a race to the court-house. That problem can be largely avoided, however, by obtaining certification of a class encompassing investors residing in all jurisdictions where comparable legislation is in effect. Other possible methods for avoiding a race to the court-house are (1) obtaining a stay of court approval of any settlement agreement until completion of all parallel litigation or (2) entering into agreements with class counsel and lead plaintiffs in other provinces for a *pro rata* distribution of all amounts assessed or paid in settlement.

Preliminary Merits Test

Under s. 138.8, no action can be commenced under s. 138.3 without leave of the court granted upon motion with notice to the defendants. The movant must establish that the action is brought in good faith and that there is a "reasonable possibility" of success. Both parties must submit affidavits "setting forth the material facts upon which each intends to rely", and the affiants may be cross-examined thereon.

If leave is granted, the plaintiff must promptly issue a news release disclosing that leave has been granted and must send written notice to the OSC, together with copies of the news release and

the Statement of Claim, when filed. Thus, s. 138.8 envisions that the motion be brought prior to the filing of the Statement of Claim.

Costs

Pursuant to s. 138.11 of the Act, the prevailing party in a s. 138.3 action is entitled to costs notwithstanding the *Class Proceedings Act, 1992*.

Limitations

Section 138.14 establishes a three-year limitation period, but stipulates that the date upon which the period begins to run is, in the case of a misrepresentation in a document, the earlier of; (a) three years after the date on which the document containing the misrepresentation was *first* released; and, (b) six months after the news release disclosing the granting of leave under s. 138.8 has been issued.

In theory, s. 138.14 could prescribe an action that has never been discovered. Specifically, if no corrective disclosure is made within three years of the first publication of the document containing the misrepresentation, and if the misrepresentation could not otherwise have been identified through the exercise of reasonable diligence, the action would nevertheless appear to be time-barred by s. 138.14.

Section 138.3(6), however, could again prove to be of considerable utility to the plaintiff in such a situation. If the misrepresentation was repeated, then one could argue that the all publications should be treated as one misrepresentation and that the operative date for determining the commencement of the limitation period should be the date upon which the misrepresentation was last published. A narrower construction of ss. 138.3(6) and 138.8 would reinforce the defendant's incentive to delay publication of a corrective disclosure.

Exclusion of other Causes of Action?

There is no provision dealing with the effect, if any, of Part XXIII.1 on common law causes of action. The question arises, therefore, as to whether it may be preferable in the right circumstances[55] to pursue a claim in negligent misrepresentation rather than under Part XXIII.1. Presumably, this would enable the class to circumvent the liability limit.

CONCLUSION

The proposed changes to the *Securites Act* provide a more plaintiff friendly framework for securities class actions in Canada involving misrepresentations on the secondary market than was previously available under the common law. Because the *Act* eliminates the reliance requirement, it proves even more favourable to plaintiffs pursuing securities class actions than would otherwise be available, even through the more plaintiff friendly American "fraud-on-the-market theory." . Many of the issues to which the revised *Act* give rise will accordingly be matters of first impression, and those who are first to master the intricacies of the legislative changes will be instrumental in establishing the courts' interpretation of the new sections.

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55 For example, in cases where the misrepresentation consisted of a single misstatement that had been disseminated by some method that rendered it likely that all class members received the misstatement, the probability of obtaining certification is significantly enhanced.

A review of the common law jurisprudence on negligent misrepresentation reveals a reluctance by Canadian courts to move away from the traditional requirement that, in order for such claims to succeed, individual reliance must be established. Attempts to import the American "fraud-on-the-market" theory into Canadian securities class actions as a mechanism for overcoming the reliance element of a negligent misrepresentation claim, have been largely unsuccessful as a result.

Nonetheless, a review of the common law arguably reveals a shift toward recognition of a cause of action akin to negligent misrepresentation, in which proof of reliance may not be required where causation can be otherwise established. In the class action context, where causation can be established absent proof of individual reliance, an argument that resolution of the common issues will significantly advance the litigation, despite a possible requirement of proving individual reliance, may be successful.