CITATION: *Green v. Canadian Imperial Bank of Commerce*, 2012 ONSC 3637
COURT FILE NO.: CV-08-00359335-0000
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ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	
HOWARD GREEN and ANNE BELL	*Joel Rochon, Peter Jervis, John Archibald & Sakie Tambakos*, for the Plaintiffs/ Applicants
Plaintiffs/Applicants	
- and -	
CANADIAN IMPERIAL BANK OF COMMERCE, GERALD McCAUGHEY, TOM WOODS, BRIAN G. SHAW, KEN KILGOUR	*James C. Tory, Sheila Block, Crawford Smith & Andrew Gray* for the Defendant/ Respondent CIBC
	Benjamin Zarnett & David Conklin, for the Defendants/Respondents, McCaughey, Woods, Shaw and Kilgour
Defendants/Respondents	
	HEARD: February 9, 10, 13-17; April 5, 2012

Contents

G.R. Strathy J.

I. INTRODUCTION

[1] The plaintiffs, two shareholders of the Canadian Imperial Bank of Commerce (CIBC or the Bank), seek leave under s.138.3 of the *Securities Act*, R.S.O. 1990, c. S.5, to pursue an action against CIBC and four senior officers for alleged misrepresentations in the secondary securities market between May 31, 2007 and February 28, 2008 (the Class Period) concerning CIBC's exposure to the U.S. residential mortgage market (the USRMM).

[2] The plaintiffs also seek to have this action certified as a class action, pursuant to s. 5 of the *Class Proceedings Act, 1992*, S.O. 1992, c. 6 (the *C.P.A.*).

[3] The plaintiffs acquired shares of CIBC during the Class Period. They allege that, during that period, CIBC misrepresented its financial position in its public disclosures by failing to reveal the full extent of its exposure to the USRMM and by failing to write down, soon enough and sufficiently enough, the positions it held in the USRMM, thereby overstating its income. They say that when the truth was finally revealed, the value of CIBC's stock fell dramatically,

causing damages to them and to others who purchased CIBC's securities during the Class Period (Class Members).

[4] Part XXIII.1 of the *Securities Act* gives a civil cause of action for damages to a shareholder of a "responsible issuer" for misrepresentations made by the issuer and by certain directors and officers, in financial statements, quarterly and annual reports and other documents and in public oral statements. The statutory provisions will be discussed below, but for present purposes, the important point is that leave of the court must be obtained in order to commence such an action. In order to grant leave, the court must be satisfied that (a) the action is being brought in good faith; and (b) there is a reasonable possibility that the action will be resolved in favour of the plaintiffs. The observations on the evidence that follow must be understood to have been made on the basis of that test, rather than on the more demanding "balance of probabilities" standard that would apply to the trial of an action. Any findings of fact made on the leave motion should therefore be understood as provisional only.

[5] The defendants say that the claim under the *Securities Act* should be dismissed because the plaintiffs have no reasonable possibility of establishing that any of the statements at issue was a misrepresentation. The also say that the action has no possibility of success because leave to pursue that claim was not granted within the three year limitation period in s. 138.14 of the *Securities Act*, with the result that the claim is time-barred. They rely on the recent decision of the Court of Appeal in *Sharma v. Timminco Limited*, 2012 ONCA 107, 109 O.R. (3d) 569 ("*Timminco*"), discussed below.

[6] In order to put the issues in context, I will begin with a brief outline of the submissions of the parties on the leave motion. I will then discuss the disclosure obligations of a public issuer of securities and the standards that govern such disclosure. I will then describe the factual background to this action, beginning with the USRMM and the complex financial instruments with exposure to that market that were held by CIBC during the Class Period. This will be followed by an outline of the events before, during and after the Class Period, including developments in the market generally, the actions taken by CIBC to assess, value and report upon its positions in the USRMM and the alleged misrepresentations made by CIBC. Finally, I will apply the test for leave set out in the *Securities Act* and the test for certification in the *C.P.A.*

[7] For the reasons that follow, I have concluded that the plaintiffs have met the test for leave in s. 138.3 of the *Securities Act* and the test for certification in s. 5(1) of the *C.P.A.* I find, however, that the plaintiffs' right to pursue the *Securities Act* cause of action is time-barred, as leave was not obtained prior to the expiry of the three year limitation period. As the *Securities Act* claim has no possibility of success and as no other cause of action is available to the plaintiffs, certification would serve no purpose and both motions are dismissed.

II. OVERVIEW OF THE PARTIES' POSITIONS

[8] In this section, I will give a brief overview of the positions of the parties. Detail and explanations of some of the more complex terminology and issues will be added during the course of these reasons. I will also expand, in due course, on the positions taken by the parties and the evidence they rely upon.

[9] At the outset of the Class Period, CIBC held two portfolios that were sensitive to the USRMM. These were investments and other financial instruments or transactions that were exposed to that market and would, generally, rise and fall with that market. The first position, which was acquired as a part of CIBC's structured finance business and was held in its trading securities portfolio, is referred to as its "direct exposure" or "unhedged position". It consisted primarily of bonds called "Residential Mortgage-Backed Securities" (RMBS) or "Collateralized Debt Obligations" (CDOs), which were secured in whole or in part by U.S. residential mortgages, including "subprime" mortgages. I will explain the nature of these assets when I examine the USRMM in my discussion of the Factual Background in Part IV of these reasons. This group of assets had a value of about US$1.7 billion at the opening of the Class Period.

