



Bill 19 - An Act to amend the Securities Act and other legislative provisions

Introduction

On November 17, 2007, The Quebec National Assembly passed Bill 19, *An Act to amend the Securities Act and other legislative provisions*. In so doing, Quebec has joined other governments who have elected to adopt a civil recourse specific to secondary market investors in securities.

In the event that an issuer or related person has produced a misrepresentation in a release document or statement, or if there is a failure to disclose a material change, or any misleading or inadequate corporate information, Bill 19 will facilitate the pursuit of damages for investors in the secondary market against the issuers or related persons. This facilitation is propelled by the fact that the investor will no longer be required to prove a cause-and-effect relationship between his loss and the distribution of such information.¹ Bill 19 reaches only those in the secondary market, and excludes any situation whereby a person acquired securities during the period of distribution either by prospectus or under a prospectus exemption. It is also inapplicable to an acquisition or disposition of a security pursuant to a take-over bid or an issuer bid.

The market place is quickly changing, and with the passing of other relevant Regulations, disclosure requirements are becoming more stringent in an effort to promote stability and certainty in the adapting market. Bill 19 will now offer a new recourse to investors and allow them to protect their interests while contemporaneously strengthening the market and promoting greater compliance with the new regulatory schemes in place.

Bill 19, introducing this new form of recourse, will undoubtedly result in an increase in the number of securities claims filed in Canada. The question of whether or not this will have a strong effect on corporations or Canadian risk managers is debatable, as most have already adjusted their operations in order to comply with similar regulations in other provinces, such as Ontario's Bill 198, and in the USA.

Bill 19 also introduces an amendment to the Act respecting the distribution of financial products and services to enable the Autorité des marchés financiers to suspend the certificate of a representative who fails to satisfy continuous training requirements. The Finance Minister has said that Continuous training is essential to maintaining skills and any breach of such an obligation must be sanctioned quickly to serve the investor better.

The purpose of this report is to give an overview of Bill 19 and its requirements focusing on the possible defendants and plaintiffs, the defences allowed, the burden of proof required and the damages which ensue.

Actions for Damages (225.8)

Prior to any claim being allowed under Bill 19, the court must give its authorization (225.4). The court will grant authorization if it deems that the action is in good-faith and there is a reasonable possibility that it will be resolved in favour of the plaintiff. Furthermore, any request for authorization must state the facts giving rise to the action and must be served on the parties with a notice of at least 10 days prior to its presentation.

Bill 19 lists four scenarios that can attract liability. An action for damages may therefore be brought when a person that acquires or disposes of an issuer's security between the time when:

- (1) The issuer, its mandatory, or other representative released a document containing a misrepresentation;
- (2) a mandatory or other representative of the issuer made a public oral statement relating to the issuer and containing a misrepresentation;
- (3) an influential person² or a mandatory or other representative of the influential person released a document or made a public oral statement in relationship to the issuer and containing a misrepresentation; or

¹ Quote by Minister of Finance, Madam Monique Jérôme-Forget

² In the context of secondary market liability, an "influential person", with respect to an issuer, is defined under Bill 19 as: "a control person, investment fund manager or promoter, or an insider who is not a director or officer of the issuer".

(4) the issuer failed to make a timely disclosure of a material change;

and the time when the misrepresentation was publicly corrected, or in the case of a failure to make a timely disclosure of a material change, the time when the material change was disclosed pursuant to securities legislation.

Potential Defendants under Bill 19 (225.8, 225.9, 225.10, 225.11)

Pursuant to Bill 19 an action may be brought, depending on the cause, against a broad spectrum of defendants. For an action based on a misrepresentation contained and disclosed in a document or a public oral statement in relationship with the issuer (225.8, 225.9, 225.10), the following defendants may be held liable:

- The issuer; Each director of the issuer at the time the document or oral statement containing the misrepresentation was released; Each officer of the issuer who authorized the public release of the document or the oral statement containing the false information or misrepresentation; the person who made the public oral statement; Each influential person and their respective directors and/or officers who knowingly influenced the issuer, or a mandatory or other representative of the issuer to release the document or a director or officer to the issuer to authorize the document or, the person who made the public oral statement; and/or Each expert, whereby the misrepresentation is contained in the expert's report, statement or opinion, and such was included, summarized, quoted from in the document or in the public oral statement and, if the document was released, or the public oral statement was made, by a person other than the expert, who consented in writing to the use of the report, statement or opinion in the document.

