Secondary Market Liability of Directors and Officers

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INTRODUCTION

In 2005, Ontario amended the *Securities Act*[1] to create new statutory causes of action in favour of the "secondary market" against directors, officers and others for misrepresentation and failure to comply with disclosure obligations. That is old news. More recently, Alberta[2], British Columbia[3], Manitoba[4], New Brunswick[5], Newfoundland & Labrador[6], Northwest Territories[7], Nova Scotia[8], Prince Edward Island[9], Quebec[10], Saskatchewan[11] and the Yukon[12] have enacted or are in the process of enacting virtually identical legislation.

These enactments significantly expand the prospects of liability of directors, officers and others in respect to claims by secondary market participants.

This paper will provide an overview of the new liability regime as well as some risk management suggestions for directors and officers.

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[1] R.S.O. 1990, c. S.5.
[2] In effect as of December 31, 2006.
[3] Royal asset received November 22, 2007; proclamation pending. Note that, unlike Ontario and most other jurisdictions, the British Columbia provisions do *not* require the "loser" to pay costs to the successful party. Saskatchewan is also in this camp.
[4] In effect as of January 1, 2006.
[5] Royal assent received May 30, 2007; proclamation pending.
[6] In effect as of June 1, 2007.
[7] Consultation Draft distributed for comment.
[8] In effect as of November 15, 2007.
[9] Royal assent received November 2, 2007; proclamation pending.
[10] In effect as of November 9, 2007.
[11] Expected to be in effect in early 2008. As noted above, Saskatchewan's legislation does not require "losers" to pay costs. Saskatchewan's legislation also does not contain limitation periods as set out in the Ontario and other legislation.
[12] Second reading December 2007.

EVOLUTION OF SECONDARY LIABILITY IN CANADA

In general terms, the secondary market is the open market for securities. The purchaser will have an indirect relationship with the issuer - in contrast, for instance, with the direct relationship between a purchaser and issuer in the case of a subscription under an offering. While Canadian securities legislation has long provided for liability of directors and officers to the "primary market" for misrepresentation, there was no parallel statutory regime for the benefit of the secondary market until the Ontario amendments noted above.[13]

Prior to the new legislative regime, actions for fraudulent or negligent misrepresentation in the secondary market were available only under the common law. For instance, for a claimant to bring an action for negligent misrepresentation at common law, he or she would have to establish a number of factors, including:

a) a duty of care based on a "special relationship" between the representor and the representee;

b) an untrue, inaccurate or misleading representation;

c) that the party making the misrepresentation was negligent in doing so;

d) that the plaintiff relied on the misrepresentation in a reasonable manner; and

e) that damages resulted due to the plaintiff's reliance on the misrepresentation.[14]

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[13] Legislation featuring the same provisions as Part XXIII.1 of Ontario's *Securities Act*, R.S.O. 1990, c. S.5 is currently in force in: Alberta as Part 17.01 of the *Securities Act*, R.S.A. 2000, c. S-4; in Manitoba as Part XVIII of *The Securities Act*, R.S.M. 1988 c. S50; in Quebec as Title VIII, Chapter II, Division II of the *Securities Act* R.S.Q. c. V-1.1; in New Brunswick as Part 11.1 of the *Securities Act*, S.N.B. 2004, c. S-5.5; in Nova Scotia as Sections 146A to 146N of the *Securities Act*, R.S.N.S. 1989 c. 418; and in Newfoundland and Labrador as Part XXII.1 of the *Securities Act*, R.S.N.L. 1990 c. S-13. Identical or near-identical legislation is currently in various stages of development in each of Canada's remaining provinces and territories with the exception of Nunavut. As of the date of this paper's writing, the statutory regimes in Canada's remaining provinces and territories are in the following stages of development: in British Columbia the relevant provisions of the *Securities Amendment Act*, S.B.C. 2007 c. 37 will come into force upon Proclamation, and will adopt the vast majority of the new regime as Part 16.1 of the *Securities Act*, R.S.B.C. 1996, c. 418; in Saskatchewan the relevant provisions of the *Securities Amendment Act*, S.S. 7007 c.41 will come into force upon Proclamation, and will similarly adopt the vast majority of the new regime as Part XVIII.1 of the *Securities Act*, 1988 c. S-42.2; in Prince Edward Island and the Yukon Territories, a regime identical to that of Ontario's will enter into force upon proclamation; and in the Northwest Territories there is currently a draft featuring the same provisions as have been adopted elsewhere in Canada, which currently has yet to be put forward as a Bill.

