

**DIRECTOR AND OFFICER LIABILITY UNDER REGULATION 52-109  
AND THE PROPOSED BILL 19**

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Remerciements à Samara Sekouti pour son aide apportée à la préparation de cette conférence.

## DIRECTOR AND OFFICER LIABILITY UNDER REGULATION 52-109 AND THE PROPOSED BILL 19

### 1. INTRODUCTION

Following the series of corporate scandals that occurred at the turn of the millennium, intense scrutiny was placed on improving corporate governance practices, particularly with respect to the disclosure and assurance of internal control over financial reporting (“**Internal Control**”). The United States response to the wave of corporate scandals essentially entailed the enactment of the *Sarbanes-Oxley Act* (“**SOX**”) in July of 2002, applicable to all publicly traded companies listed on U.S. stock exchanges<sup>1</sup>. In essence, SOX imposed additional responsibilities and obligations on the directors, officers, auditors, audit committees and even attorneys of all publicly traded companies<sup>2</sup>. Among the added responsibilities and obligations, SOX imposed Internal Control compliance requirements with respect to disclosure and certification<sup>3</sup>. These requirements are specific to the Chief Executive Officer (“**CEO**”) and the Chief Financial Officer (“**CFO**”).

In the wake of Enron and the scandals that followed, restoring investor confidence and ensuring the market’s reputability became a priority<sup>4</sup>. As noted by certain doctrinal commentators, “[i]n the post-Enron environment, all marks will be judged largely by the degree to which investors are protected”<sup>5</sup>.

Thus, it was no surprise that Canadian securities regulators followed with the enactment of *SOX-inspired* legislation<sup>6</sup>. With respect to Internal Control, this meant the implementation of *Regulation 52-109*, respecting *Certification of Disclosure in Issuers’ Annual and Interim Filings* (“**Regulation 52-109**”).

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<sup>1</sup> S. Pillway, “Forcing Canada’s Hand? The Effects of the Sarbanes-Oxley Act on Canadian Corporate Governance Reform” (2004) 30 Man. L.J. 285, para. 1-3.

<sup>2</sup> *Ibid.*, para. 11.

<sup>3</sup> *Ibid.*, para. 11.

<sup>4</sup> S. Rousseau, “*Droit des valeurs mobilières – La création des normes de gouvernance d’entreprise par les organismes de réglementation des valeurs mobilières: le rôle des pouvoirs d’ordonnance dans l’intérêt public.*” (2004) 38 R.J.T. 193, para 1-4.

<sup>5</sup> P. Puri, J. Larsen, Corporate Governance and Securities Regulation in the 21st Century, LexisNexis Butterworths, 2004, p. 58.

<sup>6</sup> E. Létourneau, Le gouvernance d’entreprise : perspectives juridiques, Éditions Yvon Blais, 2007, para. 1009-1011. However, same author notes that there exists a certain debate as to what extent U.S. corporate governance reforms should serve as an example for Canadian regulators given the differences in the markets and corporate structures.

The multitude of regulations enacted by Canadian and provincial securities regulators were essentially aimed at imposing more stringent requirements, particularly with respect to directors and officers, whom are naturally the target of corporate governance reforms<sup>7</sup>.

In view of the foregoing, it is no doubt that the risk of director and officer liability has increased over the past several years, as the reigns have gradually tightened on their respective duties and obligations. This is particularly true in the constantly evolving securities legal framework. Moreover, and among the enactment of other regulations, the currently proposed amendments to *Regulation 52-109* shall result in an expansion of director and officer duties. Additionally, the recent presentation of *Bill 19, An Act to amend the Securities Act and other legislative provisions* ("**Bill 19**") before the Quebec National Assembly shall also result in an another platform that may impose statutory civil liability on directors and officers, in the secondary market context.

