STRATEGY FOR DEFENDANTS FACING A LEAVE MOTION TO COMMENCE A CLASS ACTION UNDER THE *SECURITIES ACT*

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Introduction

Under Part XXIII.1 of the Ontario *Securities Act*[1] (the "Act"), a plaintiff may bring a claim for misrepresentation in the secondary securities market – the financial market in which previously issued financial instruments like stocks, bonds, options, and futures are bought and sold. However, leave of the court is required in order to commence such an action.

The recent cases of *Gould v. Western Coal Corporation*[2] *("Western Coal")* and *The Trustees of the Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc*.[3] ("*SNC*") showcase two different ways in which defendants can respond to a plaintiff's motion for leave to commence a class proceeding under Part XXIII.1 of the Act. In *Western Coal*, the defendants successfully contested leave and certification, resulting in the first denial of leave to commence a class action in the secondary securities market based on the merits of the claim. In *SNC*, the defendants chose not to oppose leave or certification of the action as a class proceeding and, in exchange, the plaintiffs discontinued their claims in common law and oppression, leaving only the claim under the Act. Though the defendants in *Western Coal* were successful in ending the class action, the defendants in *SNC* were also successful in bypassing the leave stage without expending considerable resources, preventing premature discovery, and in cutting down the number of claims. What is of note in these contrasting approaches is that the determination of whether to vigorously contest leave or not must be made on a case-by-case basis, keeping in mind the strength of the claim and the costs associated, both monetary and strategic.

Background on the Leave Test

[1] *Securities Act,* R.S.O. 1990 c S.5
[2] *Gould v. Western Coal Corporation*, 2012 ONSC 5184 ("*Western Coal*")
[3] *Drywall Acoustic Lathing and Insulation Local 675 Pension Fund v. SNC-Lavalin Group Inc*., 2012 ONSC 5288 ("*SNC*")

Part XXIII.1 of the Act, which came into force on December 31, 2005, allows plaintiffs to sue for misrepresentations in the secondary securities market. Section 138.3(1) of the Act creates a statutory cause of action to the benefit of anyone who acquires or disposes of the securities of an issuer in the secondary securities market between the time the document containing the misrepresentation was released and the time the misrepresentation was corrected. It is not necessary that the investor actually relied upon the misrepresentation.

In order to commence an action under s. 138.3, leave of the court is required under s. 138.8. Before the court will grant leave, it must be satisfied that: (a) the action is brought in good faith; and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff. As stated by Justice Lax in *Ainslie v. CV Technologies Inc*., "The essence of the leave motion is that putative plaintiffs are required to demonstrate the propriety of their proposed secondary market liability claim before a defendant is required to respond."[4]

The first part of the leave test has received only passing comment by courts assessing whether leave should be granted. The plaintiff must simply "establish that he or she brings the claim in the honest and reasonable belief that it has merit and that he or she has a genuine intent and capacity to prosecute the claim if leave is granted."[5] As of yet, the requirement of good faith has not been a significant hurdle to plaintiffs seeking leave, largely because defendants have not challenged plaintiffs' intentions in bringing actions. Given the time and expense involved with mounting a class action, and the ever-increasing sophistication and experience of the plaintiffs' class action bar, it is unlikely that many cases will be denied leave on this basis alone.

The second criterion of the leave test – that the case must have a "reasonable possibility of success" – has received more judicial attention. Pursuant to the test set out in *Silver v. Imax Corp. ("Imax"*), the "reasonable possibility of success" requirement captures two meanings – the possibility must be more than a "mere" possibility and it "must be based on a reasoned consideration of the evidence".[6]

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[4] *Ainslie v. CV Technologies* (2008), 93 O.R. (3d) 200 ("*CV Technologies*") at para. 15 (S.C.J.)
[5] *Green v. Canadian Imperial Bank of Commerce,* [2012] O.J. No. 3072 (S.C.J.) ("*Green*") at para. 356
[6] Silver v. *Imax Corp.,* [2009] O.J. No. 5573 (S.C.J.) ("*Imax*") at para. 324*;Western Coal* at para. 78

