CLASS PROCEEDINGS *FOR PROSPECTUS MISREPRESENTATIONS*

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The securities acts of virtually all provinces contain provisions allowing investors to bring civil actions for misrepresentations in prospectuses. The statutory provisions are significantly more advantageous to plaintiffs than common law remedies. At least theoretically, the increased possibility of civil liability for misrepresentation fosters compliance with the fundamental securities law requirement of "full, true and plain disclosure of all material facts". However, the practicality of statutory civil actions for prospectus misrepresentation is doubtful without effective class action procedures. Ontario, Canada's largest provincial capital market, has recently enacted new class action procedures which may breathe new life into what has been a moribund statutory remedy. This article explores how statutory civil actions might be brought under the new class action legislation and discusses the significant practical constraints which continue to exist.

La législation sur les valeurs mobilières de presque toutes les provinces contient des dispositions qui permettent aux investisseurs, victimes de fausses déclarations dans un prospectus, d'instituer des recours civils. Les dispositions établies par la loi sont nettement plus avantageuses pour les plaignants que les recours de common law. Du moins en théorie, l'augmentation des probabilités d'être tenu responsable civilement pour fausses déclarations favorise l'observance de l'exigence fondamentale des lois sur les valeurs mobilières en ce qui concerne la pleine divulgation de tous faits déterminants. Cependant, la viabilité des actions civiles en vertu des lois, pour fausses déclarations dans un prospectus, est douteuse sans une procédure efficace de recours collectifs. L'Ontario, le plus grand marché de capitaux au Canada, a récemment promulgué de nouvelles procédures pour les recours collectifs qui pourraient insuffier une nouvelle vie aux recours moribonds prévus par les lois. Cet article examine comment des actions civiles peuvent être instituées en vertu de la nouvelle législation sur les recours collectifs et discute des contraintes significatives qui continuent d'exister.

Introduction

One of the most feared and least used sections in all of Ontario statute law is section 130 of the *Ontario Securities Act*[1] (the "*Securities Act*"). The section imposes civil liability on issuers of securities, selling securities holders,

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[1] R.S.O. 1990, c. S-5. The substantive statutory provisions in the other provinces are very similar, footnote 68, *infra*. However, none but Quebec have modern class action procedures. For that reason this article is confined to Ontario law. On October 6, 1994 the British Columbia Minister of Finance in a report entitled: "Strengthening Securities Regulation in British Columbia" announced that the B.C. *Securities Act* will be amended to permit class action proceedings.

underwriters, directors, and, in some circumstances, third parties[2] for misrepresentations contained in prospectuses.[3] The fear section 130 generates in the investment and legal communities is evident. The best and brightest of the securities bar have written learned and lengthy articles[4] educating all concerned on section 130 and on due diligence procedures. Indeed, it is not an exaggeration to state that one of the principal roles of solicitors in public offerings is to advise the client, be it an issuer or an underwriter, on the potential liability under section 130 and on how to avoid such liability. It must be the case that since 1978, tens of millions of dollars have been spent by Canadian issuers and underwriters in the context of public offerings for legal assistance to help "bullet-proof" themselves from possible liability under section 130.

The reason for the fear in the investment and legal communities is also evident. The Securities Act contains a number of provisions designed to assist plaintiffs in overcoming hurdles that had existed at common law with respect to lawsuits based on prospectus misrepresentations. As is often the case in securities law, the Ontario provisions are based upon statutes in the United States[5] and the experience in the United States has been that actions based upon public offering documents have been frequent.[6] Indeed, these sorts of claims may have become the securities-law equivalent of "ambulance" chasing. Some lawyers in the United States specialize in launching class action "strike" suits against public corporations that experience financial difficulties or a sharp drop in their share price. Such claims routinely allege misrepresentations in recent

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[2] Third parties whose reports or opinions are referenced in the prospectus may also be sued provided their consent to such reference has been filed. Section 130(1)(d) of the *Securities Act*, and R.R.O. 1990, Reg. 1015 ss. 34 and 35.

[3] The *Act* also provides for statutory liability for misrepresentations contained in take-over bid circulars (s.131) and directors' circulars (s.131(2)). Much of the commentary in this article is equally applicable to these statutory actions. Additionally, if the common law requirements for misrepresentation or deceit can be shown, it is possible that common law actions for misrepresentation or deceit may exist for other forms of corporate communications including information circulars, press releases, financial statements and annual reports, although the practicability of prosecuting such claims is often dubious.

[4] E.g. Alboini, "Due Diligence and the Role of the Securities Lawyer" (1981-2) 6 C.B.L.J. 241; Coleman, "Prospectus Preparation: Audit Committees and Advice to Potential Targets" (presented to C.B.A. Seminar 8 May 1980) at I-22 to I-46.

[5] *The Securities Act* of 1933, 15 U.S.C.A. s. 77a - 77aa (West 1981 Supp. 1981), the ("1933 U.S. Securities Act") and in particular, ss. 11 and 12(2) thereof and the *Securities Exchange Act*, 1934 15 U.S.C.A. s. 78a - 78jj (West 1981, Supp. 1991) (the "1934 U.S. Exchange Act") and in particular, s. 10b and rule 10b-5. The 1933 U.S. Securities Act contains specific provisions relating to initial public offerings. The 1934 U.S. Exchange Act has more general "anti-fraud" provisions.

[6] The numbers in the United States are staggering. One study cited in J.A. Grudfelt "Disimplying Private Rights of Action Under the Federal Securities Laws" (1994) 107 Harv. L.R. 961 at 972 estimates that over a one-year period ending in June, 1992 at least 80 securities class actions were settled for a total of $846.7 million. Plaintiffs' lawyers received 31% of the settlement proceeds or over $250 million. One out of eight firms on the New York Stock Exchange has faced such a lawsuit in the last five years and it is stated that virtually all of these have paid some amounts in settlement.

public offerings of securities by the corporations.[7] Some commentators claim that such suits amount to "legalized blackmail".[8]

The combination of a statute designed to assist investors in recovering losses, sobering experiences south of the border and a capital market in Ontario that annually raises billions of dollars, much of it through prospectuses, on first blush appears to create an ideal environment for prospectus-based lawsuits. Yet this has not occurred. As far as can be ascertained from the law reports, no cases have ever come before any Canadian court for trial claiming statutory damages for misrepresentations contained in a prospectus.[9] How can that be? Has the Canadian securities industry reached a level of perfection in public offerings? Is it possible that the articles by members of the securities bar are simply cautious statements by overly careful lawyers? Or is it the case that section 130 in fact poses but one danger that, by a combination of economic circumstances and procedural roadblocks, has been submerged unseen in the financial statements of public corporations, their underwriters and their auditors?

The thesis of this article is that the last question posed is the proper one. It is submitted that the relative immunity Canadian public issuers, underwriters and third parties have had to actions based upon prospectuses has, at least to some extent, been contributed to by circumstances that no longer exist. The first circumstance that has changed is the general stability of Canadian public corporations. With a few notable exceptions such as the Northland and Canadian Commercial Bank failures, Canada did not experience in the 1980's the insolvencies of large, widely traded public companies. In this, it was unlike the United States where the insolvency wave hit earlier, most particularly in the thrift, banking and real estate industries. In Canada, the impact of the junk bond market failure and real estate crashes has now fully been felt. It has extended to large public companies which have had billions of dollars of equity wiped out.[10] It can only be expected that those who have suffered losses will attempt to sift through the ashes of fallen public companies to seek some recovery. Attention will naturally be drawn to

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[7] *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

[8] Block & Warren, "New Battles in the "Class Struggle" (1979) 34 Bus. Law 455 at 457-8 and accompanying footnotes. For a discussion of the dynamics which encourage defendants to settle class actions of this type, see Alexander, "Do the Merits Really Matter? A Study of Settlements in Securities Class Actions" (1991) 43 Stan. L. Rev. 497. "Eager Lawyers Cruise for Corporate Cash" *The Globe and Mail* (27 January 1994) B1 chronicles the success of one U.S. plaintiff's firm.

[9] There have been at least two common law actions against auditors relating to alleged misrepresentations in a prospectus: the cryptic *Dupuis* v. *Pan American Ltd.* (1979), 7 B.L.R. 288 (Que. Sup. Ct.) and *Akhtar* v. *MacGillvary* (1990), 77 Alta. L.R. (2d) 337 (Q.B.). There are also a number of cases in relation to real property legislation which have informational disclosure requirements somewhat similar to that in the securities legislation, exx: *Grenoble* v. *MacNaught* (1992), 31 R.P.R. (2d) 14 (B.C.C.A.), *Mountain Developments Ltd.* v. *Engineered Homes Ltd.* (1981), 37 R.P.R. 258 (B.C.C.A.) and *Abdool* v. *Somerset Place Developments of Georgetown Ltd.* (1992), 10 O.R. (3d) 120 (C.A.).