[10] The second position, referred to as CIBC's "indirect exposure" or "hedged" position, was acquired as a result of CIBC's "intermediation" business – that is, its activities as a financial intermediary, insuring the positions of others who were exposed to risk as a result of their ownership of mortgage-backed securities. These positions were held in CIBC's "derivative instruments" portfolio and consisted of a form of insurance called credit default swap (CDS) contracts, with a "notional" value of US$9.8 billion at the outset of the Class Period. The value is referred to as "notional," because money does not actually change hands when the contract is

made. The payments under the contract are calculated on the face amount as if it were the purchase price.

[11] The plaintiffs allege that, at the beginning of the Class Period, CIBC was perilously exposed to the USRMM. It held in its unhedged and hedged positions a total of US$11.5 billion of what the plaintiffs say were "risky" subprime investments. They allege that CIBC had not disclosed these positions to investors in its financial statements or quarterly reports. They say that CIBC failed to respond to warning signs that these investments were deteriorating – the US housing market was in decline, or at best stable, threatening the underlying premise on which the investments were based. Market indices were falling. The market was illiquid, meaning that CIBC could not dispose of its investments without significant losses. The parties with whom CIBC had insured or "hedged" its positions did not have the financial means to honour their obligations in the event of default in the underlying bonds.

[12] The plaintiffs say that in the Bank's quarterly report for the second quarter of 2007 (Q2 2007), which ended on April 30, 2007[1] and which was released on May 31, 2007, CIBC:

- failed to disclose its exposure to the USRMM;
- failed to disclose the extent to which its exposure was concentrated in the USRMM; and
- mis-stated its profit and loss for the quarter, as a result of its over-valuations of its subprime assets.

[13] They allege that the situation continued to deteriorate through Q3 2007 (the period May 1 to July 31, 2007). As market conditions worsened and some USRMM-based funds collapsed, the media became curious about CIBC's exposure to the USRMM and began asking questions. High level meetings took place within the Bank and at the Board level to discuss CIBC's subprime exposure, how to value it and how to report it. The plaintiffs say that press releases issued by CIBC on July 10, 2007 and August 13, 2007, attempting to assuage media concerns, were themselves misleading because they failed to fully disclose the extent of the Bank's subprime exposure.

[1] The CIBC quarters of particular concern in this action are Q2 2007 (February, March, April), Q3 2007 (May, June, July), Q4 2007 (August, September, October) and Q1 2008 (November, December 2007, January 2008). The results for the quarter were generally released 30 days after the end of the quarter.

[14] The plaintiffs say that CIBC's quarterly report for Q3 2007, which was released on August 30, 2007, continued to misrepresent its exposure to the USRMM. The report referred only to CIBC's unhedged exposure of $1.7 billion, which was described as containing a majority of AAA-rated assets. There was no disclosure of the $US9.8 billion hedged position. The plaintiffs say that this quarterly report did not comply with Canadian Generally Accepted Accounting Principles (GAAP), because it failed to disclose CIBC's entire subprime exposure of $11.5 billion, failed to disclose the weakness of its hedges and mis-stated its profit and loss for the quarter, due to its flawed valuations of its direct investments and of its hedge protection.

[15] The situation in the USRMM continued to deteriorate during Q4 2007 (ending October 30, 2007). CIBC struggled to value and to correctly disclose the extent of its exposure. In November of 2007, when the extent of CIBC's hedged exposure was leaked to the market, its share price fell 10%. On December 6, 2007, CIBC released its results for Q4 2007 and for fiscal 2007, disclosing for the first time the extent of its hedged position. This was followed by further dramatic declines in its share price. On December 19, 2007, CIBC issued a news release that it would possibly take a "large charge" in Q1 2008, which could be as high as $2 billion, as a result of the deterioration in the financial position of one of the insurers of a large portion of its hedged position. These disclosures resulted in a further drop in the share price.

[16] In Q1 2008, CIBC took write downs of approximately $2.85 billion, or $5.75 per share, on CDS protection it had purchased from insurers of its hedged position. It also recorded nearly $500 million of losses (93 cents per share) on its direct unhedged investments connected with the subprime market.

[17] When all was said and done, CIBC ultimately recorded before-tax losses of $9.3 billion and after-tax losses in excess of $6 billion due to its investments connected with the subprime mortgage market.

[18] During the Class Period, the price of CIBC shares declined from about Cdn$106 per share on May 31, 2007 to Cdn$67 per share on February 28, 2008, a drop of about 37%.

[19] In overview, the plaintiffs say that the nature and extent of CIBC's $11.5 billion exposure to the USRMM were material facts that ought to have been disclosed in CIBC's reports and

financial statements. They say that CIBC and the individual defendants, who were senior officers of CIBC, made misrepresentations in other documents and oral statements about the amount and nature of the Bank's exposure to the USRMM and the degree of risk associated with it.

[20] The defendants' response is that the plaintiffs' allegations are based on wisdom that comes with hindsight. They say that the global credit crisis and the collapse of the subprime mortgage market that preceded it was a "once-in-a-century Tsunami" that CIBC could not have foreseen. CIBC's positions in the subprime market were primarily rated AAA by reputable credit rating agencies such as Standard & Poor's Financial Services LLC ("S&P") and Moody's Investors Service Inc. (Moody's) and the possibility of default on these securities was reasonably viewed as highly unlikely. The insurers of its derivative positions were largely AAA-rated, except for one that was A-rated. In light of historical default patterns for such highly rated institutions, there was no reason to expect the widespread defaults that ultimately occurred. CIBC itself had an AA rating.