This article shall provide an overview of potential liability that may be incurred by directors and officers as a result of violating compliance requirements under *Regulation 52-109*, as well an examination of the statutory civil liability that may be incurred advent the adoption of Bill 19.

## **2. UNDERSTANDING REGULATION 52-109**

*Regulation 52-109*, that has been in force within Québec since June 2005, essentially governs the certification and disclosure requirements with respect to Internal Control. Accordingly, the essential obligation of reporting issuers under *Regulation 52-109* is to file annual and interim certifications pursuant to the regulation. These annual and interim certification forms are currently scheduled to *Regulation 52-109* as Forms 52-109F1 and 52-109F2 respectively.

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<sup>7</sup> S. Rousseau, "Le rôle des tribunaux et du conseil d'administration dans la gouvernance des sociétés ouvertes: réflexions sur la règle du jugement d'affaire" (2004) 45 *C. de D.* 469.

Presently, the annual and interim certifications that must be filed by reporting issuers essentially require an attestation by the certifying officer<sup>8</sup> of the following: (i) the certifying officer of the issuer has reviewed the filings; (ii) the issuer's filings do not contain misrepresentations and/or omissions; (iii) the issuer's financial statements and information fairly present the financial condition, results from operations and cash flow of the issuer; (iv) the certifying officers are responsible for establishing and maintaining the disclosure controls and procedures as well as the Internal Control of the issuer; (v) the certifying officers have caused the issuer to disclose in the annual management's discussion and analysis ("**MDA**") the conclusions about the effectiveness of the disclosure controls and procedures; and (vi) the certifying officers have caused the issuer to disclose in the annual MDA any recent changes in the issuer's Internal Control.

In March 2006, the *Canadian Securities Administrators* ("**CSA**") issued a notice to the effect that it was withdrawing the proposed *Multilateral Instrument 52-111, Reporting on Internal Control over Financial Reporting* ("**Multilateral Instrument 52-111**") that would have otherwise required reporting issuers to obtain an attestation report from their external auditors with respect to management's assessment of the effectiveness of an issuer's Internal Control. This would have imposed analogous requirements to those imposed in the U.S. under Section 404 of SOX. However, instead of enacting *Multilateral Instrument 52-111*, the CSA announced that it had opted to amend the existing *Regulation 52-109*.

The proposed amendments to *Regulation 52-109*, anticipated to come into force on June 30, 2008, will expand the Internal Control requirements of all reporting issuers, corporate and non-corporate, with the exception of investment funds. However, contrary to the now abandoned *Multilateral Instrument 52-111*, the revised *Regulation 52-109* shall not require reporting issuers to obtain auditor attestation with respect to management's assessment of the effectiveness of an issuer's Internal Control.

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<sup>8</sup> The certifying officer may be either the CEO, the CFO or a person performing similar functions to a CEO or a CFO, as the case may be.

From a practical perspective, these obligations essentially translate into an expansion of the certifying officers duties and obligations under both the annual and interim certifications. Notably, under the proposed amendments, the certifying officers shall be required to attest that: (i) they have evaluated the effectiveness of the issuer's Internal Control and the issuer's annual MDA discloses management's conclusions about the effectiveness of such Internal Control; (ii) the annual MDA identifies the control framework used to design the Internal Control; (iii) the annual MDA describes any reportable deficiencies<sup>9</sup> in the design of Internal Controls, as well as the action plan to remedy such deficiencies, the case may be; and (iv) they have disclosed to the issuer's auditors, board of directors and audit committee any fraud that involves management or other employees who had an important role in the Internal Control<sup>10</sup>.

It is important to note that these annual and interim certificates must be filled out in the *exact* language prescribed in the certification forms. As such, the certifying officer does not benefit from any latitude in regards to the content or wording of the certifications.

### **3. DIRECTOR AND OFFICER LIABILITY**

Historically, the control of director and officer performance and management has been somewhat restricted<sup>11</sup> resulting in their relatively limited liability. However, in the wake of tougher corporate governance rules and practices, directors and officers are inevitably seeing themselves placed at a greater risk of liability, from a regulatory, criminal and even civil perspective<sup>12</sup>.