[10] Central Capital Ltd, Standard Trustco Limited, Royal Trustco Limited, Bramalea Inc., Peoples Jewellers Inc., Grafton-Fraser Inc., Woodwards Limited, Algoma Steel, Campeau Corporation and Confederation Life for example.

reviewing prospectuses under which securities were purchased and to comparing what was said in these documents with what is now known about the actual health of the companies.[11] No one sues over a misrepresentation if the stock goes up. If the stock goes down, and most particularly if the value of the stock is entirely destroyed, investors tend to look for recovery from third parties.

The second circumstance which has recently changed relates to procedures available to enforce rights under section 130. There can be no doubt that litigation under section 130 will be extremely expensive. Potential defendants will include issuers (if solvent), underwriters, directors and accounting firms. Many potential defendants will be insured. While this provides the comfort of knowing "deep pockets" exist, it also creates the certainty of a vigorous defence. Expensive prospectus litigation only makes sense if at least one large investor who has suffered a large loss is willing to litigate or if effective class action procedures are available so that the smaller losses of a large number of investors can be dealt with in one proceeding. The paucity of section 130 actions in the past may in part be attributable to the fact that large institutional investors in Canada have been relatively less litigious than their American counterparts and that until recently it was uncertain whether one could commence a class action in Ontario based upon section 130. Although the former situation may continue to exist, the latter does not. The *Class Proceedings Act, 1992*[12] will allow class proceedings in relation to section 130 claims to be made and will provide a clear procedure for the prosecution of such actions. Class procedures may breathe life into what has been a dormant section of the *Securities Act*.

Although two of the major circumstances which may have resulted in little litigation no longer exist, it is worthy to note that the litigation climate in Ontario is still substantially different from that in the United States. The statutory

[11] Another natural place to look would be other public statements. However, as there is no statutory right of action in relation to such statements a potential plaintiff would not have the benefit of the statutory advantages, discussed below. The class of defendants would also be narrower. An underwriter would not, for instance, be a defendant as it would not be involved in certifying a press release. *Kripps* v. *Touche Ross & Co.* (1992), 69 B.C.L.R. (2d) 62, 94 D.L.R. 284 (C.A.) leave to appeal denied (1993), 101 D.L.R. (4th) vii, and *Dixon* v. *Deacon Morgan McEwan Easson* (1989), 64 D.L.R. (4th) 441 (B.C.S.C.). The British Columbia government has announced its securities legislation would be extended to give a statutory right of action, including a deemed reliance provision, for misrepresentations in press releases and "similar documents". *Supra* footnote 1. The Ontario Securities Commission (the "O.S.C.") from time to time also moots the issue: "O.S.C. Mulls Crackdown on False Statements" *The Toronto Star* (8 March 1994) D3 as has the Toronto Stock Exchange in its report, "Where Were the Directors?" (16 May 1994). A fertile ground for lawsuits may be auditor's negligence. Complicated policy issues as to the existence and scope of any duty owed by auditors to the general investing public or segments thereof arise which have not yet been resolved by Canadian courts: See for example *Caparo Industries* v. *Dickman*, [1990] 1 All E.R. 568, [1990] 2 W.L.R. 358 (H.L.) and recent Canadian authorities cited in *T.D. Bank* v. *Deloitte, Haskins & Sells* (1991), 5 O.R. (3d) 417 (Gen. Div.).

[12] S.O. 1992, c. 6. The *Class Proceedings Act* in large part stemmed from a 1982 Ontario Law Reform Commission report. The report at 226-237 deals with the desirability of making class actions available in securities claims.

remedies under the *Securities Act* in Ontario deal with a narrower range of conduct. Narrower pleading rules may deter "strike" litigation. Complex actions will not be tried with a jury and with their attendant uncertainty. Damages will be limited to actual damages.[13] Treble damages which are pursuable in the United States under RICO[14] will not be available. Additionally, although the new *Class Proceedings Act* potentially allows lawyers to claim "multiplier" fees, it is unclear that lawyers will view the possibility of receiving a multiplier of their hourly rate in the event of success as outweighing the certainty of receiving nothing in the event of failure. The usual rule that an unsuccessful plaintiff must pay the party and party costs of the defendants will act as a strong disincentive to persons lending their names as representative plaintiffs in class actions.[15] Lastly, restrictive limitation periods will result in the statutory complaints of many potential plaintiffs being out of time. The combination of all these factors makes it likely that class actions based on section 130 of the *Securities Act* will be less common than similar actions in the United States. Indeed, the practical restraints imposed by costs may result in such actions being rare.

II. *Securities Act Provisions*

In 1978, the *Securities Act* was amended to expand and clarify the civil remedies available to investors in relation to prospectuses.[16] The scheme of statutory liability found in the *Securities Act* is separate from the general common law rights available to investors to claim for misrepresentation[17] or deceit[18] and the *Securities Act* specifically provides that the statutory remedies

[13] *The Securities Act* has no provision specifically allowing punitive damages. It might be argued that no jurisdiction to award punitive damages under section 130 exists. However, courts do award punitive damages in other statutory contexts without specific authority to do so. The best example is in the area of intellectual property. It is at least arguable that the intellectual property statutes inferentially give such authority. The issue of jurisdiction has attracted little discussion. See Zimmerman, "Exemplary Damages and Copyright in Canada" (1980) 57 C.P.R. (2d) 65. In the United States, the present law is that punitive damages are not available in statutory actions but are available in common law fraud actions: *Globus* v. *Law Research Serv. Inc.*, 418 F.2d 1276 (2d Cir. 1969) and *Young* v. *Taylor* 466 F.2d 1329 (10th Cir. 1972). Even assuming jurisdiction, punitive damage awards are small save where the compensatory award would clearly be inadequate to deter reprehensible conduct. See generally *Walker* v. *C.F.T.O. Ltd.* (1987), 37 D.L.R. (4th) 224, 59 O.R. (2d) 104 (C.A.) and *Claiborne Industries Ltd.* v. *National Bank of Canada* (1989), 59 D.L.R. (4th) 533, 69 O.R. (2d) 65 (Ont. C.A.).

[14] *The Racketeer Influenced and Corrupt Organizations Act*, 18 U.S.C.A. ss. 1961-1968 (1982) whose long arm has extended into many areas of the securities field.

[15] A recent amendment to the *Law Society Act* may in some circumstances provide relief. As discussed below, under the new amendments if a representative plaintiff has received funding from the Class Proceedings Fund it will not have personal liability for costs if it is unsuccessful in its claim. The defendants' rights for costs is against the Fund only.

[16] Dey, "Securities Reform in Ontario (The *Securities Act*, 1975 - 1976)" 1 C.B.L.J. 20 provides a discussion of the background leading up to the 1978 amendments.

[17] As in *Hedley, Byrne & Co.* v. *Heller and Partners Ltd.*, [1963] 2 All E.R. 575 (H.L.).

[18] As in *Derry* v. *Peek* (1889), 14 A.C. 337 (H.L.) or *Dixon* v. *Deacon, Morgan McEwan and Easson* (1990), 70 D.L.R. (4th) 609 rev'd (1993), 102 D.L.R. (4th) 6, 12 B.L.R. (2d) 184 (B.C.C.A.).

are in addition to any other rights investors may have at law.[19] However, the *Securities Act* provisions are on balance substantially more advantageous to potential plaintiffs than common law remedies. The exception to this general rule is that the *Securities Act* has an abbreviated limitation period and a potential plaintiff who has missed the *Securities Act* limitation period may, of necessity, be forced to sue under common law principles.[20]

The general scheme in the *Securities Act* relating to civil actions based on a public offering of securities is as follows:

(a) subject to the exemptions contained in the *Securities Act*, no trade in a security is permitted unless a prospectus has been filed and been receipted by the Director of the O.S.C.[21] Although there are numerous exemptions to the prospectus requirements[22] the typical issue of common or preferred shares as traded on a Canadian stock exchange does not qualify for an exemption. A prospectus is required.[23]

(b) the prospectus must contain "full, true and plain disclosure of all material facts".[24] Certificates to this effect must be signed by the underwriters who actually contract with the issuer to purchase the securities with a view to distribution.[25] They must also be signed by the chief executive officer, the chief financial officer and two directors of the issuer on behalf of the board;[26]

(c) on an "agency" or "best efforts" offering the securities will be sold by the underwriters as agents for the issuer. The issuer is the actual vendor. In "bought" deals, the underwriters buy and sell the securities on their own account. In

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[19] S. 130(10). The provisions are also separate from the penal and administrative provisions of the *Act*. Section 122(1)(b) makes it an offence to make a statement in a prospectus which is a misrepresentation.