[21] CIBC says that the record bears out the fact that its systems and processes for the assessment and valuation of risk and disclosure to investors were sophisticated and robust. The issues received attention at the highest levels of the Bank and were reviewed, approved and enhanced by CIBC's auditors, Ernst & Young (E&Y). CIBC contends that during the Class Period, it made reasonable judgments about values and risks and that those judgments should be examined based on what the Bank knew at the time, not with the wisdom of hindsight. In making those judgments, it says, CIBC complied with all relevant regulatory and industry standards and acted on the advice of its expert auditors.

[22] In a sense, this action is all about timing – specifically, whether CIBC should have made the disclosures much earlier than Q1 2008. The plaintiffs say that CIBC should have made those disclosures no later than the beginning of the Class Period on May 31, 2007, when it released its Q2 2007 quarterly report.

[23] It will be helpful at this point to give further context to the plaintiffs' allegations by setting out the statutory disclosure obligations of a public issuer of securities, like CIBC. I will do this in section III, immediately following. In Section IV, I will set out the factual background that gives rise to this action. This includes the USRMM and particularly the subprime market and

the complex financial instruments that were developed based on that market. This is necessary in order to fully appreciate the parties' positions concerning the risk associated with the subprime market and the issues pertaining to the valuation of CIBC's positions that were sensitive to that market. The discussion will then turn to CIBC's investments, the relevant events before and during the Class Period, and the specific representations about which the plaintiffs complain.

III. THE *SECURITIES ACT* DISCLOSURE REQUIREMENTS[2]

[24] The purposes of the *Securities Act* are to protect the public from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets (s. 1.1). It is remedial legislation and it is to be given a broad interpretation: *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557, [1994] S.C.J. No. 58; *Kerr v. Danier Leather Inc.*, 2007 SCC 44, [2007] 3 S.C.R. 331 at para. 32. One of the ways in which the statute accomplishes this goal is by requiring issuers to satisfy certain disclosure obligations.

[25] A public issuer of securities in Ontario has an obligation to provide timely and accurate information to its shareholders and to potential shareholders. This is referred to as the "continuous disclosure obligation." This obligation is described in Part XVIII of the *Securities Act*, entitled "Continuous Disclosure". Continuous Disclosure is accomplished through two particular obligations on an issuer:

> (a) a duty to provide regular and periodic disclosure of quarterly and annual financial statements and annual reports;
>
> (b) a duty to make timely disclosure of important and substantial business developments as they occur.

[26] Sections 77 and 78 of the *Securities Act* require the issuer to file interim quarterly financial reports within 60 days of the end of the quarter and annual comparative financial statements, accompanied by the report of the corporation's auditor, within 140 days of the year end. Section 75(1) provides that where a "material change" occurs in the affairs of a reporting issuer, it is required to file a news release authorized by a senior officer, disclosing "the nature

[2] See generally on this topic, Jeffrey MacIntosh and Christopher Nicholls, *Securities Law* (Toronto: Irwin Law, 2002).

and substance of the change." It is also required to make a report to the Ontario Securities Commission (OSC).

[27] The term, a "material change", when used in relation to an issuer other than an investment fund, is defined in s. 1(1) as:

> (i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or
>
> (ii) a decision to implement [such] a change [...] made by the board or [...] senior management [...]

[28] It is noteworthy that this obligation is restricted to important and substantial "changes" in key aspects of the business, operations or capital of the issuer. It is not every change that could have a significant effect on the price of the issuer's securities that will trigger the disclosure obligations. The requirement to make timely disclosure of a material change is not an obligation to provide running commentary on the company's progress during the quarter or to comment on internal or external events that may impact its performance. The company is not usually in a position to provide useful information about its financial circumstances until it has completed its financial analysis at the end of the quarter or the end of the year. The sporadic disclosure of bits and pieces of information that investors might find interesting could in fact be misleading or even harmful without the balance that is afforded by the financial statements and the Management Discussion and Analysis of Financial Conditions and Results of Operations (MD&A). In fact, securities regulators contemplate that issuers should maintain "quiet periods" between the end of the quarter and the release of the quarterly results, which generally happens about four weeks later.

[29] As a public company, with its shares listed on both the Toronto Stock Exchange (TSX) and the New York Stock Exchange (NYSE), CIBC was required to comply with the two types of continuous disclosure obligations in very specific ways. The requirements are set out in National Instrument 51-102 of the Canadian Securities Administrators (NI 51-102), which has been adopted by the OSC and by other securities administrators throughout Canada. Under the NI 51-102, CIBC was required to file with the securities regulators and release to its shareholders, annual and quarterly financial statements after the end of each quarter and at the end of each

fiscal year. It is these documents, and the accompanying MD&A that are the focus of some of the plaintiffs' complaints in this action. In addition, CIBC was required to make timely disclosure of material business developments, including changes to its business operations or capital, when they occurred.

[30] The financial statements must be prepared in accordance with Canadian GAAP (see *Securities Act*, s. 78(1) and NI 52-107, s. 3.2(1)). The GAAP are expressed in the Handbook of the Canadian Institute of Chartered Accountants (the CICA Handbook or Handbook or HB). The annual financial statements must be certified by the CEO and the CFO, reviewed by the audit committee and approved by the Board. They must also be audited by an outside auditor and must be accompanied by an opinion as to whether the statements present fairly, in all material respects, the financial position, results of operations and cash flows of the issuer, in conformity with GAAP. The interim financial statements are not required to be audited, but they are required to be reviewed by the issuer's Board of Directors and by the audit committee. In CIBC's case, they were also reviewed by the external auditor, E&Y, which also made inquiries of management. The interim statements are required to provide year to date information for the particular quarter and a comparison with the corresponding period in the previous year.

