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Surge in securities class actions inevitable? Be prepared

Judicial interpretation of Ontario's *Securities Act* are making it increasingly important for lawyers to partner with third-party class action specialists.

by Eric Khan

Market cap losses rise 291% in 2004

Corporate counsel, securities lawyers and litigators in the U.S. are certainly no strangers to the world of class actions. According to Stanford Law School's Securities Class Action Clearinghouse Web site, 273 securities class actions were launched in 2002 alone. Although the number dipped somewhat in 2003, securities class action lawsuits in the U.S. rose 17% between 2003 and 2004. At the same time, companies that were the subject of class action suits saw their market capitalization drop dramatically – rising from an average $58 billion loss in 2003 to an astonishing $169 billion loss in 2004.[1]

U.S. class action filings fueled by "fraud on the market" theory

While many social and financial factors play a role in the filing of U.S. securities class actions, one of the more powerful concepts favouring U.S. plaintiffs is the "fraud on the market" theory. Under this theory, shareholders who have not actually seen or relied upon a misleading statement are still permitted to launch suits against U.S. public companies if they can demonstrate that the company's failure to disclose material information affected its share price. In effect, plaintiffs are deemed to have relied on the material misrepresentation – making class action certifications almost automatic when, for example, companies fail to disclose material information.

Exploring the Canadian experience

On this side of the border, however, securities class actions have never been quite so prevalent. Take the case of *Carom v. Bre-X Minerals Ltd.* (1999) 46 O.R. (3d) 315, for instance. In one of the most famous securities class actions in recent Canadian history, shareholders sued Bre-X for misrepresentation and conspiracy. While the Court certified the fraudulent misrepresentation claim against Bre-X and certain insiders, it specifically declined to apply the U.S. "fraud on the market" theory to such secondary market claims, where shareholders could not demonstrate their individual reliance on a specific oral or written misrepresentation.

A year later, in *Menegon v. Philip Services Corp.* (1999) O.M. No. 4080 (S.C.), the Court certified a class action against Philip Services following the launch of a suit that claimed secondary market misrepresentation. However, the Court limited the application of its decision by making it clear that the certification was based on the particular circumstances of the case. The defendants were even given explicit leave to oppose the certification at a later date.

Enter Bill 198

Given the extent of Canadian case law rejecting reliance on the "fraud on the market" theory, it has been historically difficult to certify securities class actions in Canada. However, the Keeping the Promise for a Strong Economy Act (Budget Measures), 2002 introduced amendments to Ontario's *Securities Act* that changed the face of Canadian securities class action litigation. The amendments, which are better known as Bill 198, give secondary market investors the civil right to sue issuers, directors, officers, auditors, or other influential persons responsible for publicly releasing oral or written misrepresentations. Similar provisions under the bill allow shareholders to bring actions where the company failed to disclose a material change.

The interest in these amendments relates to the clause that gives plaintiffs the statutory right to bring an action "without regard to whether" the purchaser or seller of securities relied on the alleged misrepresentation. By eliminating the need to prove specific reliance, this legislation has expanded the likelihood of securities-related class actions in Ontario.

However, rather than representing a wholesale adoption of the U.S. "fraud on the market" theory, the Securities Act amendments have injected some uniquely Canadian twists. For instance, under the legislation, the Court must still give its approval before a class action is certified which may serve to discourage spurious litigation. To obtain certification under the legislation, shareholders must prove that the issuer or named individual intentionally – or recklessly – made the misrepresentation, potentially giving defendants a due diligence defence.

Most significantly, the *Securities Act* amendments have placed a cap on the total amount of damages defendants are liable to pay. Specifically, damages against corporate issuers are limited to 5% of the company's market capitalization or $1 million, whichever is greater. Damages against individual defendants are capped at $25,000 or 50% of the person's previous year's compensation from the company.

Since enacting Bill 198, early experience has centered around the gatekeeper role imposed on the Court. *Sharma v. Timminco Ltd.* (2012) ONCA 107 was the first case to address the leave provision which has prompted calls for legislative reform from the plaintiffs bar. Potentially competing decisions in *Green v. CIBC* (2012) ONSC 3637 and *Silver v. Imax Corp.* (2012) ONSC 4881 were jointly brought before a five-judge panel of the Court of Appeal and remain under reserve.

Cross-border implications for Canadian lawyers

What implications does this shifting environment have for lawyers? Well, the consensus seems to be that plaintiff lawyers will be more likely to bring securities class action suits in Ontario. For their part, defence lawyers – particularly those representing U.S. corporations – may be more inclined to defend these cases under Ontario's jurisdiction given Bill 198's inclusion of limitation on damages. Finally, while U.S. plaintiff lawyers may not consider these new rules when contemplating North American classes, the number of parallel actions may still be on the rise as legislators throughout Canada continue to strengthen shareholder remedies in their quest to further improve corporate governance.

It is helpful also to keep in mind that litigating parties will be increasingly faced with the need to conform to both U.S. and Canadian procedural requirements. Few cases demonstrate this more clearly than *Parsons v. McDonald's Restaurants of Canada Ltd.* (2004) 45 C.P.C. (5th) 304 (S.C.J.) in which a Canadian class action suit was brought against McDonald's following a similar U.S. suit. The U.S. settlement was developed with the specific intent that it would include Canadian class members. However, the Canadian Courts permitted the Ontario case to proceed on the grounds that class members resident within our borders failed to receive adequate notice of their right to opt-out. This case highlights the need for U.S. litigators to comply with both Canadian and U.S. standards and ensure equitable treatment of the entire class population if they hope to enforce a cross-border settlement.

Strategies for managing cross-border litigation issues

In light of the decision in *Parsons v. McDonald's Restaurants of Canada Ltd.*, it is becoming increasingly important for lawyers to have access to expertise in achieving desired notice. By working with class action specialists who understand how to design notice campaigns and manage the myriad of tax reporting requirements in Canada and the U.S., lawyers can rest assured that they have the additional support necessary to ensure an efficient and effective class action process.

1 http://securities.stanford.edu/scac_press/20050103_CR_SCAC.pdf

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