DENTONS

Secondary Market Liability:

Lessons and Strategies for professional geoscientists

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Securities Law – what is it?

- Provincial regulators and legislation with some coordination of policy
- Commissions take jurisdiction by province and by agreement

- Intended to protect the public and create orderly capital markets
- Most people and professions are able to ignore securities law completely in their day to day lives

- Most of the securities laws and policies are procedural and bland, however the media headlines related to securities law are salacious examples of humans acting badly

- Public companies have entire teams devoted to compliance, capital raising activities, and disclosure
  - Continuous disclosure
  - Material event disclosure

Secondary Market Liability - “SML”

What is it?

- Securities legislation designed to protect the public from both bad acting and disengaged professionals, extending past the original primary market protections for investors
- A skeptic might consider it a statutory mechanic for fining individuals for mistakes or poor practice

- In BC, it is Part 16.1 of the *Securities Act*
- In Ontario, it is Part XXIII.1 – Civil Liability for Secondary Market Disclosure of the *Securities Act*
- A similar statutory scheme for secondary market liability was introduced in the US in 2002, with the passage of the Sarbanes-Oxley Act of 2002, Pub.L. 107-204, 116 Stat. 745
- Jurisdiction will vary based on your clients, but Canadian laws are substantially the same

- Investors have a statutory right of action where they acquired or disposed of securities while there was an uncorrected misrepresentation in a document or a public oral statement or while there was a failure to make timely disclosure of a material change as required by the Securities Act.

- But what is it, actually? Let’s do an example.

Who Does SML Catch?

1. The responsible issuer
2. Directors and officers of the responsible issuer
3. Influential people of the responsible issuer
4. People that make statements with actual, implied or apparent authority for the responsible issuer
5. Experts

Experts

A person whose profession gives authority to a statement made in a professional capacity by the person, including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist or lawyer.

- Not the same as a qualified person
- You're an expert the first day you are registered with your professional designation

Influential Person

- Control person, promoter, insider that is not a director or officer, investment fund manager (if responsible issuer is an investment fund)

What Does SML Catch?

Focus on Experts

Experts can be liable where:

- A core or non-core document containing a misrepresentation, or
- A public oral statement containing a misrepresentation is released or made by the responsible issuer or by an influential person (or by a person with actual, implied or apparent authority to act or speak on behalf of the responsible issuer or influential person, as the case may be), if each of the following is also true:
  - the misrepresentation is also contained in a report, statement or opinion made by the expert;
  - the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert; and
  - the expert either released the document or made the statement itself or consented in writing to the use of the report, statement or opinion in the document or public oral statement.

This is only a subset of the scope of liability under SML, and we're not going to cover branches not applicable to experts today.

Underlying Definitions

Release means to file with a securities commission or to otherwise make available to the public.

Misrepresentation means:

a) an untrue statement of a material fact; or

b) an omission to state a material fact that is:

   i. required to be stated, or

   ii. necessary to prevent a statement that is made from being false or misleading in the circumstances in which it was made

Document means a paper or electronic filing:

- that must be or is voluntarily filed with a securities commission
- that is required by securities law to be filed with the corporate registry or that is required to be filed with a stock exchange
- which would reasonably be expected to affect the market price or value of a security of the responsible issuer

Core Document means the largest, most significant documents like a prospectus, an annual report, a proxy circular, financial statements, or material change reports. Core Documents are specifically listed in the *Securities Act*

Material Facts

Material fact means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities of an issuer.

- Material fact is broader than the legislative concept of material change (material change being a change in the internal business, operations or capital of a company).

- A new material change in, for example, resources or reserves requires a new tech report.
- A new material fact requires a press release.
- Reports, statements and opinions of experts related to material facts may not be subject to the same internal oversight (at the expert's firm) as full tech reports.
- What does this mean? You don't need to go back in time and revise a tech report to deal with a new material fact. That new material fact is addressed in other disclosure documents and you may or may not be involved.

What is the High-Level Process for a Claim?

1. A misrepresentation is identified.
2. Someone is invested enough to pursue a claim.
3. Canada has a strike suit barrier - claim must be certified.
4. Claim proceeds until decided or settled.