In *Imax*, the test for "reasonable possibility of success" was described as a "relatively low threshold".[7] According to the court in *Dobbie v. Arctic Glacier Income Fund* ("*Arctic Glacier*"),[8] "the applicable standard is more than a mere possibility of success, but is a lower threshold than a probability."[9] In *Green v. CIBC* ("*Green*"), the Court stated that the leave requirement is "meant to screen out cases that, even though possibly brought in good faith, are so weak that they cannot possibly succeed."[10]

Although s. 138.8(1) speaks of whether the action has a reasonable possibility of success, courts have determined that each representation must be examined, in relation to each defendant, to determine whether the plaintiff's claim in respect of that representation has a real possibility of success against that defendant. The analysis also requires consideration of whether there is a real possibility that the defendant will not be able to establish the "reasonable investigation defence" in s. 138.4(6), which is a defence available to a company or individual who proves that, before the release of the document or the making of the public oral statement containing the representation, it conducted or caused to be conducted a reasonable investigation and had no reasonable grounds to believe that the document or statement contained the misrepresentation.[11]

All of the evidence must be examined to determine whether the plaintiff's case is "so weak, or has been so successfully rebutted by the defendant, that it has no reasonable prospect of success."[12] In assessing the weight to be accorded to the evidence, the court must consider the limitations of the motions process (including that the evidence is not given *viva voce*), whether the evidence has been challenged on cross-examination, and whether it is consistent with other evidence and contemporaneous documentation.[13]

Western Coal

[7] *Imax* at para. 25; *Green* at para. 373
[8] *Dobbie v. Arctic Glacier Income Fund,* 2011 ONSC 25 ("*Arctic Glacier*")
[9] *Arctic Glacier* at para. 130
[10] *Green* at para. 373
[11] *Green* at paras. 347, 377
[12] *Western Coal* at para. 106 citing *Green* at para. 374.
[13] *Western Coal* at para. 80

In *Western Coal,* the plaintiff had alleged that the defendants fabricated a financial crisis in the defendant Western Coal Corporation in order to artificially depress the stock price so they could increase their holding of the company at a discount. The plaintiff alleged that the company released contrived and unduly pessimistic news, compelling investors like the plaintiff to sell their securities and cause a dramatic drop in the share price.[14] The plaintiff's case was exclusively based on the public record, the evidentiary foundation produced by the defendants and the expert evidence of an accountant.[15]

The defendants put forward a "substantial body" of material, which provided "detailed and thoroughly documented evidence concerning their actions during the material time" as well as evidence from two expert accountants.[16] Justice Strathy disagreed with the plaintiff's argument that the defendants' "mountain of evidence" was a strategic attempt to turn the leave motion into an assessment of the merits with an incomplete evidentiary record.[17] Justice Strathy found that the defendants were entitled to put a record before the court to establish that the plaintiff's claim has no reasonable possibility of success, and the plaintiff had the opportunity to cross-examine the defendants' witnesses and request any missing documents.[18]

In this case, vigorously defending the leave motion and preparing a substantial body of evidence was a worthwhile endeavour. However, it was not the amount of the evidence, but the substance that ended the litigation. In effect, Western Coal had a complete answer to the plaintiff`s allegations. The evidence demonstrated that Western Coal was "doing precisely what the law required it to do".[19] Justice Strathy found that the plaintiff's claim was based purely on

[14] *Western Coal* at para.2-3
[15] *Western Coal* at para. 70
[16] *Western Coal* at para. 71; According to the courts in *Green* and *Sharma v. Timminco Limited,* 2012 ONCA 107 the leave motion is intended to be a screening mechanism rather than a mini-trial on the merits, given that the legislature intended that motions for leave would be heard and disposed of within three years of the alleged misrepresentations, *Green* at para. 375; However, this is not how many defendants (or plaintiffs) have approached leave. In *Imax*, for example, the defendants "put forward considerable affidavit and documentary evidence relevant to the claims and the defences". However, this evidence did not convince the motion judge that the class action was meritless and the defendants were ordered to pay costs of $385,000 on the leave motion alone. *Silver v. Imax Corporation*, 2010 ONSC 4017 re costs at paras. 26, 31
[17] *Western Coal* at para. 74
[18] *Western Coal* at para. 77
[19] *Western Coal* at para. 241

"speculation or suspicion rather than evidence" and was demonstrably unfounded.[20] Justice Strathy concluded that the plaintiff did not satisfy the "reasonable possibility of success" hurdle.