[20] It may also be possible for a plaintiff to sue under the oppression remedy if the statute under which the issuer is incorporated contains such a remedy. Misrepresentations inducing an investment may fall within the ambit of conduct which is oppressive, unfairly prejudicial or unfairly disregards the interests of a complainant. The OBCA contains no specific limitation provision for such an action. The likely candidate as the applicable limitation period is 6 years, as it is likely that an oppression remedy action is an action "on the case", *Limitations Act*, R.S.O. 1990, c. L-15, s. 45(1)(g).

[21] S. 53.

[22] S. 72.

[23] Certain secondary offerings also require a prospectus. These sales include certain sales out of a control block or sales of securities acquired under a prospectus exemption but whose resale is only permitted through a further exemption. In these circumstances persons other than the issuer must issue a prospectus. This article deals only with primary offerings. However, it is with some minor modifications applicable to secondary offerings where prospectuses are required. One obvious modification is that instead of having remedies against the issuer, purchasers in a secondary offering have remedies against the "selling security holder".

[24] Ss. 58 and 59. Prospectuses filed and receipted pursuant to the Prompt Offering System ("POP") incorporate by reference information in other continuous disclosure documents, such as financial statements. Material incorporated by reference is subject to the same requirement. The increasing use of the POP system compresses the time frame for offerings and often results in less rigorous due diligence. For an American view see: "Report on Task Force on Sellers' Due Diligence" (1993) 48 Bus. Law. 1185.

[25] S. 56

[26] If there is a "promoter", it must also sign a certificate.

addition to the underwriters who sign the prospectus, other underwriters will usually also subscribe for a tranche of the issue as members of the "banking group". Banking group members usually do not contract with the issuer directly but instead contract with the underwriters who sign the prospectus;

(d) initial sales of securities can only occur after the final receipt of the prospectus is issued by the Director. The period during which the issue is sold is the "distribution period". The Act provides that all purchasers of securities offered by way of prospectus are entitled to receive a prospectus.[27]

(e) under section 130 a purchaser who purchases securities offered by the prospectus during the distribution period can sue if the prospectus contains a "misrepresentation".[28] A misrepresentation is defined to be an untrue statement of material fact or an omission to state a material fact that is required to be stated.[29] A material fact is a fact that significantly affects or would reasonably be expected to have a significant effect on the market price or value of the securities being sold;[30]

(f) in the event of a misrepresentation in the prospectus,[31] the purchaser may have a right to either rescission or damages. The rescission right is available against the vendor of the shares: the issuer on a best efforts offering and an underwriter in a bought deal. As an alternative to a claim for rescission,[32] the purchaser may

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[27] Ss. 65 and 71.

[28] No statutory right under the *Securities Act* is afforded to persons who purchase in the secondary market (save, possibly for those who purchase from the original purchaser under a prospectus during the distribution period) or to those who purchase on the strength of misrepresentations contained in materials other than prospectuses. The result in Ontario is much the same as the result in the United States under section 12(2) of the *1933 U.S. Securities Act* after much litigation, e.g. *Ballay* v. *Legg Mason Wood Wallar Inc.*, 112 S. Ct. 79 (3rd Cir. 1991). However, statutory remedies are available in the secondary market under section 10(b) of the *1934 U.S. Exchange Act*. They are also available with respect to filings other than prospectuses. See Bloomenthal, "Securities Law Handbook" (New York: Clark Boardman Callaghan, 1994) at c. 14, 15. The possibility of extending statutory rights for misrepresentations to certain other materials required to be filed under the *Securities Act* is discussed in Gresham, "The POP System, Dissemination and Civil Liability" 1989 L.S.U.C. Special Lectures at 385. Gresham at 407-8 argues that section 130 is ambiguous as to whether it encompasses purchasers in the open market during the distribution period relying upon Dey, *supra* footnote 15 at 46-47.

[29] S. 1(1). The inclusion of omissions as misrepresentations helps avoid an uncertainty which exists at common law.

[30] S. 1(1).

[31] Generally, for securities distributed pursuant to an offering memorandum, the issuer must give a contractual right of rescission or damages for misrepresentation against the issuer which reasonably corresponds to the section 130 rights. One instance in which securities may be offered pursuant to an offering memorandum is if the cost to the purchaser of the security is not less than $150,000, s. 72(1)(d), R.R.O. 1990, Reg. 1015, s. 27(1). The limitation period for this mandatory right of action is 90 days from purchase. The relatively large amount of the investment required and the very short limitation period makes class actions relatively less likely than in a prospectus situation. It is more likely actions based on offering memorandum containing misrepresentations would be made on a common law or oppression remedy basis using regular procedures.

[32] The *Securities Act* is not clear as to when the election must be made by a purchaser between rescission and damages. Normally one is under no obligation to elect between alternative remedies until trial. A rescission claim has an advantage to a purchaser that the claim is for a liquidated amount (the entire investment) and an assessment of damages is

claim damages against the issuer or against the lead underwriters[33] who entered into the underwriting agreement with the issuer. It may also claim damages from any director of the issuer,[34] the chief executive and chief financial officer[35] or against third parties whose opinions or reports have been referenced in the prospectus and who have filed consents to the use of their reports or opinions in the prospectus;[36]

(g) section 130 provides that the purchaser is deemed to have relied upon any misrepresentation contained in a prospectus. This deeming provision does away with the usual common law requirement of proving reliance on a misrepresentation and is one of the principal advantages that the statutory claim has over the common law;[37] and

(h) although the *Securities Act* is not entirely clear, it appears the damages to which a purchaser is entitled under section 130 is the difference between the purchase price paid and the actual value of the shares.[38] However, the defendants have the opportunity to rebut the presumptive level of damages. The defendants are not liable for all or any portion of such damages that they prove do not represent the depreciation in value of the security as a result of the misrepresentation.[39] Defendants may therefore prove that other factors (e.g. market conditions) caused the decrease in value. This imposition of the burden of proof on

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not necessary. It may also allow recovery where no damages actually flow from the misrepresentation itself. As a practical matter, a claim for damages will usually not be advanced against an issuer or underwriter except where the rescission claim is time barred or where the securities have been sold. See discussion at footnote , *infra*.

[33] Damages cannot be claimed against "banking group" underwriters. The banking group members, as they do not sign the prospectus, do not certify the prospectus as containing full, true and plain disclosures of all material facts.

[34] S. 130(1)(c).

[35] S. 130(1)(e), s. 58.

[36] S. 130(1)(d).

[37] In the United States, the theory of "fraud on the market" has been developed in an attempt to avoid the requirement of actual reliance under section 10b of 1934 U.S. *Exchange Act*, *Basic Inc.* v. *Levinson*, 48 U.S. 224 (1988). The theory is that although an individual investor may not have specifically relied on a particular representation in a public offering document, the investor relied upon the market as a whole and the market value was distorted by the misrepresentation. The other principal U.S. securities statute, the 1933 U.S. *Securities Act*, in sections 11 and 12(2) has a deemed reliance provision. Whether a Canadian court would modify the common law tort of reliance as in *Basic Inc.* v. *Levinson* is doubtful. A more promising approach is that the very wide oppression remedy could be invoked to provide protection where there has been a "fraud on the market". Do investors not have a reasonable expectation that markets are not tainted by fraud? Note the concern expressed by the O.S.C. as to the protection of investor reliance and market integrity in *Re Canadian Tire Corp.* (1987), 35 B.L.R. 56. (O.S.C.).

[38] The *Securities Act* does not specify the date for the determination of damages. Normally, in a breach of contract action damages are determined as at the date the plaintiff became aware of the breach. This follows from the normal obligation to mitigate upon being made aware of a breach. The court may, in its discretion, allow damages to be determined at trial. The general rule is that the trial date is only used when a *bona fide* claim for specific performance is being made. In such circumstances mitigation is not insisted upon. Although contract rules of damage assessment may not directly apply as the action is a statutory one, they might well be applied by analogy. If they are, the exception would not apply to a section 130 action and damages assessed at trial would not be available.