[31] In addition to the quarterly and annual financial statements, CIBC, like all larger reporting issuers, was required to prepare and distribute its MD&A to shareholders on an annual and quarterly interim basis.

[32] The content of the MD&A is prescribed by Form 51-102F1, which requires that the issuer set out a "narrative explanation, through the eyes of management, of how [the] company performed during the period covered by the financial statements and of [the] company's financial condition and future prospects." The form also prescribes that the MD&A should, among other things: (a) "discuss material information that may not be fully reflected in financial statements" and (b) "discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future." An issuer is required to provide a balanced discussion of its results of operations and financial condition "including, without limitation, such considerations as liquidity and capital resources – openly reporting bad news as well as good news." To paraphrase the observation of the Ontario Securities Commission in

YBM Magnex International Inc. (Re.) (2003), 26 O.S.C.B. 5285, at para. 2, an investor is entitled to know what specific risks are presently threatening the company.

[33] The MD&A is required to disclose "material information". This requirement calls for the exercise of the issuer's judgment as to what is material. The form provides the following definition of what is likely to be "material":

> Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated?

[34] The form indicates that this concept of materiality is consistent with the reporting notion of materiality contained in the CICA Handbook.

[35] It is noteworthy that the requirement to disclose trends and risks is <u>not</u> a requirement to disclose <u>all</u> trends and risks. Rather, it is a requirement to disclose trends and risks that have affected the financial statements or are "<u>reasonably likely</u>" to affect them in the future. The words "reasonably likely" connote some element of probability and it makes sense to interpret them as "more probable than not" – thus, the issuer is not required to disclose every conceivable risk or even every potential or possible risk, but only those risks that are more probable than not to occur and to have an effect on the financial statements.

[36] In addition to these regular reporting requirements, a reporting issuer like CIBC is required to issue and file with the OSC a news release disclosing the nature and substance of any "material change" – that is, "a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer".[3]

[37] In addition to the disclosures above that are required by law, CIBC made additional regular voluntary disclosure of the following kinds on its quarterly reporting cycle coincident with the release of its quarterly and annual financial statements and MD&A:

> • a quarterly press release summarizing key information in the financial statements and MD&A;

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[3] *Securities Act*, s. 1(1).

- "Supplementary Financial Information" that was posted on CIBC's website;

- a quarterly "earnings conference call" involving senior members of management and analysts to discuss the financial results and questions arising from the quarterly and annual financial statements and MD&A;

- a quarterly "Investor Presentation" in the form of a power point presentation that is posted on CIBC's website and that sets out key points from CIBC's quarterly and annual results;

- answers to "Frequently Asked Questions" relating to the quarterly and annual financial results which, again, are posted on CIBC's website.

[38] The plaintiffs are alleging misrepresentations in connection with voluntary disclosure made by CIBC coincident with the release of the Q2, Q3, Q4 and 2007 fiscal year end results.

[39] As well, CIBC provided occasional voluntary out-of-cycle disclosure when appropriate in its judgment to address market rumours or to pre-release anticipated financial results that were out of line with market expectations. The plaintiffs allege misrepresentations in three pieces of voluntary out-of-cycle disclosure: news releases issued on July 20, August 13 and December 19, 2007.

[40] I now turn to the factual background that led to this action. The discussion begins with a description of the USRMM and the security instruments that were based on it or derived from it. I then describe the "positions" or investments held by CIBC at the outset of the Class Period that were sensitive to the ups and downs in that market. I will describe the systems in place within CIBC to analyze, value and report on its investments for the information of stockholders and investors. Finally, I will describe the key events during the Class Period, some of which for the foundation for the plaintiffs' allegations of misrepresentation.

IV. FACTUAL BACKGROUND

1. The USRMM

[41] Until the early 1970s, the residential mortgage market in the United States operated on fairly traditional lines. A person wishing to buy a home would apply for a mortgage loan from a

bank or finance company, would provide credit information and a down payment, and would – if approved – take out a long-term mortgage at a fixed rate. The lender would generally keep the mortgage until it was paid off. It was all very stable, safe and traditional.

[42] In order to increase their capital, some lenders began to sell their loans to other financial institutions and use the proceeds from these sales to finance new loans. Thus, the originator of the loan would be involved with the borrower for a relatively short term – making the loan and then selling it to a third party.

(a) RMBS, CDOs and CDS

[43] Rather than simply receiving the long-term revenue from the mortgages they acquired, the banks or financial institutions buying these mortgages saw an opportunity to make more profit by bundling up a number of mortgages into a loan pool and "securitizing" them. This process involved calculating the revenue stream that would be created by the principal and interest payments from the mortgages in the pool and securitizing these proceeds by creating a corporation or trust that would issue a debt obligation or bond, which would make payments over time to investors. The bonds were called RMBS or CDOs.

[44] For many years, RMBS were regarded as a secure and stable investment. The Levin Report[4] described the result in the following terms:

> For years, securitization worked well. Borrowers paid their 30-year, fixed rate mortgages with few defaults, and mortgage backed securities built up a reputation as a safe investment. Lenders earned fees for bundling the home loans into pools and either selling the pools or securitizing them into mortgage backed securities. Investment banks also earned fees from working with the lenders to assemble the pools, design the mortgage backed securities, obtain credit ratings for them and sell the resulting securities to investors. Investors like pension funds, insurance companies, municipalities, university endowments and hedge funds earned a reasonable rate of return on the RMBS securities they purchased.

