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CORPORATE FINANCE BULLETIN

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Dear Client/Colleague:

Secondary Market Civil Liability

Recent amendments to the *Securities Act* (British Columbia) (the *Act*) have created secondary market civil liability in British Columbia similar to existing legislation in other provinces of Canada. Investors in the secondary market can now commence legal action against a reporting issuer and its directors and officers for misleading disclosure. The secondary market includes all trading over stock exchanges and represents the majority of securities trading. These amendments may result in class action proceedings in British Columbia for misrepresentations in filed disclosure documents by investors in the secondary market.

The Right to Sue

The amendments to the *Act* provide that investors can sue a reporting issuer if they suffer damages as a result of purchasing or selling securities of that issuer in the following circumstances:

- failure of the issuer to make timely disclosure;
- a misrepresentation in a document released by the issuer or other person, including information on the issuer's website; or
- a misrepresentation made in a public oral statement by or on behalf of the issuer.

An investor need not establish that he or she relied upon, or was even aware of, the misrepresentation or failure.

Those who can be held liable are the issuer itself; its directors and officers; each influential person (includes a control person, promoter, insider, or an investment fund manager); experts (where the misrepresentation is contained in an expert report such as an audit opinion or technical report); and spokespersons for an issuer.

Limits on Liability

Damages to be assessed against issuers or other defendants are generally to be based on the difference between the value of the securities bought or sold when the disclosure record of the issuer was inaccurate and the value after proper disclosure was made. However, the legislation imposes limits on liability, as follows:

- issuers (or influential persons who are not individuals) — capped at the greater of 5% of its market capitalization and $1 million;
- directors, officers, influential persons who are individuals, or spokespersons — capped at the greater of $25,000 and 50% of the aggregate of the compensation received by the individual from the issuer and its affiliates; and
- experts — capped at the greater of $1 million and the revenue that the expert and the affiliates of the expert have earned from the issuer and its affiliates during the 12 months preceding the misrepresentation.

Significantly, these limits do not apply if the defendant knowingly participated in the misrepresentation or failure to disclose.

The Defences

An issuer or other defendant will escape liability in relation to a misrepresentation or a failure to make timely disclosure if it can prove that:

- it undertook a reasonable investigation and had no reasonable grounds at the time to believe the document or statement contained a misrepresentation or that the failure to make timely disclosure would occur (due diligence defence);
- it had no knowledge the document would be released (mistaken release defence);
- it relied on professionals or experts for expert reports (expertized statement defence);
- appropriate cautionary language and statement of material factors was included for forward-looking information (safe harbour defence); or
- the release was made without knowledge or consent, and once the person became aware, he or she notified the issuer, and if required, the securities commission (whistle-blower defence – cannot be relied upon by the issuer).

A defendant will also not be liable if it can prove that the investor acquired or disposed of the issuer's security with knowledge that the document or statement contained a misrepresentation or with knowledge of the material change.

There are two liability standards under the new provisions of the *Act*, depending on the type of disclosure at issue and who is the defendant. For core disclosure documents, including prospectuses, financial statements, MD&A, AIFs (and for the issuer and officers only, material change reports), the onus will be on the defendant to prove it can rely on an available defence once a misrepresentation is proved. However, in relation to an action initiated on the basis of a misrepresentation contained in a public oral statement or in a document that is not a core document including press releases (or for directors, material change reports), a defendant (other than an expert) will not be liable unless the investor proves that the defendant knew of, or avoided acquiring knowledge of, the misrepresentation, or that it was guilty of gross misconduct in connection with the release of the document or the making of the public oral statement.

In reviewing a due diligence defence, the *Act* requires the court to consider, among other things, the existence, if any, and the nature of the system designed to ensure the issuer meets its continuous disclosure obligations and the reasonableness of reliance by the person on the issuer's disclosure compliance system.

Minimizing Liability

In order to minimize exposure to secondary civil market liability, issuers should consider taking the following steps:

1. Develop a formal written disclosure policy with the help of legal counsel and ensure that everyone involved in the creation and release of information to the public is aware of, and follows, the policy.

2. Establish a disclosure committee consisting of senior officers to be responsible for all regulatory disclosure requirements and for overseeing the issuer's disclosure policies and procedures, including when timely disclosure of material changes in the issuer's affairs must be made.

3. Ensure that all news releases are reviewed by a business person with first hand knowledge of the subject matter, preferably a member of the issuer's disclosure committee, and by legal counsel and the issuer's qualified person, when appropriate.

4. Implement an internal certification process where personnel can certify, with respect to their areas of expertise, to the CEO and CFO that disclosure controls and procedures are in place.

5. Have disclosure documents reviewed by the disclosure committee, or specific officers not involved in the preparation of the documents. Assign specific responsibility for regularly reviewing boilerplate language, risk factor disclosure and forward-looking statement disclosure in disclosure documents to a member of the disclosure committee or other officer who has a firm understanding of the true risks of the business taken as a whole.

6. Place strict controls on who may make public statements or otherwise act as a spokesperson for the issuer so as to ensure a consistent message. Whenever possible, script public oral statements and review them after delivery to identify and correct any misrepresentations or selective disclosure. Keep records of presentations and oral statements.

7. Purchase and maintain D&O insurance.

Please note that this list is by no means exhaustive and may need to be adjusted to take into account the particular circumstances and resources of the issuer. If you would like more information about implementing policies and procedures that are tailored for your business, please contact us as set out below:

Rod McKeen
Direct: 604.692.4901
email: rmckeen@axiumlaw.com

Michael Varabioff
Direct: 604.692.4918
email: mvarabioff@axiumlaw.com

Joseph Giuffre
Direct: 604.692.4909
email: jgiuffre@axiumlaw.com

Yours truly,

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