[39] S. 130(7). This defence is not available in a rescission action.

> defendants is a significant improvement to the plaintiff's position at common law. In many circumstances, it would be impossible or at least extremely expensive for plaintiffs to prove what damages actually flowed from a misrepresentation.

Defendants in a civil action founded upon an alleged misrepresentation in a prospectus have a limited number of defences. The defences vary depending on the defendant. In an action against an issuer, the only substantive defences available are that there was no misrepresentation or that the plaintiff had knowledge of the misrepresentation.[40] The theory is that the issuer received the sale proceeds and should be absolutely liable for misrepresentation unless it can demonstrate that knowledge existed in the plaintiff.[41] Presumably, this defence will apply in only a limited number of circumstances. It may, for instance, apply where related parties[42] or others with non-public information purchased part of the initial issuance of securities.

In actions against underwriters, directors or third party experts, an additional substantive defence, the "due diligence" defence exists. There has been extensive commentary (although little Canadian jurisprudence) on due diligence and that commentary is not repeated here.[43] The defendants will not be liable if they conducted reasonable investigations and following such investigation had reasonable grounds to believe and did believe that there was no misrepresentation. Directors and officers are entitled to rely on opinions of experts such as auditors in establishing a "due diligence" defence.

A procedural defence which may be available in either a rescission or damage claim is that the action is time barred. A limitation of 180 days after the date of the purchase is imposed with respect to an action for rescission.[44] In an action for damages, the limitation period is the *earlier* of 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action or three years after the date of the transaction that gave rise to the cause of action. The rescission and damage limitation periods are substantially less than the usual time limitations in civil actions. The limitation in relation to the rescission action was amended after representations were received from the investment community to a predecessor bill.[45] The limitation periods under the *Securities*

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[40] S. 130(3).

[41] The almost absolute liability of issuers makes them the easiest target in a section 130 action. Assuming a misrepresentation occurred, the primary difficulty in a lawsuit against an issuer is the problem of collection. The importance of being able to claim against other parties is thus obvious.

[42] Presumably, related parties are unlikely to sue one another. In an insolvency different corporations in a group may be under the control of different creditor groups and lawsuits between formerly related entities may arise. An example in a non-prospectus context is *Canada (Attorney General)* v. *Standard Trust Co.* (1991), 84 D.L.R. (4th) 737 (Ont. Gen. Div.).

[43] See the authorities at footnote 4 *supra*, and Alboini, "Securities Law and Practice" (Alboini, Toronto: Carswell, 1984) at s. 23.1.1.

[44] S. 135.

[45] Dey, *supra* footnote 15 at 49-50. For criminal prosecutions, there is presently a one-year limitation period from the time the O.S.C. first has knowledge of the facts. It is

Act are specifically exempted from the impact of the proposed new *Limitations Act* (General), 1993.[46] That proposed act imposes a general limitation period of two years from the date from which the plaintiff discovered that it had a cause of action with an "ultimate" limitation period of 30 years.[47]

If a plaintiff finds itself out of time for a claim under the *Securities Act*, it is reduced to its common law claim.[48] It will not have the advantage of the deemed reliance provision. Its right to rescission will be at best uncertain given that it must prove that the misrepresentation was fundamental to it. In relation to a common law claim for damages, a plaintiff would presumptively[49] bear the burden of proving damages which would be based on the difference between the purchase price and the true value of the shares had the misrepresentation not been made. Additionally, a plaintiff in such an action would not necessarily have claims against all of the defendants who are liable under the *Securities Act*. Certain of the statutory defendants may not, under common law, be considered to have "misrepresented" anything. Under common law principles it might be difficult to claim that directors who did not sign the prospectus had individually misrepresented anything to the purchaser.[50] The plaintiff would, however, be able to claim against the issuer, the underwriter and possibly, against the directors and officers who actually sign the prospectus.[51]

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interesting to note that even a sophisticated party such as the O.S.C. has had some difficulty in commencing proceedings within a time-frame which is longer than that for the commencement of civil proceedings. In the United States, limitation periods for securities claims have, like everything else, had a litigious history. Until 1991, the limitation period for most actions were governed by general state limitation provisions. In 1991, the U.S. Supreme Court held that a federal statutory limitation period applied to most actions. That period is the lesser of one year after the facts constituting the violation ought to have been discovered or three years from the transaction. See Subcommittee on Annual Review, "Significant 1991 Court Decisions" (1992) 47 Bus. Lawyer 1678. To further complicate matters, claims based on security related transactions may, in some circumstances, be made under RICO which has its own limitation period of four years. Claims can be made under RICO when the same claims would be out of time under the securities legislation. See Bloomenthal, *supra* footnote 28, s. 15.07(b).

[46] Bill 99, (1st reading 25 November 1992), ss. 5, 18 and the schedule thereto.

[47] *Ibid.* ss. 4 and 15. The test of discovery under Bill 99 is when the person with the claim is, or ought to be, aware of the material facts.

[48] With the caveat that it is possible that an oppression remedy action might also exist.

[49] A court has the discretion to impose the burden of proof of a particular issue on a defendant who is better able to prove it or who, by its actions, has rendered it difficult for a plaintiff to prove the fact. Sopinka, Lederman & Bryant, *The Law of Evidence in Canada* (Markham, Ont.: Butterworths, 1992) at 81-94.

[50] A contrary argument exists that the two directors who sign the certificate do so as agents for their fellow directors or that the other directors in acquiescing to the provision of the certificate breach a duty of care, *Kuwait Asia Bank EC* v. *National Mutual Life Nominees Ltd.*, [1990] 3 All E.R. 404 (P.C.).

[51] The issue of the potential personal liability at common law of officers and directors who make representations is not yet fully developed, e.g. *Toronto Dominion Bank* v. *Leigh Instruments* (1991), 4 B.L.R. (2d) 220 (Ont. Div. Ct.).

III. Class Actions

(a) *The Practical Necessity*

The civil liability provisions of section 130, at least theoretically, serve two goals. First, they allow individuals recovery for individual wrongs done to them. Second, on a somewhat more lofty plane, they encourage compliance with the fundamental *Securities Act* requirement of "full, true and plain disclosure of all material facts". The possibility of civil liability hopefully results in self-policing by market participants and a better market as a whole.[52] However, it is at least arguable that the theoretical goals of section 130 have to date been simply that: theoretical. This is due to the extreme practical constraints to civil actions under section 130.

There will be thousands of purchasers under a typical prospectus offering. They will range from sophisticated institutional purchasers such as pension or mutual funds to the small retail investor who may buy on the recommendation of his or her broker. If a misrepresentation exists, all who purchased securities offered under the prospectus during the distribution period will have the same legal right to claim damages or rescission. Yet their actual positions will differ. For the large institution, the loss occasioned by any one stock purchase may be insignificant as compared to its entire portfolio of investments. The institution may be able to make up tomorrow for the loss today. In an industry which thrives on personal contacts, opportunities and information there may be a cultural disinclination to sue over a "bad investment". One does not sue someone with whom one might want to do a deal next week or next month. Lawsuits also generate publicity. For an institutional investor, a lawsuit may bring to the attention of its investors that it has made an investment which has turned out poorly. That is not an effective sales technique. The combination of all these factors may result in institutional investors being, for practical reasons, adverse to litigation.

Retail investors do not have the same cultural or institutional constraints to litigation. However, they have a overwhelming practical constraint: costs. It makes no economic sense for a typical retail investor to sue insured directors, underwriters or accountants under section 130. Such a lawsuit involves much too little to be taken seriously by potential defendants for settlement purposes. It involves much too little to proceed to trial. In addition to this virtually insuperable practical barrier, retail investors are generally less able than professional investors to discern when a misrepresentation has occurred. They have less information and less ability to analyze information.[53]

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[52] The common judicial wisdom in the United States is that "private rights of action are a most effective weapon in the enforcement of securities laws". *Bateman Eichler & Hull Richmond Inc.* v. *Berner*, 472 U.S. 299 (1985) at 310. Not everyone agrees. Protagonists on both sides write articles which conclusively prove or conclusively disprove this theory. Some of the more recent American literature is cited in Grudfelt, *supra* footnote 6 at 968-74.

[53] The practical difficulties faced by small investors in a similar type of situation are recognized in *Sparling* v. *Royal Trustco* (1984), 45 O.R. (2d) 484 at 496 (H.C.J.).