[14] *Queen v. Cognos Inc*., [1993] 1 S.C.R. 87 at para. 34.

Such claims can be difficult to prove, and generally are not amenable to certification as class actions.

The new statutory regime ostensibly avoids these difficulties by creating new causes of action which reduce the burden of proof, and which meet an important aspect of the test for class action certification.

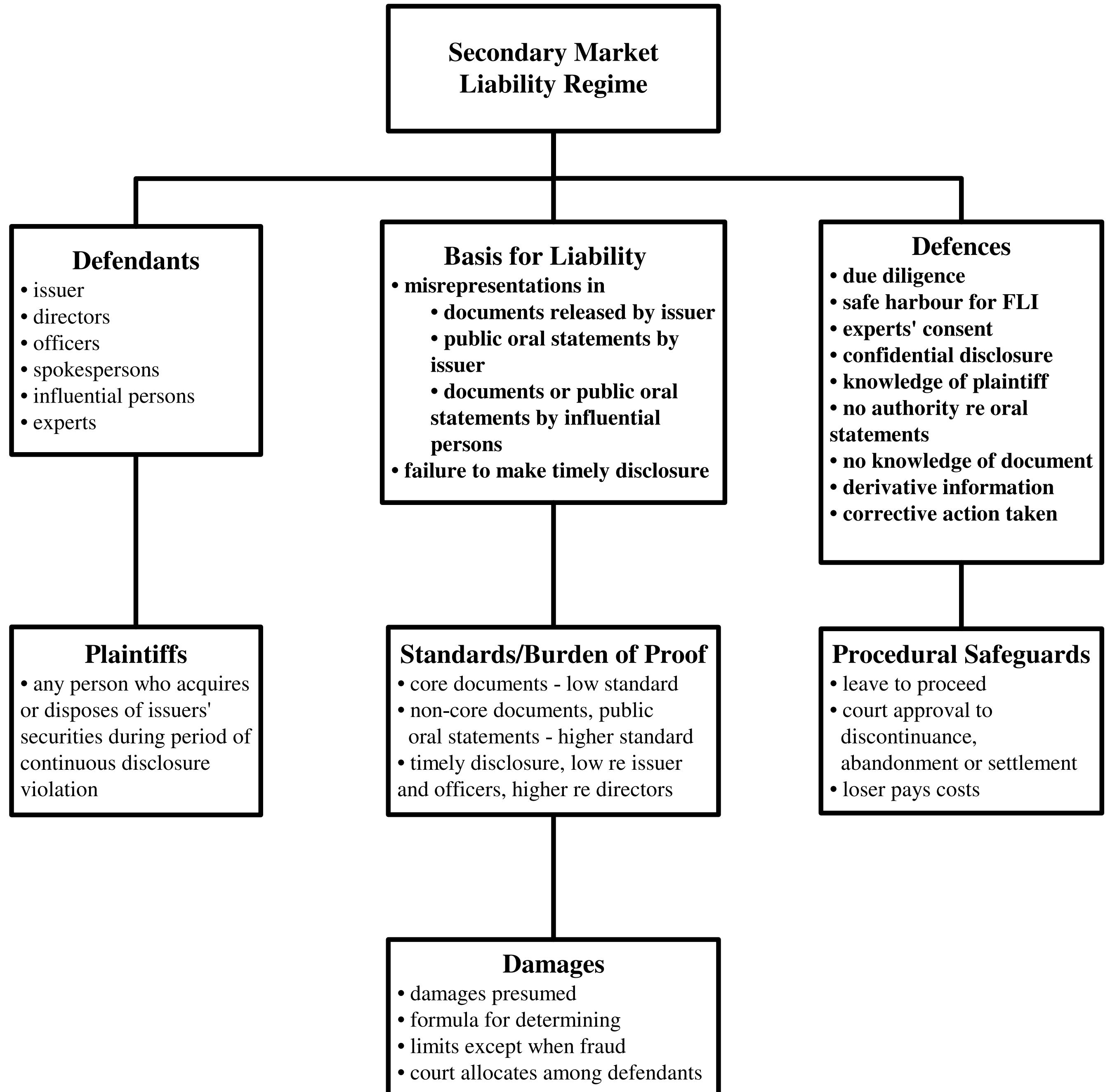
THE NEW LEGISLATIVE REGIME

Since the changes to the Ontario legislation, every province and territory in Canada with the exception of Nunavut has either placed identical or similar provisions into effect, or is in the process of doing so. While the regimes in British Columbia and Saskatchewan feature some limited deviations from the Ontario scheme, those differences are slight, and otherwise there are no material differences. For convenience, this paper will refer primarily to provisions of the Ontario *Securities Act*, R.S.O. 1990 c. S.5.

It is important to note that, to date, the new legislative regime has resulted in few publicly filed claims and, to the writer's knowledge, no jurisprudence.[15] Many have argued that the legislation is biased against secondary market claims, particularly because of the "liability caps" (discussed below). However, in light of (a) the relatively recent implementation of the regime, particularly at the national level; (b) the apparent elimination of an important bar to class certification; and (c) the ability of the courts interpret the legislative provisions, it is this writer's view that it is too early to conclude that the regime is impotent. Accordingly, this is not an area that those on the "issuer side" should take lightly.

[15] At least three actions have been commenced in Ontario, but it the writer's information that as of this date none have resulted in written decisions on any issues: *Andrew Stastny v. Southwestern Resources Corp. and John Paterson*, Court File Number 07-CV-009525 (Ont. Sup. Ct.); *Ainslie et al. v. CV Technology Inc. et al.,* Court File Number 07-CV-336986PDI; and *Martin Silver et al. v. Imax Corporation et al.*, Court File Number CV-06-3257-00.

The following is a simplified picture of the regime.



The new regime provides for a statutory right of action against a broad range of individuals and entities, including: (1) responsible issuers[16]; (2) each director and officer of the responsible issuer; (3) persons authorized to speak on behalf of a responsible issuer; (4) experts; and (5) influential persons[17] (defined as control persons, promoters, insiders and investment fund managers).[18] Actions are available against these various parties for misrepresentations made both in certain types of documents and in public oral statements. The legislation also establishes liability for an issuer's failure to make timely disclosure of material changes as required by the legislation or regulations.