Under general corporate law, directors and officers have certain core duties that when breached, may result in their civil liability. These core duties have now been codified

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<sup>9</sup> According to the CSA, a "*reportable deficiency*" may be defined as: a deficiency, or combination of deficiencies, in the design or operation of one or more controls that would cause a reasonable person to doubt that the design or operation of internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP.

<sup>10</sup> This is only a brief overview of certain significant amendments to the revised *Regulation 52-109*. For a complete overview of the proposed amendments to the regulation, please review the text of the revised regulation.

<sup>11</sup> *Supra* 5, p. 36

<sup>12</sup> *Ibid.*

under general corporate legislation on both a federal and provincial level. For example, at the federal level, Section 122 of the *Canada Business Corporations Act, R.S.C., 1985, c. C-44*, requires that directors and officers exercise their powers and discharge their duties: (i) honestly and in good faith with a view to the best interests of the corporation; and that they (ii) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances<sup>13</sup>. A breach of the foregoing duties shall possibly incur liability.

The duty to act honestly and in good faith with a view to the best interests of the corporation also imposes a fiduciary duty on directors. The importance of the fiduciary duty was discussed, relatively recently, by the Supreme Court of Canada as encompassing the following:

*“The statutory fiduciary duty requires directors and officers to act honestly and in good faith vis-à-vis the corporation. They must respect the trust and confidence that have been reposed in them to manage the assets of the corporation in pursuit of the realization of the objects of the corporation. They must avoid conflicts of interest with the corporation. They must avoid abusing their position to gain personal benefit. They must maintain the confidentiality of information they acquire by virtue of their position. Directors and officers must serve the corporation selflessly, honestly and loyally.”*<sup>14</sup>

The foregoing essentially translates into a duty for directors to act with a view to the best interests of the company, as a distinct legal person<sup>15</sup>. They must not favour any particular stakeholder and are thus required to act independently and remain free from any undue influence or pressure<sup>16</sup>, including pressure from their nominating shareholder<sup>17</sup>.

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<sup>13</sup> In Québec, these duties have been codified with respect to directors under Section 322 of the *Civil Code of Québec*, S.Q. 1991, c. 64.

<sup>14</sup> *Peoples Department Store Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, para. 35.

<sup>15</sup> P. Martel, *La compagnie au Québec*, Vol 1, *Les Aspects Juridiques*, Éditions Wilson & Lafleur, 2007, para. 23-164-23-165.

<sup>16</sup> *Ibid.*

<sup>17</sup> *Supra*, Note 15, para. 23-167-168.

Moreover, the requirement for directors and officers to exercise their duties with the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances has also been the subject of much doctrinal commentary and judicial interpretation. These duties include notably the obligations to attend board meetings, remain reasonably informed, and supervise the affairs of the company<sup>18</sup>.

When determining whether directors and officers should be held liable for a breach of the foregoing duties of care, diligence and skill, the courts generally apply the “*business judgment rule*”<sup>19</sup>. According to the business judgment rule, a court should not intervene whereby the business decision falls within a “*range of reasonableness*.”<sup>20</sup> Hence according to the Supreme Court, directors and officers will not generally be found liable for breach of their duties of care, diligence and skill under general corporate law whereby they act prudently and on a reasonably informed basis<sup>21</sup>. Accordingly, their decisions must be reasonable considering all of the circumstances about which the directors or officers knew, or ought to have known<sup>22</sup>.

The business judgment rule has served to shield directors and officers from liability for breach of their foregoing duties, whereby they can prove that the decision was reasonable under the circumstances. However, in the very recent decision of *Kerr v. Danier Leather Inc.*<sup>23</sup>, the Supreme Court of Canada appears to have put a limit on the business judgment rule with respect to director and officer duties and obligations under securities legislation.