For retail investors, there is weakness in isolation. Does it follow that there is strength in numbers? The rules of civil procedure allow multiple plaintiffs to join together in an action where their claims involve common issues of fact and law.[54] The joining together of a large number of claims has a number of advantages. It poses a more substantial risk in absolute dollar terms to the defendants. It will be more economically feasible to litigate. It also may be that sheer numbers give some credibility to a claim which an isolated investor may not have.

Although there is strength in numbers the usual rules of procedure relating to joinder of plaintiffs are inadequate for prospectus based lawsuits. Difficulties in communication are an obvious impediment. It will be difficult to locate potential plaintiffs[55] and secure their agreement to join. All this must be done within the restrictive limitation period imposed by the Securities Act. Persons willing to join may recant when informed that being a named plaintiff creates personal exposure to liability for costs. Institutions may prefer anonymity. Further, an institutional investor may see itself as potentially carrying a disproportionate burden of the litigation as smaller investors lose interest or are unable to contribute funds to its prosecution. If litigation is started with dozens or hundreds of named plaintiffs, a logistic nightmare may result. The Statement of Claim will need to allege the facts material to each plaintiff. Each plaintiff will have to file an Affidavit of Documents. Each will need to appear for discovery. The combination of these factors may prevent a lawsuit under the regular joinder rules from reaching the stage where it achieves the critical mass where it must be taken seriously by defendants or where it can proceed to trial if settlement does not occur.[56]

Given the virtual impossibility of lawsuits by isolated plaintiffs and the impracticability of joinder of multiple plaintiffs, if there is to be any effective recourse under section 130 some other procedure to bring together numerous claims is necessary. One possibility would be for the *Securities Act* to incorporate a provision allowing the O.S.C. to bring a civil action on behalf of purchasers for damages suffered as a result of a misrepresentation.[57] However, that course has not been followed and the role of the O.S.C. is restricted to its ability to prosecute or take administrative sanctions.[58] In the absence of a tailor-

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[54] Ontario, *Rules of Civil Procedure*, r. 5.02.

[55] Some disgruntled investors take out advertisements to attempt to rally support. See, for example, "Notice to Public Security Holders of Royal Trustco Limited" *Globe & Mail* (19 April 1993) B2.

[56] An alternative to joinder might be a "test case" or "test cases" as occurred in the Mississauga rail disaster, *Canadian Systems Group (EST) Ltd.* v. *Allendale Mutual Insurance* (1982), 137 D.L.R. (3d) 287 (H.C.J.), aff'd 41 O.R. (2d) 135 (Div. Ct.). This presumes, however, that multiple plaintiffs will commence actions and the question then becomes how to deal logistically with multiple actions.

[57] In the insider trading context, under section 135 the O.S.C. does have the power to apply for leave to commence an action on behalf of the issuer involved.

[58] It might be noted, however, that the potential threat of administrative sanctions may encourage market participants to "voluntarily" make compensation to persons allegedly injured by such conduct. The best example of this phenomenon is the payment of $18

made procedure in the *Securities Act* some more general procedure is needed. This has now been created by the *Class Proceedings Act.*

(b) *Availability, Certification and Prosecution*

The new *Class Proceedings Act* creates a code governing the commencement and conduct of class actions. It supersedes the rather terse wording of Rule 12.01 of the *Rules of Civil Procedure* which, in words taken from a 19th century English predecessor, had simply stated that where numerous persons had the same interest one of them might bring a proceeding on behalf of or for the benefit of all. The provision was entirely deficient for anything other than the simplest of situations where there was a total identity of interests among persons on whose behalf the action was commenced. The *Rules of Civil Procedure* contained little or no guidance in many practice areas such as how notice was to be communicated to class members on whose behalf a representative action had been commenced, how documentary and oral discovery was to proceed, how costs were to be dealt with and how settlement was to be effected. The Supreme Court of Canada in *Naken* v. *General Motors*[59] held that the predecessor to Rule 12[60] given its multiple frailties, could not safely be the basis for any class action, save where parties having an identity of interest were claiming against a common fund.[61] As a result, prior to the *Class Proceedings Act*, it would have been uncertain as to whether a class action for misrepresentation in a prospectus would have been available.[62] Even if such a claim was permitted the uncertainties involved in the procedures to be employed would have resulted in multiple procedural motions had one attempted to do so. Representative plaintiffs would have been ground down in interlocutory proceedings.

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million into a compensation fund in the context of an administrative hearing relating to alleged insider trading in the shares of Laidlaw Inc.; O.S.C. Annual Report 1993 at 19. Further, it is possible to argue that the power of the O.S.C. to bring an application as a complainant under section 248 of the *Business Corporations Act* allows the O.S.C. to bring a civil action under that section where the oppressive actions of an Ontario incorporated offering corporation involve misrepresentations in a prospectus. In *Tsui* v. *International Capital Corp.*, [1993] 4 W.W.R. 613 (Sask. Q.B.) aff'd [1993] 4 W.W.R. lxvii (note), a failure to meet representations in a private placement offering memorandum was one of the factors relied upon in holding conduct to be oppressive. The only reported case in which the O.S.C. has brought an oppression remedy action is *O.S.C.* v. *McLaughlin* (1987), 11 O.S.C.B. 442 (H.C.J.). That litigation has dragged on for so long and been so expensive that one might question the O.S.C.'s appetite for additional representative actions.

[59] [1983] 1 S.C.R. 72.

[60] The Supreme Court considered Rule 75 under the old *Rules of Practice*. Rule 75 is the same as Rule 12.

[61] An example where Rule 12 was usefully utilised was employee pension surplus actions.

[62] *Sherman* v. *Drabinsky* (1990), 74 O.R. (2d) 596 (H.C.J.), where, however, the claim was on a common law basis and where a material element in the court's refusal to allow a based claim class action was that reliance (which need not be shown in a statutory action) would vary from one individual to the next. For a English attempt, see *Prudential Assurance Co.* v. *Newman Industries Ltd. (No.1)*, [1979] 3 All E.R. 507, *Prudential Assurance Co. Ltd.* v. *Newman Industries Ltd. (No.2)*, [1980] 2 All E.R. 841 rev'd in part,

The *Class Proceedings Act* substantially expands upon the circumstances in which class actions are available and stipulates procedures to be employed in the conduct of such actions. It adjusts the balance between plaintiffs and defendants in mass injury litigation in order to facilitate the practical prosecution of such claims. A member of a class may commence a proceeding on behalf of the members.[63] A motion is then brought to the Court for certification of the class proceeding after defences have been filed. The Court certifies the class proceedings provided that a cause of action is shown on the pleadings, common issues exist as among members of the class and a class proceeding is the preferable procedure for the resolution of these common issues.[64] The narrow strictures of the old Rule 12 are done away with. The representative plaintiff must be capable of fairly representing the class, be free from conflicts with other members on common issues and have a workable plan for notifying[65] the class and proceeding with the action. Provision is made for common adjudication of common issues and individual adjudication of issues individual to individual class members should such issues arise in the action. Notice is to be provided to class members and class members have the opportunity to "opt out" of the class proceeding should they wish to do so.[66]

The class on whose behalf an action under section 130 of the *Securities Act* would be launched would be those persons who purchased the securities offered under the prospectus during the distribution period.[67] There will be a number

[1982] 1 E.R. 354 (C.A.). In the *Prudential Assurance case*, the two court motions plus one appeal with respect to the propriety of the pleading and a horribly botched-up preliminary hearing as to whether a derivative claim should be allowed to proceed took *128* days of court time which must be a record of some sort. The most recent Canadian case is *Korte* v. *Deloitte Haskins Sells* (1993), 15 C.P.C. (3d) 109 (Alta C.A.) leave to appeal refused (1993), 18 C.P.C. (3d) 48 (class action allowed to proceed as it was not clear reliance needed to be shown, no discussion of procedural quagmire resulting).

[63] S. 2(1).

[64] S. 5. The reported cases considering this section as at writing are unexceptional. In *Abdool* v. *Anaheim Management Ltd.* (1993), 15 O.R. (3d) 39 (Ont. Gen. Div.) certification was refused given that the claim was for common law misrepresentation and individual reliance therefore needed to be shown.

[65] Under section 17, the Court determines the actual method of notification. In the typical situation, the defendants may have better knowledge of the potential class members than does the representative plaintiff. It may make sense to order the defendants to divulge that information for the purpose of notification. The costs associated with notice may be very significant and may be a substantial impediment to a class action. With a large class, the cost may amount to thousands of dollars depending on the form of notice required. Block & Warren, *supra* footnote 8 at 459.