Under the new regime, statutory liability arises notwithstanding that a plaintiff is unable to prove reliance on the misrepresentation or failure to make timely disclosure. Further, in instances where the misrepresentation pertains to certain fundamental or "core documents", the investor will not have to establish that the reporting issuer or other responsible person knew of the misrepresentation, deliberately avoided acquiring knowledge, or was guilty of gross misconduct in connection with the release of the document. A summary of the separate causes of action created by the amendments follows.

(a) **Misrepresentations in a Document**

Where an issuer or a person or company with actual, implied or apparent authority to act on that issuer's behalf releases a document containing a misrepresentation, any person or company who acquired or disposed of any of that issuer's shares during the period between the release of the document and when the misrepresentation is publicly corrected has a potential cause of action against all of the parties referred to above.[19] The liability of those parties is allocated as follows:

(i) the responsible issuer may be liable on proving only the misrepresentation;

(ii) each director of the responsible issuer may be liable on the same basis;

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[16] *Securities Act*, R.S.O. 1990, c. S.5, s. 138.1.
[17] *Ibid.*
[18] *Ibid.*
[19] *Ibid at* s. 138.3.

(iii) each officer of the responsible issuer may be liable where the plaintiff establishes that the officer authorized, permitted or acquiesced in the release of the document;

(iv) each influential person, and each director or officer of an influential person may be liable where the plaintiff establishes that the party in question knowingly influenced the responsible issuer or a party acting on its behalf to issue the document, or knowingly influenced a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document; and

(v) each expert may be liable where the plaintiff proves that the misrepresentation is also contained in a report, statement or opinion made by that expert; the document includes, summarizes or quotes from the expert's report; and where the expert consented in writing to use of the report in the impugned document.