*Kerr v. Danier Leather Inc.* (“**Danier**”) involved a class action suit instituted on behalf of the shareholders against Danier Leather Inc. (“**Danier Leather**”) for misrepresentation

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<sup>18</sup> R. Crête, S. Rousseau, *Droit des Sociétés par Actions: Principes Fondamentaux*, Les Éditions Thémis, 2002.463-474.

<sup>19</sup> *Supra*, Note 6, para 6101-6102.

<sup>20</sup> *Maple Leaf Foods Inc. v. Schneider Corp.*, (1998), 42 O.R. (3d) 177, p. 192

<sup>21</sup> *Peoples*, *Supra* 14, para. 65-67

<sup>22</sup> *Ibid.*

<sup>23</sup> 2007 S.C.C. 44 (October 12, 2007)

in a prospectus; ultimately the only one of its kind that reached the Supreme Court level.

Essentially, Danier Leather had made an initial public offering of its shares through a prospectus, the latter of which contained a forecast including certain projected results. However, subsequently, an internal company analysis that had been prepared before its public offering closed, illustrated that Danier Leather's results were behind its forecasted projections. Nonetheless, Danier Leather's senior management did not update the prospectus. Following the closing of the initial public offering, Danier Leather issued a revised forecast, on the basis of new information, and the share price significantly dropped thereby triggering a class action under securities legislation for prospectus misrepresentation.

Ultimately, the Supreme Court of Canada concluded that if a prospectus, or an amendment thereto, is free of misrepresentations on the date it is filed, failure to disclose subsequent information that amounted to a "*material fact*" shall not trigger liability for prospectus misrepresentation under Section 130(1) of Ontario *Securities Act*, R.S.O. 1990, c. S.5, particularly since the legal obligation to disclose applies to a "*material change*" and not to a material fact.

The court also made some imperative commentary on director and officer reliance on the business judgment rule. Particularly, the Supreme Court held that while forecasting is a matter of business judgment, disclosure is a matter of legal obligation pursuant to securities legislation. As such, the business judgment rule may not apply to shield directors and officers from their disclosure duties. Hence, the business judgment rule cannot be invoked as a defence against a director or officer's decision not to disclose information that must be disclosed under securities legislation.

The foregoing conclusion may result in an expanded risk of liability for issuers, directors and officers alike for breach of their disclosure obligations as it opens the door for courts and securities regulators to question the merits of disclosure decisions. In other words,



the Supreme Court held that such decisions are not protected under the business judgment rule.

In addition to the foregoing, directors and officers have a myriad of other statutory duties and obligations under both general corporate legislation and other legislative frameworks such as those duties and obligations imposed by securities legislation. This issue concurrently brings us to the consequences of breaching Internal Control under *Regulation 52-109*.

#### 4. DIRECTOR AND OFFICER LIABILITY FOR BREACH OF *REGULATION 52-109*

Whereby a CFO or CEO, does not comply with his duties and obligations under *Regulation 52-109*, whether knowingly or negligently, he or she may be faced with liability. According to a notice published by the CSA, a violation of *Regulation 52-109* shall be viewed as a “serious breach of securities law”<sup>24</sup>.

Pursuant to the *Policy Statement to Regulation 52-109 Respecting Certification of Disclosure in Issuers’ Annual and Interim Filings*<sup>25</sup> (“**Policy**”), published in May 2007 by the *Autorité des marchés financiers* (“**Authority**”), the regulatory body in Québec responsible for the enforcement and governance of the financial sector, an officer who provides a false certification shall be subject to potential quasi-criminal, administrative or civil proceedings under securities legislation. Part 12 of the Policy also states that officers who breach *Regulation 52-109* are subject to private actions for damages either at common law or, in Québec, under the civil law<sup>26</sup>.