[66] The fact that members "opt out" as opposed to "opt in" is of importance. Many investors who have financially or psychologically written off an investment might not take positive steps to "opt in" but may very well be content to stay in if they are automatically included. For the bashful institutional investor, the procedure also allows it to distance itself from litigation while receiving its benefits. As a practical matter, as class members are not personally liable for costs the only monetary reason to "opt out" is if the member feels it can do a better job recovering its loss by itself than could the class on its behalf.

[67] With the caveat that an argument may exist that open market purchasers of such securities during the distribution period cannot make claims pursuant to Section. 130. See Gresham, *supra* footnote 28.

of common issues between the members of the class. The common issues will include:

(a) whether a misrepresentation occurred;

(b) whether a "due diligence" defence is available to all or any of the defendants;

(c) in a damages action, any defence by the defendants that the depreciation in value of the security was not due to the misrepresentation but due to other factors.

The "deemed reliance" provision in section 130 is of very substantial assistance in a class action as the Court will not need to enter into an inquiry as to whether any particular class member read the prospectus or relied upon the misrepresentation. This will simply not be an issue in the litigation, unlike a common law action for misrepresentation.

There may be some instances where the creation of sub-classes may be necessary. One example where this may occur is where the distribution has occurred nationally and where the class members who purchased in other provinces will have their claims governed by the laws of those provinces. Although the civil remedy provisions for prospectus misrepresentation are highly uniform across the country[68] it is still true that different statutes will apply to different class members depending upon the jurisdiction of their transaction. However, the similarity in the substantive content of the provincial laws and the absence of any conflict of interest between the sub-classes should permit all such sub-classes, if created, to be represented by the same counsel. To the extent issues arise out of the individual provincial securities Acts, these could be the subject of legal submissions on the basis of evidence common to all sub-classes.[69]

Individual issues will also arise. In a few cases, there may be an allegation that individual class members knew of the misrepresentation at the time of purchase.

[68] The provisions in Alberta, British Columbia, Saskatchewan, Newfoundland, Nova Scotia and Price Edward Island are virtually identical. *Securities Act*, S.A. 1981 c.S-6-1, s. 168, *Securities Act*, S.B.C. 1985, c.83, s. 114, *Securities Act*, S. Nfld. 1990, c.48, s. 130, *Securities Act*, R.S.N.S. 1989, c.418, s. 137, *Securities Act*, R.S.P.E.I., c.5-3, s. 16, *Securities Act*, S.S. 1988, c. S-42.2, s. 137. There are slight variations in Quebec and Manitoba. *Securities Act*, R,S.Q. c. V-1.1 s. 217, *Securities Act*, R.S.M. 1988, c.550, s.65 and s.141. New Brunswick has no equivalent provision to section 130. *Security Fraud Prevention Act*, R.S.N.B. 1973, c.5-6.

[69] The discussion pre-supposes that an Ontario Court would permit non-Ontario residents to have their claims advanced in an Ontario class action. There are no specific provisions in the *Class Proceedings Act* dealing with extra-Ontario factors. Presumably, the normal jurisdictional and stay rules would be applied with whatever modifications are appropriate. Under *Amchem Products Inc.* v. *British Columbia (Workers Compensation Board)*, [1993] 1 S.C.R. 897, 102 D.L.R. (4th) 96, it may be possible for defendants to argue that they should not be subject in Ontario to claims arising out of non-Ontario transactions if this amounts to "forum shopping". Conversely, there is a good deal of practical sense in allowing claims arising out of non-Ontario transactions to be brought in conjunction with claims arising out of Ontario transactions. See generally Walsh, Comment (1994), 73 Can. Bar. Rev. 394. Litigation involving transactions in several provinces was allowed to proceed by way of class action in *Korte* v. *Deloitte Haskins Sells supra* footnote 62 and in *Millgate Financial Corporation Limited* v. *B.F. Realty et al*, [1994] O.J. No. 1968 (QL).

An allegation that an individual member knew[70] of the misrepresentation more than six months prior to the commencement of the action would also raise an individual issue. This allegation may be raised, for instance, where the corporation has after the prospectus disseminated to the public information by way of press release or otherwise which either corrected or supplemented information in the prospectus. Remedies will also raise individual issues. The number of securities purchased will vary among members. Some members may be best served by receiving rescission. Other members may have crystallised their losses by reselling either before or after the misrepresentation became generally known.[71] However, at the end of the day it is likely that many of the individual issues relating to rescission and damages will be fairly straightforward and may involve little more than arithmetic.

Although a class action under section 130 would give rise to a mixture of common issues and individual issues, common issues would be at the heart of the claim. It makes eminent sense to deal with such common issues in a common proceeding first. The *Class Proceedings Act* provides for such a procedure.[72] Presumably, defendants in order to discourage plaintiffs from proceeding will have an interest in delaying litigation and increasing the costs of litigation and to that extent, will have an incentive to complicate the class action by lengthening the pre-trial process. If discovery of individual class members in the class action was allowed, the litigation would be bogged down by examinations for discovery of individual class members. The practical reality is that individual class members will have little or no information on the common issues which are at the heart of the class action. It is to be expected, therefore, that the courts will exercise their discretion[73] to refuse discovery of individual members on common issues.

If a representative plaintiff is successful at trial on the common issues, notice to individual class members must be given.[74] Determination of individual

[70] The Act is not clear as to whether "knowledge" is subjective or whether it includes deemed or, "ought to have known" knowledge. If it includes deemed knowledge, a knowledge defence may raise a common issue or a mixture of individual and common issues.

[71] Those who have sold would likely, under the normal common-law rules, be precluded from claiming rescission and would be restricted to damages. The result under the *Securities Act* may well be the same but there is at least an argument that the statute somehow allows a rescission right after sale. Section 137, dealing with purchases from a dealer as principal in a non-prospectus context, provides that rescission is only available if the purchaser still owns the security. In contrast, section 130 is silent on the requirement that the security still be owned. It is arguable the omission in section 130 results in there being no requirement of ownership. If rescission is available under section 130 after a sale by a plaintiff, presumably a successful plaintiff would have to go back into the market after trial and buy securities to fulfil its obligation to re-convey on rescission being granted. If the rescission right somehow continues to exist notwithstanding a sale this would be another significant advantage which a statutory action has over a common-law action as it would avoid a damage calculation. Indeed, it might result in a windfall as the recovery to a purchaser may be greater than its actual damages.

[72] Ss.11, 18, 25.

[73] Section15(3) contains a list of factors the court can consider in granting leave to discover class members.

[74] S.18.

issues follows. To the extent that the defendants claim some or all of the class members can not recover as they had actual knowledge of the misrepresentation at the time of purchase or more than six months prior to the lawsuit being commenced, individual proceedings to determine the state of individual knowledge may be necessary.[75] If no such issues arise, the only individual issues will relate to the monetary relief to which the individuals are entitled. The court in its determination of common issues will have determined the extent to which the depreciation in the value of the securities was the result of the misrepresentation. This common determination may in many instances set different levels of recoverable loss for different time periods following the issue. The damages of individual class members will involve an application of this common determination to their particular circumstances. This, in turn, will depend on what individual class members did by way of selling or holding the securities in question. It is unlikely that there would be any serious factual dispute about these issues. Formal mini-trials involving each member would not appear to be necessary. It may well be sufficient for members to submit claims to a claims officer for initial approval much as claims are submitted in a bankruptcy or CCAA proceeding.[76] To the extent that any dispute arises with respect to any individual claim it should be easily disposed of in a summary fashion. The largely mechanical nature of the quantification of individual damages following a determination of the common issues in many ways highlights why class actions are so ideally suited for this type of action.

(c) *Joinder with Other Claims*

In some circumstances, a representative plaintiff may wish to join a section 130 claim with other claims. It may be felt that joinder of other claims would allow separate avenues of recovery or contribute to the strength of the section 130 claim.

Examples include:

(i) claims for common law misrepresentations relating to open market purchases made in reliance upon the representations contained in a prospectus;[77]

(ii) claims for auditor's negligence. Under section 130, auditors will not be liable for misrepresentation in the financial statements as incorporated in a prospectus unless they failed to conduct reasonable investigations or believed there had been a misrepresentation. Arguably, this is not as wide as common law negligence.

[75] If the knowledge question for limitation purposes is what "ought to have been known", it is possible that this issue will have been resolved as part of the common issues.

[76] This procedure is specifically contemplated in section 24(6) in the context of an aggregate assessment of claims. An aggregate assessment would be possible for rescission claims. For damage claims individual calculations may be necessary.

