FARRIS

Corporate News Bulletin

ONTARIO CIVIL LIABILITY

Preparing for Ontario's New Civil Liability Laws

On December 31, 2005, new laws will come into force in Ontario that will give investors the right to sue public companies, their directors and officers, and others when there is a misrepresentation in a publicly disclosed document or a public oral statement, or when there is a failure to make timely disclosure of material changes in the affairs of a company. Those associated with public companies will need to ensure proper measures are taken to protect their company and themselves from this new risk.

Background

The Government of Ontario has proclaimed significant amendments to its *Securities Act* that will come into force on December 31, 2005. The *Securities Act* has long provided a right for investors to sue companies and individuals for misrepresentations in a prospectus, offering memorandum or take-over bid circular. As a result of the amendments to the *Securities Act*, investors who buy and sell securities of a public company through a stock exchange or other secondary market will now be provided a similar right to sue for misrepresentations in a company's public disclosures. These rights will apply in respect of public companies that are a "reporting issuer" in Ontario, or other public companies with a real and substantial connection to Ontario. It is expected that these new rights will most often be exercised through class action lawsuits.

What You Can be Sued For

The new laws create three ways for investors to sue:
Where Documents Released by a Company Contain a Misrepresentation – From the time that a company publicly releases a document that contains a misrepresentation , an investor who trades in the company's securities before the misrepresentation is corrected will have the right to sue.

Those at risk of being sued include the company itself, directors, and officers, influential persons (an insider, a controlling shareholder or a promoter) and experts involved in the release of the document. A "document" includes documents filed with the Ontario Securities Commission, a stock exchange or a government agency, or any other written communication which would reasonably be expected to affect the market price or value of the securities of the company. A "document" can include postings to a company's website.

September, 2005

Farris, Vaughan, Wills & Murphy LLP
Barristers and Solicitors
PO Box 10026,
Pacific Centre South
25th Floor, 700 West Georgia St.
Vancouver, BC V7Y 1B3
Telephone: (604) 684-9151
Facsimile: (604) 661-9349
Email: info@farris.com

A member of Lex Mundi, the World's Leading Association of Independent LawFirms

By Trevor Scott and Catherine Anderson

Where Public Oral Statements Contain a Misrepresentation – If a person who speaks on behalf of a company makes a public oral statement about the company that contains a misrepresentation, then any investor who traded the company's securities in the period before the misrepresentation was corrected has the right to sue. Each of the company itself, the person who made the public statement (e.g. investor relations personnel), and directors, officers, influential persons and experts who were involved in the making of the statement are all at risk of being sued. Public oral statements can include statements made at a shareholders' meeting or on an analyst call.

Failure to Make Timely Disclosure of a Material Change – Where a company fails to make timely disclosure of material changes in its affairs, any investor who trades in the company's securities before the change is disclosed has the right to sue. Each of the company, and directors, officers and influential persons who were involved in the failure to disclose may be sued.

How Much You Can be Sued For

The amount an investor is entitled to in a successful lawsuit is based upon the effect the disclosure violation had on the market price for the security. However, no amount will be included to the extent that a defendant proves the change in the market price is unrelated to the disclosure violation.

Where multiple defendants are held liable in the lawsuit, each defendant is liable only in proportion to its relative responsibility. However, defendants (other than the company) who authorized, permitted or acquiesced in the disclosure violation may be liable for the full amount of the lawsuit, jointly and severally. A defendant's liability is also subject to certain limits:

Company – liability may not exceed the greater of $1 million and 5% of its market capitalization.

Individual – liability is limited to the greater of $25,000 and 50% of his or her total compensation from the company and its affiliates during the preceding 12 months (including the value of any options, pension benefits and stock appreciation rights granted during that period).

Expert - liability is limited to the greater of $1 million and the fees earned by the expert from the company and its affiliates during the preceding 12 months.

These limits do not apply to a defendant (other than the company) that authorized, permitted or acquiesced in the disclosure violation.

What Defences You have if Sued

Defendants will have several defences to a lawsuit, including:

Reasonable Investigation Defence – Defendants will not be liable if they prove that they:

- conducted or caused to be conducted a "reasonable investigation"; and

- had no reasonable grounds to believe that the document or oral public statement contained a misrepresentation, or that timely disclosure would not be made.