Although liability under *Regulation 52-109* does not appear to be modified under the proposed amendments, given that the amendments shall expand the duties imposed on CEOs and CFOs, one may infer that subsequent to the amendments, there shall be an expanded risk of liability.

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<sup>24</sup> Notice No. 57-302: *Failure to File Certificates under Regulation 52-109 Respecting Certification of Disclosure in Issuers’ Annual and Interim Filings*.

<sup>25</sup> Available on the website of the Québec *Autorité des marchés financières* at : [http://www.lautorite.qc.ca/userfiles/File/reglementation/valeurs-mobilieres/Normes/52-109PSang\\_cons01.pdf](http://www.lautorite.qc.ca/userfiles/File/reglementation/valeurs-mobilieres/Normes/52-109PSang_cons01.pdf).

<sup>26</sup> Such action may be taken under 1457 of the *Civil Code of Québec*.

## 4.1 LIABILITY UNDER SECURITIES LEGISLATION

### 4.1.1 *A statutory offence liable to a penalty*

The Authority disposes of several remedies so as to ensure the respect of securities legislation<sup>27</sup>. According to the Québec *Securities Act*, R.S.Q., c. V-1.1 (“**Act**”), any person who contravenes either a provision of the Act<sup>28</sup> or a provision of a regulation under the authority of the Act<sup>29</sup>, is guilty of an offence and is liable to a penalty. Such a penalty may range from \$ 1,000 to \$ 20,000 in the case of a natural person, and up to \$50,000 in any other case. Accordingly, the quantum of the penalty shall depend upon the particular damages suffered by the investors and/or the advantages that the defendant derived from the offence<sup>30</sup>.

### 4.1.2 *Application for an Injunction*

The Act also allows the Authority, to apply to the Superior Court for an injunction in respect to any matter relating to the Act or its regulations<sup>31</sup>.

### 4.1.3 *Powers to intervene and request a declaratory judgment and/or a condemnation to pay compensatory and/or punitive damages*

Moreover, the authority also has the power to intervene in any civil proceedings relating to any provision of the Act or a regulations under the authority of the Act<sup>32</sup>. Furthermore, the Authority may also apply to the court for a declaratory judgment to the effect that a person has failed to discharge a duty and/or an obligation under the Act or a regulation under the authority of the Act, and request that the defendant in such proceedings be condemned to pay both compensatory and punitive damages<sup>33</sup>.

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<sup>27</sup> C. Turcotte, *Le Droit des Valeurs Mobilières*, Lapointe Rosenstein, Éditions Yvon Blais, 2005, p. 470.

<sup>28</sup> Section 202 Act.

<sup>29</sup> Section 203 Act.

<sup>30</sup> Section 202(2) Act.

<sup>31</sup> Section 268 Act.

<sup>32</sup> Section 269 Act.

<sup>33</sup> Section 269.2 Act.

## 4.2 LIABILITY AT COMMON LAW OR UNDER THE CIVIL CODE OF QUÉBEC

Pursuant to Part 12 of *Regulation 52-109*, in addition to statutory liability under the Act, directors and officers may also face liability in the form of a private action undertaken by an investor who relied on the certification when making an investment<sup>34</sup>. Within Québec, a civil liability action may be instituted pursuant to Section 1457 of the *Civil Code of Québec*. However, it appears that investors may soon have another platform upon which they may institute proceedings. Accordingly, Québec provincial regulators are in the process of adopting a statutory civil liability a similar remedy specifically for investors in Ontario.

### 4.2.1 Civil Liability under the proposed Bill 19

Bill 19, presented to parliament for a first reading in June of 2007, has proposed a series of amendments to the Act with the ultimate objective of introducing a new civil liability remedy available for investors, specifically in the secondary market context. The Québec government's adoption of Bill 19 would follow in the footsteps of the Ontario government's adoption of Bill 198, that has instituted a remedy for secondary market liability.