The burden of proof placed on claimants also changes depending on the classification of the document as either "core" or "non-core."[20] Where a document can be classified as "non-core," the defendants will not be liable unless the plaintiff also establishes that the defendants had actual and contemporaneous knowledge of the misrepresentation, or that they deliberately avoided acquiring that knowledge, or through a failure to act was guilty of "gross misconduct" in connection with the release of the document.[21]

Given the defence available in the case of non-core documents, the definition of what constitutes a "core" document is an important one. Generally, in the case of a director of the issuer or an influential person who is not also an officer, a core document consists of the following:

(a) a prospectus;

(b) a take-over bid circular;

(c) an issuer bid circular;

(d) a directors' circular;

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[20] *Ibid*. at s. 138.4.
[21] *Ibid*.

(e) a notice of change or variation in respect of a take-over bid circular;

(f) an issuer bid circular or directors' circular;

(g) a rights offering circular;

(h) management's discussion and analysis;

(i) an annual information form;

(j) an information circular; or

(k) annual financial statements and interim financial statements of the responsible issuer.

In relation to a responsible issuer or an officer of a responsible issuer, a core document is defined as each of the documents referred to above, in addition to any material change report required by the legislation in question or by the regulations of the responsible issuer.

A non-core document is defined as any written communication, including a communication prepared and transmitted electronically, which is:

(a) required to be filed with the Securities Commission;

(b) not required to be filed with the Securities Commission, but which:

  (i) is nevertheless filed with the Securities Commission;

  (ii) is filed or required to be filed with a government or agency under applicable securities legislation, with any stock exchange or quotation and trade reporting system under its by-laws, rules or regulations; or

  (iii) that is any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer.

The definition of "document" is quite wide, and parties who may be potential defendants under the legislation should be aware of the substantial range of written communications in which a misrepresentation can lead to liability. For instance, the definition as it currently stands includes statements made on a website.

(b) Misrepresentations in Public Oral Statements

Plaintiffs under the legislation have a similar cause of action where a misrepresentation is made in a public oral statement by a person with actual, implied or apparent authority to speak on behalf of the responsible issuer.[22] The statement must relate to the business or affairs of the responsible issuer. Where the plaintiff can establish that such a misrepresentation was made, he or she is entitled to bring an action for damages arising during the period of time between the making of the statement and the time when the misrepresentation was publicly corrected. As with misrepresentations in documents, the plaintiff will not be required to prove that he or she relied on the misrepresentation. A cause of action relating to a public oral statement is available against a similar range of potential plaintiffs. The possible defendants are as follows:

(i) the responsible issuer;

(ii) the person who made the public oral statement;

(iii) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement;

(iv) each influential person, and each director and officer of the influential person, who knowingly influenced the person who made the public oral statement to do so, or who knowingly influenced a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and

(v) each expert where the plaintiff proves that: the misrepresentation is also contained in a report, statement or opinion made by that expert; the public oral statement includes, summarizes or quotes from the expert's report; and where the expert consented in writing to use of the report in the impugned statement.[23]

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[22] *Ibid*. at s. 138.3(2).
[23] *Ibid.*

As with non-core documents, however, in an action based on misrepresentation in a public oral statement the plaintiff will be required to prove that the defendant either knew of the misrepresentation at the time, deliberately avoided acquiring that knowledge, or through a failure to act was guilty of a gross misconduct in connection with the making of the public oral statement.[24]

Further, where the person making the public oral statement had apparent authority to do so, but lacked either implied or actual authority from the responsible issuer, the maker of the statement shall be the only party liable for any losses related to securities acquired or disposed of prior to any other possible defendant either becoming aware, or prior to the point when they should reasonably have become aware, of the misrepresentation.[25]