In determining whether an investigation was reasonable, the court must consider certain factors, including the existence of a system designed to ensure the company meets its continuous disclosure obligations and the reasonableness of the reliance by a defendant on that disclosure compliance system. A written disclosure policy will be essential for every company to rely on this defence.

Where Corrective Action Taken – A defendant (other than the company) is not liable if the disclosure violation was made without the knowledge or consent of the defendant, and if after the defendant became aware of the disclosure violation, the defendant notified the board of directors of the company of the disclosure violation. If no correction is made by the company within two business days, the defendant must notify the Ontario Securities Commission of the disclosure violation.

Forward Looking Information - There will be no liability for forward-looking information if:

- it contains reasonable cautionary language identifying the forward looking information;
- it identifies the material factors that could cause actual results to differ materially from the forecast or projection;
- it states the material factors or assumptions that were applied in making the forecast or projection; and
- there is a reasonable basis for making the forecast or projection.

Reasonable Reliance on Experts - There is no liability for non-experts for any document that includes, summarizes or quotes from a report, statement or opinion made by an expert who gave consent to the use of it, provided the defendant did not know, and had no reasonable grounds to believe, that there had been a misrepresentation made on the authority of the expert, and the report, statement or opinion made by the expert is fairly represented.

Procedural Safeguards

In the United States, there has been a history of class actions being brought against public companies in the hope that the companies will agree to an early settlement. These "strike suits" are often initiated immediately following any sudden drop in the trading price of a company's securities.

The new laws contain procedural safeguards designed to prevent strike suits. First, leave to proceed must be obtained from the court in order to commence a lawsuit. The court will only grant leave if it is satisfied that the action is being brought in good faith, and there is a reasonable possibility that the plaintiff will succeed at trial. Second, court approval is required before a lawsuit can be discontinued, abandoned or settled.

The new laws include a "loser pays" costs rule, which is also designed to discourage the bringing of strike suits. The new laws provide that the prevailing party in any lawsuit is entitled to costs, and the court must order costs against the losing party in any lawsuit (including any class action). In the United States, the losing party in a class action is generally not required to pay the costs of the successful party.

What You Should Do About these Changes

Directors and officers of public companies will want to review their company's disclosure practices to minimize their liability exposure under these new laws, including:

- **Ensure that your company has a formal, written disclosure policy**. At a minimum, this policy should state who is authorized to make public statements on behalf of the company, and set out the system of review and approval that is in place for documents that are released to the public. This policy may also clarify the process that the company uses to ensure public oral statements are not made by company representatives without prior vetting, or without subsequent review to ensure an absence of misrepresentations.

- **Educate those who decide when material changes will be disclosed of the new risks.** The stakes have been raised for those who decide when material changes in the affairs of a company will be disclosed – they will now be at risk of being personally liable if they do not disclose material changes on a timely basis.

- **Correct disclosure violations promptly**. When a disclosure violation is discovered, immediate steps should be taken to correct the error. Only investors who trade the company's securities while the disclosure violation exists are allowed to sue under the new laws, so prompt corrective action will minimize the number of potential investors who can sue.

- **Plan and Record Public Presentations and Oral Statements**. Public presentations and oral statements by people who speak on behalf of the company, including directors and officers, should be carefully planned. It will be important to make and retain records of public presentations and oral statements. Those responsible for corporate disclosure should review these records immediately after the public presentation or statement to identify and correct any misrepresentations.

Additional Information
If you wish to discuss any aspect of this commentary, please contact any of the following members of Farris' Securities Practice Group:

Cameron Belsher
604-661-9326
cbelsher@farris.com

Mitchell Gropper
604-661-9322
mgropper@farris.com

Dean O'Leary
604-661-9316
doleary@farris.com

Brian Canfield
604-661-9362
bcanfield@farris.com

Elizabeth Harrison, Q.C.
604-661-9367
eharrison@farris.com

Candy Saga
604-661-9339
csaga@farris.com

Herb Dodd
604-661-9352
hdodd@farris.com

Hector MacKay-Dunn, Q.C.
604-661-9307
hmackay-dunn@farris.com

Ron Murray
604-661-9306
rmurray@farris.com

Brad Newby
604-661-9308
bnewby@farris.com

Trevor Scott
604-661-1732
tscott@farris.com

David Selley
604-661-1718
dselley@farris.com

Catherine Anderson
604-661-9341
canderson@farris.com