[77] In *Al-Nakib Investment Jersey Ltd.* v. *Longcroft*, [1990] 1 W.L.R. 1390 (Ch. Div.) it was held the duty owed with respect to prospectus misrepresentations only extended to those purchasing under the prospectus and not to open market purchasers. A similar result was reached in *Montreal Trust Co. of Canada* v. *Scotia McLeod Inc.*, [1994] O.J. No. 1970 (QL).

A negligent error of opinion may not, for instance, fall within the section 130 criteria;[78]

(iii) common law claims based on other corporate misrepresentations, such as those contained in press releases or financial statements;

(iv) claims based on abusive transactions which reduced the value of the securities;[79]

(v) claims related to improper market manipulation.[80]

Normally, a plaintiff is allowed to join in one proceeding any claims it has against a defendant.[81] However, in a class action proceeding joinder poses difficulties. Common law claims may be less appropriate than a section 130 claim for class adjudication as they may involve more issues which must be determined on an individual basis. An obvious example is that under the current law individual reliance is necessary to found a claim for common law misrepresentation. Further the class affected by one type of misconduct may differ from that affected by another given that the shareholder composition will change with normal market trading. Different representative plaintiffs for the different classes may be necessary. Separate counsel for different classes may be necessary. Even if class procedures are the preferable procedure for determining the common issues, any attempt to join such a claim with a section 130 claim will no doubt result in vigorous opposition by defendants at the certification hearing. Any plaintiff considering such joinder might seriously consider whether the attempt is worthwhile.

(d) *Practical Restraints*

(i) Costs

It is likely that the most significant practical restraint to class actions will be costs. Two difficulties arise. The first difficulty relates to funding the expenses of litigation. The second relates to the potential personal liability of the representative plaintiff for costs in the event that the action is unsuccessful. Although both difficulties have to some extent been addressed in the legislation, it can reasonably be expected that cost issues will remain a serious practical impediment. Indeed, the extent of the impediment is such that it may be questionable whether class actions which have a small investor as a representative

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[78] As a possible example, the Federal Superintendent of Financial Institutions was quoted in the *Globe & Mail* (16 March 1993) as stating that prior to its insolvency, he had told one financial holding company that its carrying of goodwill as an asset on its balance sheet was "crazy accounting" and that amortizing that goodwill over forty years was "nuts". If a plaintiff commenced an action against auditors in relation to such an accounting practice, it may be that no liability could be found under section 130. However, a normal negligence claim would raise questions as to whether the auditors' opinion was or was not negligent.

[79] *Millgate Financial Corporation Limited* v. *B.F. Realty et al*, *supra* footnote 69.

[80] E.g. *Globe and Mail* (17 December 1993) B1 relating to manipulation in share trading of Lawson Mardon in advance of a public financing by prospectus.

[81] *Supra* footnote 54.

plaintiff are practical. It may be more likely that the class action procedure will, because of cost constraints, be used by large investors who are willing to fund litigation and who use the class action procedure to advance claims on their own behalf and on behalf of other investors thus multiplying the amount in issue beyond their individual claim.[82]

The potential expense of securities class action litigation is evident. Frequently, there will be doubts as to whether the issuer will be able to pay any judgment received. Other parties will therefore be added. There will be complex factual and legal issues. There will be an immediate requirement for a motion to certify the class. Significant costs may be associated with providing notice to class members. Thousands of documents will be produced by the defendants and weeks (if not months) will be spent on documentary and oral discovery. Expert opinions will be required given the issues raised in the litigation such as the quality of financial information, the reasonableness of investigations conducted, the materiality of any untrue statement, and damages. It can reasonably be anticipated that the costs prior to trial will run into the several hundreds of thousands of dollars.[83]

It can also reasonably be expected that, in most instances, the legal costs of the defendants will be a number of times greater than that of the plaintiffs. Multiple defendants will attract multiple counsel. A representative plaintiff will potentially be liable for party and party costs which could easily run into the hundreds of thousands of dollars. There is at least some risk that a representative plaintiff if it does not have a large personal financial interest in the litigation, may have an order for security for costs made against it.[84] This would stop the class action in its tracks.[85]

The legislation has a number of provisions which are designed to alleviate, to some extent, the practical impediment posed to class actions by costs. First,

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[82] This may have been the case in *Prudential Assurance*, *supra* footnote 62.

[83] In *Canadian Express Ltd.* v. *Blair* (1992), 8 O.R. (3d) 769 (H.C.) the party and party costs bill submitted (but not approved) for an eight day hearing was something in excess of $300,000 which would indicate the solicitor and client fees were in the range of $600,000. In a recent valuation case, *New Quebec Raglan Mines Ltd.* v. *Blok-Andersen* (1993), 9 B.L.R. (2d) 132 (Ont.Gen.Div.), the costs of the dissenters totalled $902,000 after a trial of about seven days. The costs in a complex civil proceeding *C.D.I.C.* v. *C.C.B.* (1992), 97 D.L.R. (4th) 385 (S.C.C.) are estimated at over $5 million, in Crawford and Campbell, "The Use of Participation Agreements in Bank Rescues" (1993) 9 B.F.L.R. 45 at 58.

[84] On the theory that it is a "nominal plaintiff" see Rule 56.01(d). It may well be that as the representative plaintiff has a personal claim, it is not a nominal plaintiff and security should not be ordered on that basis. One might also refer to the change in wording from the old Rule 373. However, in the no stone unturned approach of modern litigation, there is little doubt that such motions would be brought. Rule 56.09 may also be available to a defendant. Defendants opposing a class certification order may argue that a term of any such certification order should be an order under Rule 56.09 for the posting of security for costs.

[85] The Court may refuse an order for security for costs if such an order would deprive an "impecunious" plaintiff of its ability to prosecute an action. In determining whether a representative plaintiff is impecunious regard may be had to the ability to raise funds from the class: *Kurzela* v. *526442 Ontario Limited* (1988), 66 O.R. (2d) 446 (Div. Ct.).

the *Law Society Class Proceeding Funding Act* (the "*Class Proceeding Funding Act*")[86] sets up an initial fund of $300,000, to be later supplemented, from which monies may be used to assist class action plaintiffs in the payment of disbursements.[87] Class action plaintiffs have no right to funding for disbursements. Funding is in the discretion of the Committee which administers the Fund.[88] A term of any funding assistance is that the Fund be repaid its funding out of any settlement proceeds. Additionally, a 10% levy on Fund-assisted proceeds is imposed. This levy is designed to fund future Fund activities. Assistance with respect to the disbursements may provide relief to representative plaintiffs, particularly to the extent the litigation requires expert fees.[89] However, given the small initial size of the Fund, the demands likely to be made upon the Fund and the costs of litigation, it is problematic as to how much assistance will be available to be given to any one class action. Even an award of $30,000 or 10% of the total initial Fund size to help fund disbursements would not go very far in the modern world of commercial litigation.

In regards to potential liability for the defendants' costs the *Class Proceeding Act* does not change the usual rule that an unsuccessful plaintiff is prima facie liable for the defendants' costs.[90] Arguably, some additional discretion is given to the courts with respect to the factors which may be considered in relation to the award of costs[91] but any change if it exists, is slight. However, the Class *Proceeding Funding Act* does contain a section which, if applicable, allows representative plaintiffs a complete immunity from any award against them of party and party costs. Section 59.4 provides that if the plaintiff has received financial support from the Fund, a successful defendant has no right to claim party and party costs against the plaintiff. A successful defendant claims its costs from the Fund. As a practical matter, unless a representative plaintiff of modest means is willing to risk insolvency[92] for the sake of a class action, it is likely that the only instances where such a person will continue a class action is where class proceeding funding is received. It is only then that the representative plaintiff can secure immunity from a personal order of costs. It follows that in many cases, the funding application may very well determine whether a class action by a representative of modest means proceeds. If no funding (and hence, no immunity from costs) is received that may be an end to the action.[93]

[86] S.O. 1992, c. 7.

[87] Reg. 771/92 contains a code for applying for class action funding. See also professional practice notice at (1993) 4 W.D.C.P (2d) 75.

[88] Reg. 771/92, section 4.

[89] Expert fees must be specifically approved, Reg 771/92, section 3.

[90] See Fox, *New Class Proceedings Legislation* (Mississauga: Insight Press, 1991), c. 12.

[91] Under section 31 the Court can consider whether the action was a test case, raised a novel point of law or involved a matter of public interest.