Before *Western Coal*, the only cases in which leave to commence an action under Part XXIII.1 was denied were those that were not commenced within the limitation period of three years set out in the *Securities Act* such as *Green* and *Sharma v. Timminco Limited*. These cases seemed to suggest that, if a claim is brought within the limitation period, the leave test would not be a significant impediment to proceeding with a class action for misrepresentation in the secondary securities market. Read in this context, *Western Coal* should be regarded as the exception rather than the new rule. The threshold on the leave motion remains very low. Defendants should consider the unlikelihood of success when determining whether to expend the resources necessary to contest a leave motion.

SNC

The class action in *SNC* results from losses suffered by the company after it announced an investigation by the company's audit committee into certain improper contracts, which violated the company's internal policies, and that its internal controls over disclosure, compliance, and financial reporting were inadequate. The plaintiffs allege that disclosure documents issued by SNC contained misrepresentations relating to the adequacy of SNC's internal controls, compliance of SNC's financial statements with generally accepted accounting principles, and compliance of management with the company's code of ethics.

Since *Ainslie v. CV Technologies Inc*. ("*CV Technologies*")[21] it has been clear that defendants are not obliged to lead evidence in response to a leave motion. In *CV Technologies*, Justice Lax stated that s. 138.8 was enacted to protect defendants from coercive litigation and to reduce their exposure to costly proceedings, not to assist plaintiffs in securing evidence upon which to base an action under Part XXIII.1. To require defendants to file evidence that may not be

[20] *Western Coal* at para. 262, citing *Imax* at para. 330
[21] *Ainslie v. CV Technologies Inc*. (2008), 93 O.R. (3d) 200, leave to appeal to the Divisional Court granted, but the matter was settled before an appeal was heard.

necessary for the leave motion would serve no purpose other than to expose defendants to time-consuming and costly discovery and would sanction fishing expeditions.[22] However, a defendant who chooses not to file evidence in response to a leave motion takes the risk that leave will be granted and may forego the right to assert the statutory defences under Part XXIII.1 of the Act.

In *SNC*, the parties came to an agreement that the defendants would not oppose leave under Part XXIII.1 of the Act or certification of the action as a class proceeding if the plaintiffs discontinued, with prejudice, their common law and oppression claims.[23] The defendants also agreed to pay the costs of disseminating the notice of certification and receiving opt out from class members (approximately $150,000) and to reimburse fees paid to experts who swore affidavits in support of the plaintiffs' leave and certification motions (approximately $98,000).[24] In so doing, the defendants wisely saved themselves an expensive step in the long road of expensive steps that is defending a class action.

A contested leave motion advances the plaintiffs' investigation of the case and ultimately their preparation for trial. Moreover, as evidenced by *Imax*, the costs associated with a leave motion can be substantial and, if leave is granted – as it will be more often than not – the defendant will have also provided free and early discovery to the plaintiff on the merits of the case.

Conclusion

While *Western Coal* may give some hope to defendants that they could halt an expensive class action before it begins in earnest, caution must be exercised to engage in a contested leave motion only where the defendants have a "slam dunk" defence on the merits, as in *Western Coal*. Contesting a leave motion can be extremely expensive as it often involves multiple affiants and experts. It may also be strategically unwise. Given that the leave motion is a merits-based test, filing affidavits and opening those affiants up to cross-examination will give early discovery on the merits to the plaintiffs. In not opposing a leave motion, defendants can save

[22] *CV Technologies* at para. 25
[23] *CV Technologies* at para. 33
[24] *CV Technologies* at paras. 34, 35

substantial costs and avoid disclosing evidence that would not otherwise be available at this stage in the proceedings. Defendants should consider whether the time, expense, and risk of contesting a leave motion are worth it, given the very low chance of defeating such a motion.