Canada's Strike Suit Barrier

Part I

- Strike suit barrier: a plaintiff must obtain court approval to proceed with an action
- To obtain leave, a plaintiff must establish:
  - The action is brought in good faith
  - There is a reasonable possibility that the plaintiff will succeed
- Gatekeeping function: very few cases progress beyond the leave stage
  - 2012 study by NERA: of 35 secondary market liability actions filed, only 2 progressed beyond leave stage
  - *Wong v. Pretium Resources Inc.*, 2021 ONSC 54 – first trial decision on the merits

Canada’s Strike Suit Barrier

Good faith

- Claimant is bringing their action in the “honest belief that they have an arguable claim, and for reasons that are consistent with the purpose of the statutory cause of action”: *Silver v. IMAX (2009), 66 BLR (4th) 222 (ON SC)*
- Good faith is a low barrier to meet because:
  - There doesn’t have to be any kind of knowledge or belief in the investment, or knowledge about the investment, on the part of the investor. SML is not for the participants in your 'family and friends' rounds, it is for strangers around the world.
  - There is not much actual case law on this aspect of the strike suit barrier, it seems to be assumed with the facts and accepted by all parties that make it to trial.
  - Perhaps bad faith cases don't even make it this far, so we won't ever see cases or decisions turning on this point.

Canada's Strike Suit Barrier

Preliminary merits

- Is there a "reasonable possibility" that the plaintiff will succeed?
  - Not a trial on the merits, but an investigation into whether there was something that could reasonably possibly be a misrepresentation, and whether there are plaintiffs who lost money during the misrepresentation period.
  - Evidentiary threshold: both prospective plaintiff and defendant will have to file affidavit evidence
  - Provide credible evidence that permits the court to conclude the claimant has more than a *de minimis* possibility of succeeding at trial
  - Defendant has a correspondingly high evidentiary burden to dissuade the court to grant leave
  - Used by the court to evaluate scope of the claim (i.e. allowing two claims of misrepresentation out of 20 to proceed to trial)

What happens to certified claims?

- **Timeline – litigation is a time-consuming process**
  - Motion for leave - preparation of affidavits, cross-examination of witnesses, scheduling
  - Typically will take years to get to trial
  - Limitation periods

- **Procedural Issues**
  - Serve and file affidavit evidence setting forth material facts – not an obligation for defendants
  - Potential witnesses

- **Impact on your day-to-day life and profession**
  - Litigation is often time-consuming and stressful
  - Reputational concerns

What Needs to be Proven in Court?

Part I

What does a claimant need to prove?

For a Core Document:

- There was a misrepresentation in the market and a loss to the investor while that misrepresentation was not identified. The misrepresentation is in: a report, statement, or opinion.

For any other Document or a public oral statement:

- There was a misrepresentation in the market and a loss to the investor while that misrepresentation was not identified. The misrepresentation is in: a report, statement, or opinion.

Interesting to note that, for any other Document or a public oral statement, where the defendant is not an expert, the defendant is provided with an additional degree of protection, and the claimant must also prove any one of these three things:

a) The defendant knew that there was a misrepresentation at the time that the document was released or public oral statement was made.

b) The defendant deliberately avoided acquiring knowledge that the document or public oral statement contained a misrepresentation at or before the time that the document was released or the public oral statement was made.

c) The defendant engaged in gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation.

What Needs to be Proven in Court?

Part II

Damages

Two ways of calculating damages for SML:

1) Where a buyer paid too much for the stock

   and

2) Where a seller received too little for the stock

In both cases, there is a prescribed formula to measuring what the investor lost, and it can be a crystalized loss, an average market loss from the stock movement at the time the misrepresentation became known, or a fictional loss where the investor did not dispose or acquire but still experienced the market loss in value due to the misrepresentation.

What about other market factors, like the index or industry falling at the same time?

- The defendant is not responsible for paying damages with respect to lost value that it can prove was unrelated to the misrepresentation or failure to make timely disclosure of a material change. This would include other things going on at the responsible issuer, in the industry, and in the world.

What Don’t They Need to Prove?

What don’t they need to prove?

- Knowledge or Reliance
  - There is NO reliance requirement for misrepresentations by experts. It doesn’t matter that the secondary market did not read your report, or even know they held the stock in question. Liability doesn’t require the investor to be aware of anything, or to have turned their mind to your work.
- Malicious Intent, Bad Acting.
  - There is also no requirement for an expert to have a culpable state of mind. You don’t need to be a bad actor. A misrepresentation action is distinct from any additional fraud or criminal claim where intent is considered.