[92] E.g., possibly a corporation with few assets. Conversely, having such a person as a representative plaintiff would increase the risk of security for costs being ordered.

[93] In *Elliott* v. *C.B.C.* (1994), 24 C.P.C. (3d) 143 at 169 (Ont. Gen. Div.), a cost decision following an unsuccessful attempt at a class action libel suit, the cost award in favour of the successful defendants totalled $95,000.

It is to be expected that the Committee making a decision with respect to funding would be very wary to fund a section 130 action given the potential of extremely significant liability to the Fund for the defendant's costs. One unsuccessful class action might entirely deplete the Fund. Given that much of the evidence necessary to evaluate the merits of the claim will not be in the plaintiff's possession at the time an action is instituted[94] it will be difficult for the Committee to form a definite initial opinion as to the merits of the lawsuit.[95] It will therefore be difficult for the Committee to estimate what risk funding might pose to the Fund. Further, there will normally be at least some members of the class who have the means to contribute to funding section 130 litigation.[96] Why should the Fund support litigation if the members who are able to do so, won't? Every dollar directed to such a section 130 action is a dollar unavailable for other types of actions, many of which may involve cases where none of the members can realistically be expected to contribute to an action's costs. As well, the simple fact is that a claim based on section 130 may not have the same social cachet as an environmental or product liability claim. One can question, therefore whether a class proceeding funding will ever be available for any action under section 130 of the *Securities Act.*

The legislation does not provide assistance for funding the solicitor fees of a representative plaintiff. The litigation will therefore have to be carried by the plaintiff's solicitors or a deep pocketed representative plaintiff will have to be found.[97] In order to provide some incentive for the commencement of class actions, the *Class Proceedings Act* does provide some encouragement to solicitors to carry class actions. If the plaintiff's solicitors agree that they will only be paid in the event of success, the court has the power to award the solicitors a multiplier of their normal fees.[98] The multiplier is compensation for the risk incurred. There are no guidelines under the *Class Proceedings Act* as to what the multiplier should be. Presumably, it will depend on the court's view of the risk undertaken and the benefit to the class from the solicitors taking the risk to prosecute the action. Given the virtual certainty of vigourous defences to prospectus based actions and their novelty, the risk to a firm of solicitors in taking such a class action may be very considerable indeed. Whether the possible benefit outweighs the risk involved will presumably be a business

[94] E.g. what steps were taken by way of "due diligence".

[95] This is one of the factors to be considered by the Committee making the funding decision, section 59.3(4)(a).

[96] One of the factors to be taken into account by the Committee is whether the plaintiff has made reasonable efforts to raise funds from other sources, section 59.3(4)(c).

[97] In some cases there may be some possibility that a court would order interim costs to be paid to the representative plaintiff. If a claim was made under the "oppression remedy" provision specific statutory jurisdiction would exist to make such an order e.g. *Alles* v. *Maurice* (1992), 5 B.L.R. (2d) 146 (Ont. Gen. Div.). There may as well be an inherent discretion *Wallersteiner* v. *Moir* (No. 2), [1975] 1 All E.R. 849 (C.A.), *Reay* v. *Landcorp Ontario Ltd.*, [1993] O.J. No. 883 (QL).

[98] *Class Proceedings Act*, s. 33. The provisions are modelled after developments in certain states in the United States. See O'Sullivan at c. 12 of *New Class Proceedings Legislation supra* footnote 90 for a full discussion.

decision for the solicitors involved. Compared to the United States, however, the lure will be less strong given the differences in substantive law and in procedures.[99]

(ii) Pleading Requirements

The rules of pleading in Ontario require a plaintiff to plead the material facts on which its claim is based. The pleadings in turn govern the scope of the proceedings. They determine the scope of documentary and oral discovery and what evidence is relevant at trial. It follows that a statement of claim claiming relief under section 130 must contain the material facts setting out the misrepresentation or misrepresentations complained of. In addition to pleading material facts, common law actions for misrepresentation are specified in the rules[100] as requiring the pleading of "full particulars". Particulars are further details of the claim necessary to tell the defendants the case they have to meet. By analogy, such a requirement of full particulars might well extend to a section 130 action.

The Ontario practice differs significantly from the practice in the United States. In the United States, "notice pleading" is sufficient.[101] The distinction between the American and Canadian practice may best be illustrated by example. Under U.S. notice pleading it would be sufficient to allege that the financial information in the prospectus was misleading. This would not be permissible under Ontario rules if full particulars are in fact required. One would need to plead which specific information was misleading and how it was misleading. In simple terms, the U.S. procedure sanctions fishing expeditions while under Ontario procedure the plaintiff before it commences an action must have some significant knowledge of misrepresentations in order to frame its claim.[102] If a

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[99] As discussed above.

[100] Rule 25.06(8) Ontario, Rules of Civil Procedure, r. 25.06.

[101] *New Battles in the "Class Struggle"*, *supra* footnote 7 at 45. However, under Federal Civil Procedure Rule 9(b) particulars are required of allegations of fraud. Complaints under section 11 and 2(2) of the 1933 *Securities Act* are not fraud complaints and do not require particulars. *Shapiro* v. *UJB Financial Corp.*, 964 F. 2d 272 (3d Cir. 1992). As a practical matter, fraud claims are often joined with claims under these statutory provisions and complaints frequently contain lengthy recitals of particulars.

[102] This rule of pleading produces some unusual results. For instance, conspiracy is an action which must be plead with great particularity. A precise account of each defendants allegedly conspirational acts must be plead: *Pindoff Records Sales* v. *CBS Music Products* (1989), 44 C.P.C. (2d) 308 (Ont. Gen. Div) and *Key Property Management (1986) Inc.* v. *Middlesex Condominium Corp. No. 134* (1991), 50 C.P.C. (2d) 255 (Ont. Gen. Div.). One might think that the hallmark of a successful conspiracy is that a plaintiff would] not know the particulars of the defendant's conduct and that the pleading rule therefore acts to exclude precisely those persons who might have valid claims. However, the rule requiring particularity in certain actions is best seen as being grounded in a policy which is designed to discourage marginal lawsuits. The rule, although possibly harsh in some circumstances, acts as a filter to screen out claims which on average have a very low likelihood of success.

plaintiff does not have enough knowledge to formulate a claim properly, the claim will be struck out. The plaintiff will therefore not get to the discovery process which might have allowed it to discover what misrepresentations actually occurred.[103] The relative precision required by the Ontario rules of pleading has some potential for unfairness in light of the relatively short limitation provisions in the Act as the facts necessary to support a claim in the detail required by the pleading rules must come to light within the limitation period.[104]

IV. Conclusion

The new *Class Proceedings Act* is a bold attempt to create a set of procedures which will make it practical for numerous claims involving common issues to be prosecuted in a single action. A statutory action based on a prospectus misrepresentation is an ideal candidate for a class proceeding. The vital issues in such litigation will be common to all purchasers of securities. If the claims of all purchasers can be adjudicated together large sums of money will be involved. The amounts involved will justify the costs. Class proceedings thus create the possibility of recovery for injured small investors when none for practical purposes existed under previous procedures. Real risk of civil liability for misrepresentations might, on one theory of how the securities market works, be expected to result in better compliance with the requirement of "full, true and plain disclosure" under the *Securities Act*, to the benefit of investors as a whole. However, it is uncertain whether the promise held out by class proceedings will be realized. Significant practical restraints will impede the effectiveness of the procedure. Effective application of class proceedings to section 130 actions may very well depend upon the availability of funding from the Class Proceeding Fund. Whether such funding will be available is entirely uncertain.

The uncertainty as to the practical effectiveness of the *Class Proceedings Act* is, of course, not limited to actions based for prospectus misrepresentation. It applies to all actions for mass injuries. The *Class Proceedings Act* makes such proceedings more feasible than they were before. Whether it goes far enough to redress the practical difficulties faced by plaintiffs remains to be seen. For many years, section 130 has been feared by the legal and investment communities. Only time will tell whether the *Class Proceedings Act* has finally given it real teeth.

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[103] In the United States, discovery is also frequently available in advance of a motion to dismiss on a pleadings basis. This allows a plaintiff information to correct any deficiencies in its pleading. Savett, *Trial and Preparation of a Securities Class Action Fraud Case* (Ottawa: Canadian Institute, 1992).

[104] It is, however, likely that a plaintiff could amend the pleading at some later stage if an action is commenced prior to the limitation period and further information on additional misrepresentations is discovered after the limitation period.