[4] Report of the United States Senate Permanent Subcommittee on Investigations, "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse" (Washington, D.C.: April 13, 2011).

[45] Over time, there were changes in US Treasury rules concerning the capital reserves that banks were required to hold on RMBS securities. These rules were tied to the credit rating agencies' rating of these securities. Due in part to these changes, an incentive developed to generate more and more mortgages to fuel the market's appetite both for mortgage-backed securities and for the consequent securitization fees earned by investment banks that assembled the mortgage pools, designed the RMBS bonds, obtained credit ratings for them and sold them to investors. The result was that, instead of providing loans to investors who had a proven credit history and a down-payment, lenders moved – with considerable appetite – into the so-called "subprime" mortgage market.

[46] Subprime mortgages were provided to higher risk borrowers, including those with histories of default, foreclosure, bankruptcy and high credit loads. In some cases, aggressive lending practices, prompted by the desire to earn a quick fee on the sale of the mortgage, resulted in loans being made without requiring any down-payment and without any sort of verification of the borrower's income or capacity to repay the loan. In the most extreme circumstances, subprime loans were made to so-called "NINJA" borrowers – "no income, no job, no assets."

[47] The apparent folly of these subprime loans, which appear at first blush to have been doomed to default, was justified by one factor – the long history of a year-over-year increase in the U.S. housing market. Loans would be made to subprime borrowers with an initial low "teaser" rate of interest for the first two or three years, and would be recalibrated with a higher variable rate for the balance of the mortgage term, unless the borrower refinanced and paid off the original loan in the interim. The theory was that the buyer would be able to establish a better credit rating by successfully paying off the loan for two or three years, and, with rising home prices, the increase in the equity in the borrower's home would allow him or her to refinance on more favourable terms, before the higher interest rate kicked in.

[48] RMBS and CDO bonds were typically issued in different tranches, with each tranche having a unique risk profile, a different rate of return and a specific credit rating. From the point of view of the bondholder, the risk attached to a bond backed in whole or in part by subprime mortgages, was mitigated by the contractual features attached to each particular tranche. The most highly rated tranche of an RMBS was typically the "super senior" tranche, with a priority

claim to the cash flow from the mortgage pool, the lowest rate of return and the highest rating – typically AAA. "Mezzanine" tranches were ranked below the "Super Senior" tranches and typically had ratings from BBB- to AA. "Subordinated" tranches had ratings of BB or B and "first loss" or equity tranches were unrated.

[49] Although the tranches of a particular RMBS were all secured by the same underlying pool of mortgages, their ratings were based on different credit risks associated with each unique tranche. For example, the revenue stream from the underlying collateral pool was allocated from the top down from the most senior tranche to the most junior. If there were defaults in the underlying mortgage pool, the income stream to the "first loss" tranche would be affected first. There were other means of enhancing the security of a particular tranche, including "overcollateralization", which provided more underlying collateral than the liability under the bond, to create a cushion against losses, thereby protecting the most senior tranche. The overcollateralization also included cash flow generated from the payment of interest and principal on the underlying mortgages, as well as pre-payments due to repayments of the underlying mortgages, with the result that the senior tranches would be paid down first.

[50] CDOs were a somewhat more complex structured finance product that bundled together and re-securitized underlying income producing assets, including tranches of RMBS, commercial mortgages and other assets. Like a RMBS, a CDO would be structured in tranches and each tranche would be assigned a specific credit rating. It was not unusual that a CDO containing BBB tranches of many different RMBS would have an AAA-rated super senior tranche, in recognition of the priority and credit enhancement features attached to that tranche. Some CDOs, referred to as "CDO-squared", were created from tranches of other CDO bonds. To use a common example, a CDO could be created from the "mezzanine" tranches of 10 different RMBS and could then itself be divided into tranches based on the characteristics and risk attached to each layer.

[51] A Credit Default Swap (CDS) is a financial instrument, sometimes described as a "synthetic security" or derivative, used as a hedge or protection against the risk of default of a security. It could also be used by speculators to profit from the default of a security. It was called a derivative because its value was "derived" from the value of the underlying security. The CDS

pays the buyer in the event of losses on the security that forms the reference asset. The reference asset might be a CDO tranche, a bundle of CDOs, or even one of the actively traded CDS indices, the ABX or the TABX, discussed below.

[52] A CDS can be thought of as a form of insurance that enables a party holding the reference asset to protect itself against losses on its position by paying a premium to the seller. A financial institution might, for a fee, sell a CDS to guarantee a tranche of a CDO against default. CIBC engaged in this business during the Class Period, not only by selling such protection but also by hedging its own exposure by buying CDS protection from third parties. It could make a profit on its CDS position based on the difference between the premium it charged for the CDS that it issued and the premium it paid to purchase a CDS in order to hedge its position.

[53] The underlying position that was being hedged was the "reference asset" or the "hedged position". The CDS that was purchased from a counterparty to insure the position was called the "hedge position".

[54] The CDS "spread" refers to the cost of insuring the reference asset, expressed as a percentage of the notional amount of the reference asset being covered. The higher the risk of default associated with the reference asset, the higher the spread. In its capacity as a seller of CDS protection, CIBC planned to make a profit on the difference between the premium it received from selling the CDS and the cost of buying a CDS from its counterparty.