Under 225.11, an action based on a failure to make a timely disclosure of a material change, the potential defendants are:

- The issuer; Directors and officers of the issuer who authorized, or rather, acquiesced in the failure to make such timely disclosure; and/or Influential persons who knowingly influenced the issuer or a mandatory or other representative of the issuer, in the failure to make such timely disclosure.

Plaintiff's Burden of Proof (225.12)

According to Bill 19, it is not necessary for the plaintiff to prove that he relied on the document or public oral statement containing a misrepresentation or on the issuer having

complied with its timely disclosure obligations when the plaintiff acquired or disposed of the issuer's security.

However, in the case of a misrepresentation contained in a document or public oral statement, unless the misrepresentation was contained in a core document or whereby the defendant is an expert, the plaintiff is required to prove that the defendant:

- (1) knew, at the time that the document was released or the public oral statement was made, that the document or public oral statement contained a misrepresentation or deliberately avoided acquiring such knowledge at or before that time; or
- (2) was guilty of a gross fault in connection with the release of the document or the making of the public oral statement.

Additionally, whereby the cause of action is based on the failure by an issuer to make a timely disclosure of a material change, unless the defendant is the issuer, the investment fund manager or an officer of the issuer or the investment fund, the plaintiff is required to prove that the defendant:

- (1) knew, at the time that a material change report should have been filed, of the change and that the change was a material change, or deliberately avoided acquiring such knowledge at or before that time; or
- (2) was guilty of a gross fault in connection with the failure to make a timely disclosure.

In determining whether a "gross fault" was committed for the purposes of the foregoing, Bill 19 contains a series of "relevant circumstances" that may be considered including:

- Knowledge, experience and function of the defendant; Office held, if the defendant was an officer; Presence or absence of another relationship with the issuer, if the defendant was a director; Existence and the nature of any system designed to ensure that the issuer meets its continuous disclosure obligations, and the reasonableness of reliance by the defendant on that system; Reasonableness of reliance by the defendant on the issuer's officers and employees and on others whose duties would in the ordinary course have given them knowledge of the relevant facts; Period within which disclosure was required to be made under the Act or a regulation thereof; Extent of which the defendant knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement; Role and responsibility of the defendant in the preparation and release of the document, or the making of the public oral statement containing the misrepresentation or in the ascertaining of the facts contained in that document or public oral statement; and

Role and responsibility of the defendant in the decision not to disclose the material change.

Defences available under Bill 19

Bill 19 allows for the following defences to be brought forward by the defendant in order to defeat an action brought under the preceding sections.

a) Awareness of the Plaintiff (225.17)

An action may be defeated if it can be established that the plaintiff was aware of the alleged false information and/or misrepresentation which is the basis for the action. Similarly, in the case of a failure to make a timely disclosure of a material change, the defendant may invoke as a defence, the fact that the plaintiff was aware of the material change that should have been disclosed.

b) Due Diligence Defence (225.17 and 225.18)

A defendant may also invoke that he/she had conducted, or caused to be conducted, a reasonable investigation and had no reasonable grounds to believe that the document or public oral statement would contain such a misrepresentation or false information, or that the failure to make a timely disclosure would occur. In determining whether an investigation was "*reasonable*", the Bill refers to the same "*relevant circumstances*" used to determine whether a gross fault was committed under 225.15.

c) The defendant had no reasonable grounds to believe that the document or oral statement contained a misrepresentation (225.19)

This defence may be invoked in the event that the misrepresentation was:

(i) also contained in a document filed by or on behalf of a third person, other than the issuer, with the Authority or an extra-provincial securities commission within the meaning of section 305.1 of the Act or a stock exchange, and was not corrected in another document filed by or on behalf of that third person with the Authority, commission or stock exchange before the issuer or the mandatory, or other representative of the issuer released the document or made the public oral statement;

(ii) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation; *and*

(iii) when the document was released or the public oral statement was made, the defendant did not know and had no

reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

d) Defence for a person other than an issuer (225.20)

Additional defences are also provided exclusively for non-issuer defendants. These defences allow the non-issuer to claim in his defence that:

(i) the document was released, the public oral statement was made or the failure to make a timely disclosure occurred without the defendant's knowledge or consent;

(ii) once he or she became aware of the misrepresentation or the failure to make a timely disclosure but before the misrepresentation was corrected or the material change was disclosed in the manner required under the present act, the defendant promptly notified the board of directors of the issuer of the misrepresentation or the failure to make a timely disclosure; *and* if no correction of the misrepresentation or no subsequent disclosure of the material change was made within a delay of two business days after such notification, the defendant, unless prohibited by law or by professional confidentiality rules, promptly notified the Authority, in writing, of the misrepresentation in the document or public oral statement or failure to make a timely disclosure.