Before proceeding with an overview of the proposals contained in Bill 19, it is important to note that these new proposals apply *solely* to transactions in the secondary market context. Hence, the proposals do not apply to persons that subscribe for, or acquire, securities during the period of a distribution of securities made with a prospectus, or, unless otherwise provided by regulation, under a prospectus exemption granted either under the Act or a regulation under the authority of the Act<sup>35</sup>. Moreover, the proposals do not apply to a person acquiring or disposing of securities in the context of a take-over bid or issuer bid, save and except otherwise provided by regulation<sup>36</sup>.

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<sup>34</sup> M. Gillen, *Securities Regulation in Canada*, 3rd edition, Thomson Carswell, 2007.

<sup>35</sup> Section 225.2 Bill 19.

<sup>36</sup> Section 225.2 Bill 19.

a) Causes for Action

The proposed remedy under Bill 19, shall allow a person, rather an investor, to institute proceedings for damages in the context of four particular situations. Thus, an investor disposes of a cause for action in any of the following four circumstances<sup>37</sup>:

(1) The investor acquires or disposes of an issuer's security between the time when the issuer, its mandatory, or other representative released a document containing a misrepresentation;

(2) The investor acquires or disposes of an issuer's security between the time when a mandatory or other representative of the issuer made a public oral statement relating to the issuer and containing a misrepresentation;

(3) The investor acquires or disposes of an issuer's security between the time when an influential person<sup>38</sup> 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

(4) The investor acquires or disposes of an issuer's security between the time when 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.

b) Authorization is required prior to instituting an action pursuant to Bill 19

Under Bill 19, it is necessary to obtain prior authorization from the court before instituted an action for damages<sup>39</sup>. 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

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<sup>37</sup> Section 225.8 - 225.11 Bill 19.

<sup>38</sup> 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".

<sup>39</sup> 225.4 Bill 19.

days prior to its presentation<sup>40</sup>. Accordingly, authorization shall be granted by the court whereby it is held that the action has been instituted in good faith and that it presents a “reasonable possibility” of success<sup>41</sup>.

c) Potential Defendants under Bill 19

The entities and persons who may face liability under Bill 19 is quite broad; essentially in the case of an action for a misrepresentation contained and disclosed in a document or a public oral statement in relationship with the issuer, the target defendants may be<sup>42</sup>:

- 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;
- In the case of a public oral statement containing a misrepresentation or false information, 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.

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<sup>40</sup> *Ibid.*

<sup>41</sup> 225.4(2) Bill 19.

<sup>42</sup> 225.8-225.10 Bill 19.

In the case of an action based on a failure to make a timely disclosures of a material change, the potential defendants are<sup>43</sup>:

- 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.

d) Plaintiff's Burden of Proof

According to Bill 19, it is not necessary for the plaintiff to prove that he/she 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<sup>44</sup>.

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<sup>45</sup>:

(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

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<sup>43</sup> 225.11 Bill 19.

<sup>44</sup> Section 225.12 Bill 19.

<sup>45</sup> Section 225.13 Bill 19.

investment fund manager or an officer of the issuer or the investment fund, the plaintiff is required to prove that the defendant<sup>46</sup>:

(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<sup>47</sup>:

- 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;

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<sup>46</sup> Section 225.14 Bill 19.

<sup>47</sup> Section 225.15 Bill 19.

- 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.

e) Defences that may be successfully invoked against a suit pursuant to Bill 19

It will be possible to invoke several defences against an action under the proposed Bill 19; these defences have been expressly outlined under the proposed legislation. The following paragraphs explore some of these defences.

i) Plaintiff was aware of the alleged false information and/or misrepresentation

A defendant may defeat an action pursuant to Bill 19 by establishing that the plaintiff was aware of the alleged false information and/or misrepresentation at the time the alleged transaction was conducted<sup>48</sup>. 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<sup>49</sup>.

ii) Due Diligence Defence

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<sup>50</sup>. In determining whether an

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<sup>48</sup> 225.17 Bill 19.

