Fogler, Rubinoff LLP
Fogler, Rubinoff LLP Barristers & Solicitors
95 Wellington Street West
Suite 1200, Toronto-Dominion Centre
Toronto, ON M5J 2Z9
Tel: 416.864.9700 Fax: 416.941.8852
www.foglerubinoff.com

ONTARIO'S NEW CIVIL LIABILITY REGIME FOR PUBLIC COMPANIES

SUMMARY OF THE NEW REGIME

The Ontario government has proclaimed into force effective December 31, 2005 the new *Securities Act* (Ontario) regime that gives securityholders a limited, statutory right to sue an issuer and its directors, management, controlling shareholders and others if the issuer's continuous disclosure is improper and securities of such issuer were purchased or sold on a stock exchange or other secondary markets[1].

When Can Someone Bring an Action?

A person will have the right to sue if they buy or sell securities of a reporting issuer (or other public company with a real and substantial connection to Ontario, e.g.) in the secondary market at a time in which there is a continuous disclosure violation. A disclosure violation begins when a misrepresentation about the issuer is made in a public document or an oral statement, or when the issuer fails to make timely disclosure of a material change in its affairs. The disclosure violation ends when the disclosure is corrected or the material change is disclosed.

Who is Potentially Liable?

The persons and issuers who are potentially liable will depend on the type of continuous disclosure violation. If an issuer files a document that is alleged to contain a misrepresentation, claims can be asserted against (i) the issuer; (ii) each director; (iii) each officer who authorized, permitted or acquiesced in the release of the document; and (iv) each "influential person" (an insider, a 20% shareholder, a promoter, a fund manager and spokespersons for any of them), and each director or officer of an influential person, who knowingly influenced the issuer to file the document or who knowingly influenced a director or an officer of the issuer to authorize, permit or acquiesce in the filing of the document containing the disclosure violation. If the misrepresentation occurs in a portion of the document upon which an opinion is provided by an expert (e.g. accountant, lawyer, professional engineer, etc.), the expert can also be sued if he or she consented to the use of the opinion or report in the document.

"Core" vs. "Non-Core" Documents and Oral Public Statements

Under the new legislation, documents will be classified as "core" or "non-core" documents; however, this classification will not be the same for all parties. For example, material change reports will be core documents for officers but not for outside directors. Generally, the plaintiff's ability to sue successfully will be more difficult for claims (i) about non-core documents and oral public statements; and (ii) against outside directors or influential persons about a failure to make timely

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[1] The regime will also apply to acquisitions or dispositions of securities in certain exempt takeover bids and exempt issuer bids.

disclosure. If a plaintiff establishes a cause of action due to a misrepresentation in a core document, the onus will shift to the defendant to establish a defence to escape liability. As a default rule, defendants, other than issuers and experts, are not liable for misrepresentations in non-core documents or public oral statements. Notwithstanding the aforementioned, a cause of action will exist where it is proven that the defendant was aware or avoided becoming aware of the misrepresentation in the non-core document or statement.

Defences and Safe Harbour for Forward-Looking Statements

There are a number of possible defences available to defendants, including the following:

1. *Due Diligence Defence* - all defendants will have a due diligence defence if they prove that they (i) conducted or caused to be conducted a reasonable investigation; and (ii) had no reasonable grounds to believe that the document or oral public statement contained a misrepresentation, or that timely disclosure would not be made.
2. *Expert Information* - Non-experts will not be responsible for disclosure that has been prepared and approved by an expert.
3. *Confidential Material Change Report* - There will be no liability for failing to make timely disclosure if the issuer filed a confidential material change report, subject to their being a reasonable basis for making the disclosure on a confidential basis and certain other conditions being satisfied.
4. *Corrective Action* - By taking corrective action, defendants (other than the issuer) may limit their potential liability for continuous disclosure violations made without their knowledge.
5. *Forward-Looking Disclaimer* - There will be no liability for forward-looking information if (i) it contains reasonable cautionary language; (ii) it identifies the material factors that could cause actual results to differ materially from the forecast or projection; (iii) it states the material factors or assumptions that were applied in making the forecast or projection; and (iv) there is a reasonable basis for making the forecast or projection.

Calculation of Damages and Limits on Liability

The legislation contains complex rules to calculate a plaintiff's loss. In addition, these rules do not require a plaintiff to sell the security in order to crystallize the loss. Generally, the court will determine each defendant's responsibility for the plaintiff's losses, and each defendant will be liable for his, her or its proportionate share of the damages. However, directors, officers, influential persons or experts who act knowingly in a violation may be fully liable, jointly and severally, for all damages.