(c) Misrepresentations by Influential Persons

The legislation defines "Influential Persons" to be a control person, a promoter, an insider who is neither a director nor an officer of the responsible issuer, and an investment fund manager where the responsible issuer is an investment fund.[26] The legislation grants a plaintiff a cause of action on the basis of a misrepresentation either in a document or in a public oral statement where it is made by an Influential Person, or by a person or company with actual, implied or apparent authority to act on behalf of that Influential Person.[27] Proof of reliance upon the misrepresentation in question is not required, and as with the other causes of action based on misrepresentation, the plaintiff will have an action for damages sustained during the period from when the misrepresentation was made until its public correction against the following potential defendants:

(i) the responsible issuer, where the plaintiff proves that a director or officer of the responsible issuer, or an investment fund manager where the responsible issuer in an investment fund, authorized, permitted or acquiesced in the release of the document or public oral statement;

[24] *Ibid.* at s. 138.4(1).
[25] *Ibid.* at s. 138.3(7).
[26] *Ibid.* at s. 138.1.
[27] *Ibid.* at s. 138.3(3).

(ii) where the misrepresentation is in a public oral statement, the person who made it;

(iii) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document or making of the statement;

(iv) the influential person;

(v) each director and officer of the influential person who authorized, permitted or acquiesced in the release of the document or the making of the statement; and

(vi) each expert where the plaintiff proves that: the misrepresentation is also contained in a report, statement or opinion made by that expert; the impugned document or public oral statement includes, summarizes or quotes from the expert's report; and where the expert consented in writing to use of the report in the impugned document or statement.[28]

As with misrepresentations in public oral statements, where the person making the statement has only apparent authority to speak on behalf of the issuer, that person shall be the only party liable for damages accrued during the period when the misrepresentation is made and another party discovers the misrepresentation or reasonably should have done so.[29] As with the preceding causes of action, where the misrepresentation is made in a non-core document or in a public oral statement, in order for the plaintiff to establish a party's liability, he or she must prove that the party knew at the time the relevant document was released or the representation was made that it contained the misrepresentation, or that the party deliberately avoided acquiring that knowledge, or that the party was guilty of gross misconduct in connection with the release of the document or making of the statement.[30]

[28] *Ibid.* at s. 138.3(3).
[29] *Ibid*. at s. 138.3(7).
[30] *Ibid*. at s. 138.4.

(d) Failure to Make Timely Disclosure

The legislation defines the concept of "failure to make timely disclosure" as a failure to disclose a material change in the manner and at the time required under the legislation or its regulations. Where such a failure occurs, the legislation provides a person who bought or sold securities during the period of non-disclosure with a cause of action for damages arising between the failure to disclose and the subsequent disclosure of the relevant material change.[31] The legislation does not require the plaintiff to prove that he or she relied upon the responsible issuer's failure to comply with its disclosure requirements, and affords an action against the following parties:

(i) the responsible issuer;

(ii) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure; and

(iii) each influential person, and each director and officer of that influential person, who knowingly influenced the responsible issuer or any company acting on behalf of the responsible issuer into failing to make timely disclosure, or who knowingly influenced a director or officer of the responsible issuer to participate in the failure to make timely disclosure.[32]

A person or company other than the responsible issuer, an officer of the responsible issuer or an investment fund manager or its officers, however, will not be liable under this provision unless the plaintiff can prove that the party knew at the time of the failure to disclose the relevant change and that it was a material change, or that the party deliberately avoided acquiring that knowledge, or that the party was guilty of gross misconduct in connection with the failure to make timely disclosure.[33]

[31] *Ibid*. at s. 138.3(4).
[32] *Ibid.*
[33] *Ibid*. at ss. 138.4(3) and (4).

(e) **Defences**

Once a plaintiff has established the requirements of a cause of action under the legislation, the onus shifts to the defendants to prove a number of available defences. There are also a number of procedural safeguards which operate largely in favour of defendants, which shall also be touched upon later in this paper. The following defences are available under the legislative regime:

(i) ***Plaintiff's Knowledge***

Where a defendant can establish that the plaintiff either acquired or disposed of an issuer's security with knowledge of the misrepresentation or of the material change in question, no party shall be liable under any of the causes of action detailed above.[34]