[55] The subprime market was therefore premised on the sustainability of the historical upwards trend of U.S. home prices. The performance of the underlying RMBS bonds was critically dependent on the rate at which home prices appreciated. It was the appreciation in home prices, with consequent re-financing and pre-payment of mortgages in the underlying pool, that pumped the flow of funds to the higher level tranches. Without this, the losses in the underlying mortgage pools would be higher than anticipated and there would be losses on the RMBS bonds. When home prices reached a plateau, then began to fall in 2006 and 2007, U.S. mortgagors began to default in record numbers. With those defaults came defaults in the RMBS that securitized the underlying mortgages and, with that, came the "subprime crisis" and, ultimately, the financial crisis that rocked world markets.

(b) Credit Ratings and the Rating Agencies

[56] A credit rating is an assessment of the security of a particular financial instrument such as a bond or a tranche of a RMBS or CDO. Credit ratings are issued by companies that have been approved for that purpose by the United States Securities and Exchange Commission. Two of the pre-eminent rating agencies during the material time were S&P and Moody's.

[57] A credit rating reflects the rating agency's assessment of the probability of a default or losses in the investment. The highest rating is AAA and the lowest rating is D. An institution creating and marketing a RMBS or CDO would engage one of the rating agencies to rate the bond. An investor could thus acquire an interest in the bond, knowing that it had received a particular rating (for example AAA, A or BB), and could match the rate of return with his or her risk tolerance. An AAA rating carried the greatest security, the least risk and generally the lowest rate of return. Bonds rated AAA and AA are regarded as "high credit quality". Bonds rated A and BBB are referred to as "medium credit quality". Collectively, bonds with AAA to BBB ratings (high credit quality and medium credit quality) are referred to as "investment grade" due to their reliability to repay the debt in the short term, making them suitable investments for banks and other financial institutions.

[58] The rating agencies played a critical role in the subprime mortgage market and in the ultimate financial crisis, because they assigned ratings to the tranches in the RMBS, the CDOs and the other financial instruments that were created by the financial community and sold to investors. These ratings were assigned at the time the securities were issued for sale and were generally accepted at the time as an informed independent assessment of the security of the investment.

[59] With the benefit of hindsight and as a result of the decline of the U.S. housing market, we now know that these ratings were unreliable. The Levin Report issued a damning indictment of the role of the rating agencies in the subprime crisis. It found that they had a conflict of interest because they were paid to issue the ratings and bonds could not be marketed without favourable ratings. The Committee stated, at pages 6-7 of its report:

> Between 2004 and 2007, Moody's and S&P issued credit ratings for tens of thousands of U.S. residential mortgage backed

securities (RMBS) and collateralized debt obligations (CDOs). Taking in increasing revenue from Wall Street firms, Moody's and S&P issued AAA and other investment grade credit ratings for the vast majority of those RMBS and CDO securities, deeming them safe investments even though many relied on high risk home loans. In late 2006, high risk mortgages began incurring delinquencies and defaults at an alarming rate. Despite signs of a deteriorating mortgage market, Moody's and S&P continued for six months to issue investment grade ratings for numerous RMBS and CDO securities.

Then, in July 2007, as mortgage delinquencies intensified and RMBS and CDO securities began incurring losses, both companies abruptly reversed course and began downgrading at record numbers hundreds and then thousands of their RMBS and CDO ratings, some less than a year old. Investors like banks, pension funds, and insurance companies, who are by rule barred from owning low rated securities, were forced to sell off their downgraded RMBS and CDO holdings, because they had lost their investment grade status. RMBS and CDO securities held by financial firms lost much of their value, and new securitizations were unable to find investors. The subprime RMBS market initially froze and then collapsed, leaving investors and financial firms around the world holding unmarketable subprime RMBS securities plummeting in value. A few months later, the CDO market collapsed as well.

Traditionally, investments holding AAA ratings have had a less than 1% probability of incurring defaults. But in 2007, the vast majority of RMBS and CDO securities with AAA ratings incurred substantial losses; some failed outright. Analysts have determined that over 90% of the AAA ratings given to subprime RMBS securities originated in 2006 and 2007 were later downgraded by the credit rating agencies to junk status. ... Those widespread losses led, in turn, to a loss of investor confidence in the value of the AAA rating, in the holdings of major U.S. financial institutions, and even in the viability of U.S. financial markets.

Inaccurate AAA credit ratings introduced risk into the U.S. financial system and constituted a key cause of the financial crisis. In addition, the July mass downgrades, which were unprecedented in number and scope, precipitated the collapse of the RMBS and CDO secondary markets, and perhaps more than any other single event triggered the beginning of the financial crisis...

It was not in the short term economic interest of either Moody's or S&P, however, to provide accurate credit ratings for high risk

> RMBS and CDO securities, because doing so would have hurt their own revenues. Instead, the credit rating agencies' profits became increasingly reliant on the fees generated by issuing a large volume of structured finance ratings. In the end, Moody's and S&P provided AAA ratings to tens of thousands of high risk RMBS and CDO securities and then, when those products began to incur losses, issued mass downgrades that shocked the financial markets, hammered the value of the mortgage related securities, and helped trigger the financial crisis.

[60] As I will discuss below, ne of the questions that CIBC asked itself in the midst of the subprime crisis and one of the questions that would ultimately be asked by the court if this action were to proceed to trial, is whether CIBC placed undue reliance on the rating agencies in the acquisition of its positions in the subprime market. The same question can be asked about whether CIBC's valuations of its positions were unduly reliant on the rating agencies' assessments.