<sup>49</sup> *Ibid.*

<sup>50</sup> Section 225.17(2) Bill 19.



investigation was “reasonable”, the Bill refers to the same “relevant circumstances” used to determine whether a gross fault was committed<sup>51</sup>.

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

This defence may be invoked whereby the misrepresentation was<sup>52</sup>:

(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.

iv) Defence for a person other than an issuer

Bill 19 also provides for additional defences open solely to non-issuer defendants<sup>53</sup>. For example, a non-issuer defendant may invoke, as a defence:

(i) that 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 securities legislation, the defendant

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<sup>51</sup> 225.18 referring to 225.15 Bill 19.

<sup>52</sup> Section 225.19 Bill 19.

<sup>53</sup> Section 225.20 Bill 19.

promptly notified the board of directors of the issuer of the misrepresentation or the failure to make a timely disclosure; *and*

(iii) 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.

v) *Lack of authority*

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<sup>54</sup>.

vi) *Defence with respect to forward-looking information*

A defendant may defeat an action for a misrepresentation in forward-looking information in a document or a public oral statement by proving that<sup>55</sup>:

(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*

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<sup>54</sup> 225.21 Bill 19.

<sup>55</sup> 225.22; see also 225.23 Bill 19.

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

It is important to note however that this defence may 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<sup>56</sup>.

vii) Defence for a person other than an expert

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<sup>57</sup>:

(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.

viii) Defence available specifically to experts

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<sup>58</sup>.

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<sup>56</sup> 225.22 Bill 19.

<sup>57</sup> 225.24 Bill 19.

<sup>58</sup> 225.25 Bill 19.

ix) Defence for failure to make a timely disclosure of a material change

A defendant may defeat an action for failure to make a timely disclosure of a material change by proving that<sup>59</sup>:

(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.

**5. BILL 19 : WILL IT UNLEASH CLASS ACTIONS AGAINST PUBLIC COMPANIES?**

While Bill 19 is not expected to come into force anytime in the near future, given its preliminary state, one may nonetheless look to the repercussions of Ontario's Bill 198 so as to foresee the possible trends that Bill 19 may fashion.

Prior to coming into force, Ontario's Bill 198 created a significant buzz with respect to a possible surge in shareholder and investor class actions; law firms and accounting firms were quick to publish bulletins foreseeing these class action lawsuits based on misrepresentations. However, since Bill 198 has come into force, there have been very few class actions that have actually been filed to date.

In September of 2006, a \$600 million class action was commenced against Toronto-based Imax Corporation ("IMAX") including as defendants IMAX's co-CEOs and former CFO. The suit is being instituted on behalf of U.S. shareholders, and essentially alleges

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<sup>59</sup> 225.27 Bill 19.

misrepresentations concerning IMAX's 2005 earnings. The suit was instituted following an announcement by IMAX that it was being investigated by the U.S. Securities and Exchange Commission in August 2006. The IMAX class action has yet to reach trial level.

Very recently, reports have also been published that another class action has been filed against CV Technologies Inc. ("**CV**"), the manufacturer of *Cold-Fx*, along with CV's CEO, two other members of CV's board and CV's auditors. However, no subsequent proceedings appear to have been publicly filed to date.

## **6. CONCLUSION**

In recent years, the underlying intent of Canadian securities regulators has focused on improving corporate governance practices and restoring investor confidence. However, this has resulted in the imposition of important duties and obligations upon directors and officers of public companies. As such, directors and officers must be vigilant so as to ensure that they adequately comply with their statutory requirements and implement an efficient Internal Control framework within their companies so as to avoid facing the risk of liability. In Québec, liability for breach of *Regulation 52-109* may stem from securities legislation, specifically the Act, the *Civil Code of Québec*, and advent the coming into force of Bill 19, a new platform for statutory civil liability.