(ii) ***Due Diligence***

A defendant shall not be liable in an action for misrepresentation where that party proves that before the release of the impugned document or the making of the public oral statement in question, the person or company conducted or caused to be conducted a reasonable investigation, and that at the time the misrepresentation was made that party had no reasonable grounds upon which to believe that the document or public oral statement contained a misrepresentation.[35] This defence should be of particular interest to issuers, as well as their directors and officers, as it contemplates potential preventative measures which might be undertaken. The legislation sets out a number of factors to be considered by the court in determining both whether an investigation was reasonable and in determining whether a party is guilty of gross misconduct:

(a) the nature of the responsible issuer;

(b) the knowledge, experience and function of the person or company;

(c) the office held, where the person in question is an officer;

(d) whether or not a director of a responsible issuer had any other relationship with that issuer;

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[34] *Ibid.* at s. 138.3(5).
[35] *Ibid.* at s. 138.3(6).

(e) the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations;

(f) the reasonableness of reliance by the person or company on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would have given them knowledge of the relevant facts;

(g) the period within which disclosure was required to be made;

(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert;

(i) the extent to which the person or company knew, or should reasonably have known, the content and method of dissemination of the impugned document or public oral statement;

(j) where the cause of action is based on a misrepresentation, the role and responsibility of the person or company in the preparation or release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained within the document or statement; and

(k) in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.[36]

The courts will likely consider whether or not an issuer involved in a misrepresentation or a failure to make timely disclosure had an adequate system in place for the detection and prevention of such mistakes and whether such system was followed.

(iii) ***Confidential Disclosure***

There is no liability for failure to make timely disclosure if disclosure was made to the Securities Commission on a confidential basis provided there was a reasonable basis for making confidential disclosure and that disclosure of the material change was made public promptly once the basis for confidentiality ceased to exist.

[36] *Ibid.* at s. 183.3(7).

(iv) ***Forward-Looking Information***

There is also no liability with respect to forward looking information if reasonable cautionary language is utilized and a statement of the material factors or assumptions is set out within the document or public oral statement containing the forward-looking information. In particular, the legislation specifies that a party will not be liable for a misrepresentation where the document or public oral statement in question contained reasonable cautionary language identifying the forward-looking information, identifying material factors that could cause actual results to materially differ from the prediction, and stating the material factors and assumptions applied in drawing the conclusion reached.[37] In the case of a public oral statement, the defence will be made out where the person making the statement made a cautionary statement explaining that the public oral statement contained forward looking information, that the actual results could differ materially, and that material factors or assumptions were applied in reaching the conclusions drawn. Additionally, the person making the statement must indicate that additional information about the material factors which could lead to a material difference from the stated forecast is contained in a readily-available document, which must be identified.[38]

(v) ***Reliance Upon Expert Reports***

A party other than an expert will not be liable under any cause of action discussed above where the misrepresentation stems from reliance upon an expert's report. In order to avoid liability under this defence a defendant must establish that the consent of the relevant expert was obtained before releasing the expert report or statement; that the defendant had no reasonable grounds to believe there was a misrepresentation in expert material; and that the document or oral statement fairly represented the report, statement or opinion made by the expert.[39]

[37] *Ibid.* at s. 183.3(9).
[38] *Ibid*. at s. 183.3(9.1).
[39] *Ibid*. at s. 183.3(11).

(vi) ***No Knowledge of Release***

A defendant will also not be liable for a misrepresentation contained in a document where the defendant proves that at the time of the document's release he or she did not know and had no reasonable grounds upon which to believe that the document would be released.[40] This defence does not apply, however, to documents which are required to be filed with the relevant regulatory authorities.

(vii) ***Derivative Information***

A defendant will not be liable for a misrepresentation contained in a document or public oral statement where the misrepresentation was also contained in a document filed by or on behalf of another person or company, other than the responsible issuer, with the Securities Commission, any other securities regulatory authority in Canada, or a stock exchange which was not subsequently corrected by another document filed by or on behalf of that person or company. The defence requires that the document or public oral statement issued by the defendant referenced the document containing the misrepresentation, and that at the time the defendant released its document or made its statement that it had no reasonable grounds upon which to believe that its document or statement contained a misrepresentation.[41]

(viii) ***Corrective Action Taken***

A defendant other than the responsible issuer is not liable under any of the causes of action detailed above where the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the defendant and when the defendant, upon learning of the misrepresentation or failure to disclose before the error was corrected, promptly notified the board of directors of the responsible issuer of the error, and, if no correction is subsequently undertaken within two business days of notifying the board notifies the Securities Commission of the error.[42]

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[40] *Ibid.* at s. 183.3(13).
[41] *Ibid.* at s. 183.3(15).
[42] *Ibid.*.