(c) The ABX and TABX Indices

[61] In early 2006, private interests developed an index, referred to as the ABX index, which monitored the cost of obtaining CDS protection on tranches of subprime RMBS bonds. Every six months, twenty reference subprime RMBS transactions were selected and the cost of CDS protection was determined for each of five tranches of the underlying transactions – the AAA, AA, A, BBB and BBB- tranches. The sub-index would reflect the cost of buying CDS protection on each tranche. Six months later, twenty new transactions would be examined and new data would be obtained.

[62] The TABX index operated in a similar fashion, but was applied to CDO transactions that were collateralized by BBB and BBB- RMBS. It tracked the prices of CDS protection on the AAA to BBB- tranches of the CDOs.

[63] Although these indices might be regarded as a barometer of the health of the U.S. subprime market, they were not created for that purpose. They were created so that investors could buy and sell derivative contracts tied to the value of the indices. This allowed investors to bet for or against the index, effectively hedging their positions.

2. CIBC's Exposure to the USRMM at the Outset of the Class Period

[64] As mentioned earlier, in the Overview section, CIBC's positions sensitive to the USRMM during the Class Period fell into two categories. They were held in two different portfolios and were subject to different accounting requirements:

> (a) The unhedged positions: these were direct holdings by CIBC of RMBS and of CDOs backed by collateral pools that included RMBS and were held as part of CIBC's "Securities" portfolio;
>
> (b) The hedged positions: these were CDS contracts that referenced either RMBS or CDOs with collateral pools that included RMBS, and were held in CIBC's "Derivative Instruments" portfolio.

[65] I will describe these positions in somewhat more detail.

(a) The Unhedged Positions

[66] The unhedged position had been acquired by CIBC between approximately April 2006 and April 2007 as part of its investment banking business. It had purchased debt instruments, RMBS and CDOs, which it "warehoused", with a view to structuring CDOs and selling them at a profit. As the market for this type of security had deteriorated by early 2007, CIBC was left sitting with RMBS and CDOs that could not be sold except at a significant loss. Accordingly, these instruments were retained by CIBC and were shown on its balance sheet as part of its trading securities portfolio.

[67] This position had a notional value or face value at the end of Q2 2007 of US$1.7 billion. It was composed of $1.2 billion in CDO tranches that were primarily rated AAA and $0.5 billion in investment-grade RMBS. About 60% of the collateral securing these investments was in the USRMM.

[68] Within CIBC's total securities portfolio of $83 billion, the unhedged position represented about 2% of CIBC's direct investments.

[69] As the market continued to decline in 2007, CIBC was able to partially hedge this position by purchasing "directional" hedges of about $300 million. These hedges were not

directly referable to the underlying assets, but were sensitive to the "direction" of the USRMM, thus providing some protection in the event of further decline in the market.

(b) The Hedged Positions

[70] CIBC acquired its hedged positions by selling CDS protection to third parties on a RMBS or CDO positions held by the third parties. Basically, CIBC would agree to insure a third party's position against default in the underlying bond, i.e., the reference asset. CIBC would then insure or hedge this position, by buying CDS protection from another party (called the "counterparty") on the same underlying reference asset. It earned a profit or "spread" based on the difference between what it received from the buyer of the CDS it sold and what it was required to pay for the CDS it bought from its counterparty. If there was a default on the reference asset, CIBC's liability to its purchaser would – in theory at least – be recouped from the party from whom it had bought protection – its counterparty. This depended, of course, on the credit-worthiness and solvency of the counterparty.

[71] The reference assets for which CIBC had sold credit protection were all equivalent to AAA-rated "super senior" RMBS or CDOs. As well, the hedge counterparties from which CIBC had purchased CDS protection had ratings from AAA to A and were, therefore, investment grade. The largest contract, in the amount of $3.476 billion, was with ACA Financial Guarantee Corp. (ACA), which had an A rating. ACA was referred to as a "monoline" insurer because its business consisted of only one type of insurance – typically financial guarantee insurance or "credit wraps" for bonds and other debt instruments.

[72] The other hedge positions were with institutions with ratings between AA and AAA, most being the latter. The total notional amount of CIBC's hedge positions was $9.882 billion.

[73] CIBC says that its hedged position exposed to the USRMM must be considered in the context of its total "notional" derivatives exposure of approximately CAD$1.3 trillion as at October 31, 2006. CIBC says that banks are able to assume such large "notional" exposures and are permitted by their regulators to do so, because the risk associated with these positions is "managed" through hedges to offset the "notional" exposure.

[74] Overall, therefore, although the plaintiffs emphasize CIBC's "massive" $11.5 billion exposure to the USRMM, CIBC says that its positions were not viewed as risky at the time, because (a) the unhedged positions and the reference obligations underlying the hedged positions were highly rated; (b) the hedged positions were protected by insurance, in the form of CDSs, purchased from counterparties who were "investment grade"; and (c) the unhedged positions and the hedged positions were only a small portion of CIBC's securities and credit derivatives portfolios.

3. CIBC's Personnel, Structures and Processes

[75] It is an important part of the defendants' case that they carried out a reasonable investigation to ensure that any statements made in CIBC's public disclosures were true and that they had no reasonable grounds to believe otherwise. They rely, in particular, on the systems that CIBC had in place to ensure that it would meet its continuous disclosure obligations under the *Securities Act*. The individual defendants also attest to their reasonable reliance on CIBC's internal systems and their lack of personal knowledge of deficiencies in CIBC's disclosure, if indeed there were deficiencies.