A particular defendant's total liability to all plaintiffs for the same violation is capped under this regime as follows:

1. *Issuer* – Liability is limited to the greater of $1 million and 5% of its market capitalization.
2. *Directors, Officers and other Individuals* - The liability limit is equal to the greater of $25,000 and 50% of their total 12-month compensation from the issuer and its affiliates. If the individual is a director or officer of an influential person, liability is equal to the greater of $25,000 and 50% of their total 12-month compensation from the influential person and its affiliates.

3. *Influential Persons* – Liability shall not exceed the greater of $25,000 and 50% of the aggregate of the influential person's compensation from the issuer. If the influential person is not an individual, liability shall not exceed the greater of $1 million and 5% of its market capitalization.
4. *Experts* - Liability is limited to the greater of $1 million and the revenue that the expert has earned from the issuer and its affiliates during the 12 months preceding the misrepresentation.

Limits on liability do not apply to a defendant (other than the issuer) where the plaintiff proves that the person or company authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure.

Protection Against Strike Suits

The law contains two measures to reduce the potential for actions to be brought soon after a fall in an issuer's share value[2] even if there has been no continuous disclosure violation. A plaintiff is required to obtain leave of the court before bringing an action, and the court will grant leave only if it is satisfied that the action is being brought in good faith and has a reasonable prospect of success at trial. The court must also approve any proposed settlement of a lawsuit.

PRACTICAL ISSUES TO BE CONSIDERED BY ISSUERS AND THEIR OFFICERS AND DIRECTORS

When Should Material Changes be Disclosed?

Under securities legislation, a "material change", which is an event that triggers a public disclosure obligation, is defined to include a change in the business, operations or capital of an issuer that would reasonably be expected to have a significant effect on the market price or value of its securities. This definition requires officers and directors to make a business judgement, either alone or based on information or advice from capital markets professionals. Given the higher stakes involved under the new regime, the decision about when to disclose major corporate events has been made more difficult. Under this new regime, issuers may decide to disclose negotiations of significant transactions at an earlier stage in an attempt to err on the side of caution.

In order to provide protection from liability, issuers may decide to file a confidential material change report[3]. However, in such a case, potential defendants in a lawsuit must be prepared to defend the reasonableness of the decision to make a confidential filing.

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[2] Such suits have become commonplace in the United States and are often referred to as "strike suits".

[3] The provisions in securities legislation dealing with the filing of confidential material change reports have existed for many years, but until now have been seldom used.

Written Disclosure Policy

The legislation provides the court with discretion to consider a number of factors in determining the liability of the parties involved. One such factor is the existence of a suitable system to ensure the appropriate persons have complied with the disclosure obligations of the issuer. An appropriately designed disclosure policy will be essential in demonstrating due diligence. As a result, it would be prudent for all reporting issuers with a real and substantial connection to Ontario to put in place a written disclosure policy as soon as practicable, if they have not already done so. The policy should deal with all issues surrounding disclosure obligations of the issuer, including the following:

5. Assigning responsibility for determining whether a material change has occurred and set out a process for making such a determination.
6. Creating a review procedure to be followed prior to the release of public documents, such as: news releases, material change reports, annual information forms, annual and interim financial statements, annual and interim management's discussion and analysis and proxy circulars.
7. Assigning responsibility for ongoing review of public disclosure to ensure accuracy and, if necessary, identify and correct any misrepresentations or instances of selective disclosure.
8. Creating a procedure for correcting misrepresentations or addressing a failure to make a timely disclosure as diligently as possible when brought to the attention of the issuer that such an error has been made.

Public Presentations and Oral Statements

When people speak in public on behalf of the issuer, such statements should be carefully planned; off-the-cuff remarks should be avoided. It is highly recommended that records (electronically or otherwise) of public presentations and oral statements be retained by the issuer and reviewed by the responsible person to ensure accuracy of disclosure.

Forward-Looking Statements

The cautionary language that accompanies any forward-looking statements made in disclosure documents should be beyond boilerplate in order to rely on available defences under the new regime. The cautionary language must: (i) identify the material factors that could cause actual results to vary; and (ii) state the material factors and assumptions that were applied in preparing the forward-looking information. There must also be a reasonable basis for any forecast or projection.

Expert Reports and Third-Party Disclosure

If a report of an expert (i.e. accountant, actuary, appraiser, auditor, engineer, etc.) is included, summarized or quoted in a public document or a public oral statement, the issuer should obtain the written consent of that expert. Similarly, when disclosure is based on a third-party's disclosure that is publicly filed with securities regulators, the disclosure should explicitly refer to the source of the information. In each of these cases there are defences available.

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This update is intended for general informational purposes only and should not be relied upon as legal advice.

For further information, please contact:
Karen Murray
(416) 365-3711
kmurray@foglerubinoff.com

or

Rick Moscone
(416) 941-8858
rmoscone@foglerubinoff.com

or your usual Fogler, Rubinoff LLP contact.