(f) ***Measure of Damages Available - "the Cap"***

The legislation provides for a system which measures damages based on the timing of the misrepresentation or failure to make timely disclosure and its subsequent correction. Damages are intended to compensate the plaintiff for any loss in the value of his or her securities caused by the misrepresentation or failure to disclose. While the regime features different methods of calculating damages for plaintiffs who acquired shares and plaintiffs who disposed of them during the relevant period, in each case the benchmark date for determining damages is ten trading days after the misrepresentation or failure to disclose is publicly corrected.[43] In the case of a plaintiff who purchased securities during the period of misrepresentation or non-disclosure and sold them on or before the tenth trading day after a public correction, damages will equal the difference between the average purchase price of the shares and the price received upon their sale.[44] Where such a purchaser sells the relevant securities after the tenth trading day after correction, damages will equal the lesser of: 1) the difference between the average price paid and the price received upon sale; or 2) the weighted average trading price of the securities on the principal market over the ten trading days following the correction.[45] Likely, the second method will be used in the event that a plaintiff retains his or her shares indefinitely. In the case of a plaintiff who sustained losses through the sale of securities during the relevant period, damages will simply equal the difference between the average purchase price and the sale price of the relevant securities. Importantly, a defendant in any event will not be held liable for any loss in the value of the securities where the losses are attributable to a change in the market price which is unrelated to the misrepresentation or failure to disclose.[46] The onus in proving unrelated losses falls squarely on the defendant, however; without clear proof, damages will be assumed in favour of the plaintiff. Such a defence will likely require expert evidence as to the true cause of the losses.

While the legislation favours plaintiffs by presuming an amount of damages, it does impose ceilings on the liability of potential defendants. Each potential defendant has a defined "liability limit", which can only be exceeded where a party, with the exception of a responsible issuer,

[43] *Ibid.* at s. 138.5.
[44] *Ibid.* at s. 138.5(1).
[45] *Ibid.*
[46] *Ibid.* at s. 138.5(3).

knowingly participated in making of the misrepresentation or failure to make timely disclosure.[47] Where the ceiling does apply, in the case of an officer or director of the responsible issuer or an influential person damages will be limited to the greater of $25,000 and 50% of that party's aggregate compensation received from either from the responsible issuer or the influential party and any affiliates in the 12 months preceding the date of the misrepresentation or failure to make timely disclosure.[48] In the case of a responsible issuer or an influential person which is not an individual, liability caps at the greater of 5% of its market capitalization or $1 million. In the case of an expert, however, the ceiling is the greater of $1 million or the revenue that the expert and its affiliates have earned from the responsible issuer and its affiliates in the 12 months preceding the misrepresentation or the failure to make timely disclosure.

In addition to a legislated ceiling on damages, the regime also provides for proportionate liability amongst a group of defendants, rather than joint and several liability.[49] Damages will be determined in respect of each defendant based on that party's degree of responsibility, up to the maximum limit. As is the case with the availability of the liability limit, however, proportionality will only be available if the defendant relying upon it, other than the responsible issuer, did not knowingly participate in the making of a misrepresentation of failure to make timely disclosure of a material change.

(g) Procedural Safeguards

In an attempt to control a potential flood of unmeritorious actions, the legislation imposes a number of restraints upon potential plaintiffs. None of the actions discussed above may be brought without first obtaining leave of the court. In such an application, the plaintiff and each defendant must file an affidavit containing the material facts to be relied upon, and the deponents of these affidavits may be subject to cross-examination.[50] Importantly, leave will only be granted where the court is satisfied that the action is brought in good faith, and that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff. Further,

[47] *Ibid.* at s. 138.6(1).
[48] *Ibid.* at s. 138.1.
[49] *Ibid.* at s. 138.6.
[50] *Ibid.* at s. 138.8. One should note that provincial court rules may result in different levels of access to cross-examination.

an action brought under the regime cannot be discontinued, settled or abandoned without leave of the court, and upon whatever terms the court deems fit.[51] Both of these features are designed to discourage potential plaintiffs from launching an unmeritorious suit in the hopes of simply being paid out with a quick settlement - the proverbial "strike suit."