Settle or Trial, and Wrapping Up

Settlements

- Most cases settle; very few actions which have been granted leave have proceeded to trial

Trial verdicts and appeals

- Right of appeal after trial
- Experts - Financial penalties under the *Securities Act*
  - The HIGHER of $1M and what you or your firm made off of the issuer and its affiliates in the prior twelve months
- For directors and officers of the issuer, it is the higher of $25,000 and 50% of the last year's compensation from the issuer group
- However, no limits for any group if the defendant knew the material fact was a misrepresentation when they authorized, permitted, or acquiesced in the release of the material fact

Defences for Experts

1. Due Diligence
2. Properly Qualified Forward Looking Information
3. They Already Knew
4. Reliance on Experts
5. Unauthorized Release or Revoked Consent
6. Corrective Action

Defences for Experts

Due Diligence

Due Diligence (section 138.4(6) of the Securities Act)

- Before the release, the expert has conducted or caused to be conducted a ***reasonable*** investigation,

  and

- At the time of release, the expert had no reasonable grounds to believe that the document or oral statement contained the misrepresentation.

In assessing reasonableness, a court must consider all relevant circumstances, including:

…

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

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 medium of dissemination of the document or public oral statement;

j) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement;

…

Defences for Experts

Forward Looking Information – “FLI”

- **There is a specific defence** for forward looking information in your tech reports. It is in section 140.4(9) of the BC *Securities Act.*
- The defence only covers misreps in the forward looking information, and requires three things:
  1) Reasonable cautionary language included in the document proximate to (beside) the FLI that identifies the FLI and the material factors that could cause the actual results to differ from your conclusion, forecast, or projection
  2) A statement of the material factors or assumptions that were applied in the work
  3) That the expert had a reasonable basis for drawing the conclusion or making the forecast or projection set out in the FLI

- What you'd need to focus on to have a defence for a misrep in your FLI is ensuring the best practice cautionary language is included in each report and press release and update. Make sure you know what cautions are needed for your statements, and then, don't rely on others to put the disclaimers in, do it yourself.
- If you do it right, you've got a full defence for those FLI statements.

Defences for Experts

Forward Looking Information – Climate Change Scrutiny

- As a future point of interest, there has been increasing attention to cautionary language in FLI statements relating to climate change. Several Canadian issuers have adopted and publicized climate-related objectives, including targets to cut greenhouse gas emissions. Such objectives are often integrated as FLI in a number of public documents.

- There are secondary market liabilities in this specific context, and many issuers have enhanced their cautionary language for forward-looking statements to better address climate-related statements. We expect this trend to grow in the coming years.

- If you come across statements related to climate change in FLI, scrutinize and enhance the accompanying cautionary language to mitigate potential legal risks. Stay informed about evolving regulations and industry best practices in addressing climate-related forward-looking statements.

Defences for Experts

They Already Knew, and Reliance on Experts

They Already Knew

1. At its core, conflicts with the requirement that an action is brought in good faith.
2. This particular defence and potential conflict hasn't made it to trial or been discussed by the courts in detail yet.
3. It’s knowledge that the material fact was a misrepresentation that counts, not simply knowledge of the material fact. So they need to know the fact is wrong, or a fact was required and was omitted.

Reliance on Experts

-this is not for experts but is worth noting-

1. All other persons that have liability under the SML regime have a full defence if they relied on the work of an expert, and they did not know or have reasonable grounds to know about the misrepresentation.
2. This emphasizes the role of experts, and geos, as gatekeepers of the market – market integrity relies on expert skills to maintain the market integrity.

Defences for Experts

No Consent or Corrective Action

No Consent

- Was never given,

  or

- Was revoked – meaning that prior to the release of the document or to the making of the public oral statement, they had withdrawn their prior written consent, provided that this withdrawal was in writing.

Corrective Action Taken

- In general, potential defendants are not liable with respect to misrepresentations made without their knowledge or consent if they take prompt corrective action by promptly advising the board of directors of the responsible issuer of the misrepresentation or failure, and, if no correction or disclosure is made within two business days, promptly advising the OSC in writing of the misrepresentation or failure.
- Defendants who are prohibited by law or professional confidentiality rules from disclosing this information to the OSC are not required to make disclosure to the OSC in order to satisfy the defence. *Check your professional code and confidentiality rules.*

Tools to Consider for Your Practice

- Code of Ethics and Professional Governance Act
- Use cautionary language of Forward Looking Information
- Speak up once misrepresentation is detected
- Monitor your past work and clients

Questions?

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