e) Lack of authority (225.21)

Whereby an action is based on a misrepresentation contained in a public oral statement, a defendant may defeat such an action by proving that it was not aware, or should not reasonably have become aware of the misrepresentation before the plaintiff acquired or disposed of the issuer's securities and by proving that the person who made the public oral statement had no authority, other than apparent authority, to make such a statement.

f) Defence with respect to forward-looking information (225.22)

A defendant may defeat an action for a misrepresentation in forward-looking information in a document or a public oral statement. This defence, however, does not apply to forward-looking information in a financial statement required to be filed under the Act or the regulations or in a document released in connection with an initial public offering. To invoke this defence the defendant must prove that:

(i) the document or public oral statement containing the forward-looking information contained, proximate to that information,

(a) reasonable cautionary language clearly identifying the forward-looking information as such, and identifying material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information;

(b) a statement of the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection; *and*

(ii) the defendant had a reasonable basis for drawing the conclusions or making the forecasts or projections set out in the forward-looking information.

g) Defence for a person other than an expert (225.24)

A defendant, other than an expert, may defeat an action for misrepresentation in a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert, with the expert's written consent to the use of the report, statement or opinion, if the consent had not been withdrawn in writing before the document was released or the public oral statement was made, by proving that:

(i) the defendant did not know and had no reasonable grounds to believe that there was a misrepresentation in the report, statement or opinion of the expert that was included, summarized or quoted from in the document or public oral statement; and

(ii) the report, statement or opinion of the expert was fairly represented in the document or public oral statement.

h) Defence available specifically to experts(225.25)

A defendant expert may defeat an action pursuant to Bill 19 by proving that the written consent previously provided to the use of a report, statement or opinion made by the expert was withdrawn in writing before the document was released or the public oral statement was made.

i) Defense against Released Document without knowledge (225.26)

An action may be defeated if the defendant had no reasonable grounds to believe that the document would be released.

j) Defence for failure to make a timely disclosure of a material change (225.27)

A defendant may defeat an action for failure to make a timely disclosure of a material change by proving that:

(i) the issuer, in accordance with the Act or the regulations, filed the material change report with the Authority without making the report public and the issuer had a reasonable basis to file the report on a confidential basis;

(ii) if the change remains material, the issuer promptly made the material change public when the basis for confidentiality ceased to exist;

(iii) the defendant or issuer did not release a document or make a public oral statement that, due to the undisclosed material change report, contained a misrepresentation; *and*

(iv) if the material change became publicly known in a manner other than the manner required under securities legislation the issuer promptly disclosed the material change in accordance with securities legislation.

Damages

The Bill also outlines the process and calculations necessary for the assessment of damages and the apportionment of liability. Once the defendant is found liable, section 225.28 is invoked in order to determine the damages to be received.

Securities acquired and not disposed of (225.28(1))

Damages under this section are to be equal to the number of securities acquired and not disposed of, multiplied by the difference between the average price paid per security (including commission) and the trading price of the issuer's securities on the principal market for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under this act, and in the event that the latter unit is not accessible, the amount that the court considers just.

Securities subsequently disposed of (225.28(2))

With respect to securities that the plaintiff had subsequently disposed of on or before the last of the 10 trading days, damages are to be equal to the difference between the average price paid for those securities (including commissions) and the price received on the disposition of those securities (without deducting commissions) calculated taking into account the result of hedging or other risk limitation transactions.

In the event that the plaintiff subsequently disposed of the securities after the last 10 trading days, assessed damages will be equal to the lesser amount of the preceding calculations.

The damages assessed, however do not include any amount that the defendant proves is attributable to a change in the market price of securities that is unrelated to the

misrepresentation or the failure to make timely disclosure (225.30).

Solidary Liability (225.31)

Defendants are solidarily liable for the whole amount of the damages. The court determines the portion of damages paid by each defendant, and may even hold a defendant, who is not an issuer, liable for the whole amount.

Unless the plaintiff proves that the defendant, other than issuer, was aware of the basis of the claim, the damages paid are the lesser amount of either 225.28 or 225.29 or the maximum amounts as prescribed by the act under 225.33.

Conclusion

As Bill 19 has just been introduced, it is too early to predict how the legislation will be explained and interpreted by the courts, and therefore this report can only offer an overview of what the Bill proposes through its sections. As time passes, and claims are brought under the bill and subsequently handled by the courts, a greater understanding of its potential and implications will be available.

This update is intended to provide general comment only and should not be relied upon as legal advice.

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