Most of the regimes across Canada also feature a "loser pays" provision requiring the losing party to pay costs: the court retains no residual discretion to alter the costs order in the event of a novel point of law or test case, which could also serve to discourage potential plaintiffs, as costs awards in a class action under these provisions could potentially be substantial.[52] While this provision is or will be featured in most provinces, it is not featured in the legislation proposed by either British Columbia or Saskatchewan.

2. **Some Advice for Directors and Officers**

The following are certain actions that can be taken by directors and officer of either responsible issuers or "influential" corporations to protect against personal liability under the amendments. These are some tips provided in a vaccuum. Directors and officers should seek advice from legal counsel that addresses their particular circumstances.

An important line of defence for directors and officers is a review of the company's disclosure policies and practices. In order for directors to establish the due diligence defence, it may be necessary at a minimum to put in place the necessary systems, policies and procedures; monitor their operation; and carefully review any material provided to them, while paying particular attention to descriptions of transactions approved by the board. Directors should be comfortable enough with the procedures in place to rely on the officers or other parties involved in the system and should respond promptly to any "red flags" that arise in the process.

Officers, particularly those involved in preparing market disclosure material, should consider what will be necessary to establish a due diligence defence. It will often be of assistance to

[51] *Ibid.* at s. 138.10.
[52] *Ibid.* at s. 138.11.

officers in establishing the defence if collective rather than individual decisions are made and if professional advice has been obtained where appropriate.

One method through which to assist both the directors and officers to establish the due diligence defence would be to establish a disclosure committee, comprised of a group of officers and employees, and possibly a director, with an appropriate range of skills who are responsible for implementation of the policy, including determination of materiality, establishing review procedures for various classes of documents and for oral presentations, maintenance and review of a disclosure record including web site material, educating staff, and reporting to the board or a board committee regularly. If a disclosure committee is established the review procedures may be contained in the disclosure policy or established by the committee and approved by the board or a board committee.

Establishing a due diligence defence will also be easier if a disclosure record is kept containing copies of all disclosure documents, transcripts of oral presentations and evidence of the compliance with the disclosure systems, including minutes of disclosure committee proceedings.

With regard to oral presentations, controls and procedures should be implemented with respect to all oral presentations including those to investors, analysts, or industry associations. Careful attention should also be paid to responses to e-mail inquiries received form investors and others. Policies should be developed for such presentations, and it may be beneficial for an issuer to publicly identify spokespersons authorized to speak on its behalf.

Directors and officers should review the insurance policies and the indemnities currently in place to ensure that they remain protected even under the new regime:

(i) review indemnities to ensure that the broadest coverage possible is obtained and that the agreement includes provision for advance of expenses pending final determination of any claim; and

(ii) review your Director and Officer insurance policies with your insurer, paying particular attention to the following:

    (1) Are the policy limits adequate having regard to the fact that the policy limits include defence costs and operate in effect on a "first come first served basis"?

(2) Is the range of coverage appropriate? Do you have the full range of coverage available? For example, "Side A" coverage which protects the Directors and Officers, "Side "B which reimburses the issuer for any amounts for which it indemnifies the Directors and Officers, and "Side C" coverage for liabilities of the issuer?

(3) Are corporate spokespersons who are not officers properly insured?

(4) Can the policy be cancelled by the insurer for any reason other than non payment?

(5) Is the "Side A" coverage providing protection for the directors and officers non rescindable?

(6) Does the policy have provisions ensuring that coverage for innocent directors is not lost through the fraud or misconduct of others?

The new secondary liability regime has the potential to impose liability on directors and officers and others in situations where the common law is relatively impotent. Accordingly, directors, officers and the other persons potentially liable should understand the regime and consider any possible means by which to manage the new liability risk.

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