(a) The Individual Defendants

[76] The individual defendants were all members of the Senior Executive Team (SET) of CIBC and held the following positions:

[77] Gerald McCaughey was the President and Chief Executive Officer (CEO) of CIBC during the Class Period. McCaughey, together with the Chief Financial Officer (CFO), Tom Woods, was responsible for signing certificates relating to CIBC's financial reports at the end of each quarter and at the year end. The certificates stated, in part:

> Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report.

[78] The certificate confirmed McCaughey and Woods' joint responsibility for establishing and maintaining CIBC's financial reporting systems.

[79] McCaughey deposes that CIBC had appropriate systems, processes and controls in place to value and report on its financial positions, including its credit risks. He concludes that CIBC's disclosures during the Class Period were appropriate and timely and notes that "CIBC was a leader in its disclosure concerning exposure to the USRMM" during the Class Period.

[80] Woods was Senior Executive Vice President and CFO of CIBC from May 1, 2003 until January, 2008, when he became Senior Executive Vice President and Chief Risk Officer (CRO). As CFO of CIBC during the Class Period, Woods oversaw CIBC's Finance Division.

[81] Woods deposed that he was satisfied that CIBC's financial reporting systems were appropriate and that they had been followed. The financial results, disclosures and press releases pertaining to them were reviewed by the Audit Committee and then by the Board. The quarterly reports were reviewed by E&Y and the annual statements were audited by E&Y before they were released. In addition, E&Y reviewed CIBC's internal controls over financial reporting and found that they met applicable standards.

[82] In describing CIBC's reporting on its positions sensitive to the USRMM during the Class Period, Woods emphasizes that judgments were made based on the market and information that was available at the time, which was assessed with reference to CIBC's historical experience. He states that at the outset of the Class Period, those positions were not of material concern, because they involved the highest-rated tranches of CDOs and were considered unlikely to default in light of historic default probabilities for securities with such ratings. CIBC, he says, also protected itself against what was considered to be a "remote" risk of default by hedging the risk in respect of most of its positions with investment grade counterparties which, again based on historical default probabilities, were unlikely to default.

[83] Woods states that when in Q2 2007 it was noted that "challenges experienced by the USRMM had caused a relatively small negative impact on CIBC's unhedged positions", he and McCaughey decided to "examine our valuation and mark to market processes for unhedged positions to ensure that they were appropriate."[5] They focused on their unhedged positions,

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[5] The concept of "mark to market" or "mark to mark", refers to a GAAP requirement that a company report its trading securities and derivative positions in its financial statements at their "fair value". Changes in the fair value must be reflected in the earnings for the period. This is discussed in more detail in Part V.

because they considered that their hedged positions were fully protected. They engaged E&Y to review CIBC's valuation process during the May 2007 month end in order to provide comments on the June 2007 month end. E&Y confirmed the reasonableness of the valuations in May and June and also confirmed the methodology. E&Y continued to remain involved in advising CIBC concerning the valuation and accounting treatment of its positions. Commencing in November, 2007, it gave input concerning the valuation of the hedged positions. Woods' evidence is that the involvement and advice of E&Y confirmed his belief that CIBC's valuations were reasonable and that its disclosures were "appropriately informed by reasonable valuations of the positions at each relevant point in time".

[84] Woods also describes the steps that he personally took to ensure that he and CIBC had appropriate knowledge about its USRMM positions and the factors affecting them. Without being exhaustive, these steps included:

- participation in internal discussions with Finance and Risk Management;
- discussions with E&Y;
- communicating with the CEO and Audit Committee;
- monitoring disclosures by other financial institutions and rating agency information;
- speaking to economists, analysts and regulators.

[85] He also describes CIBC's monitoring of ACA and its rating prospects and the presentations to the Audit Committee and the Board during this period, including a special meeting of the Audit Committee on November 16, 2007. At this special meeting, there was a discussion of the credit, accounting and disclosures issues arising from S&P's announcement that it had placed ACA on credit watch.

[86] In sum, Woods' evidence was that CIBC's disclosures were appropriate and timely. The market volatility that occurred in the latter part of 2007 was "of a kind not experienced since the Great Depression". Throughout this period, CIBC closely monitored market conditions and assessed the implications for reporting and disclosures. Ultimately, "[A]s a result of

unprecedented and unforeseen market conditions", it was necessary for CIBC to take substantial writedowns on the mark to market value of its positions.

[87] Brian Shaw was the Senior Executive Vice President of CIBC and Chairman and CEO of CIBC World Markets (CIBCWM) from December 2, 2004 to February 29, 2008. As Chairman and CEO of CIBC World Markets, Shaw had responsibility for strategy, execution and marketing performance.

[88] Ken Kilgour was Senior Executive Vice-President and Chief Risk Officer (CRO) of CIBC from May 31, 2007 to November 2007.

[89] In essence, the evidence of all the individual defendants is that they contributed to and relied upon CIBC's risk management processes, controls and systems. They believed that CIBC's risk management and disclosures of its hedged and unhedged positions that are in issue in the action were appropriate.

(b) CIBC Structures and Practices

[90] As would be expected in a Canadian chartered bank and one of the country's largest financial institutions, there was a well-established and robust governance structure within CIBC to address matters of risk assessment, audit and disclosure. I will briefly describe the key components of this system.

[91] The Board had a standing committee, known as the Risk Management Committee, which was charged with the responsibility of identifying, measuring, monitoring and controlling CIBC's principal business risks. It was composed of five directors, who were independent of management. As the subprime mortgage crisis escalated in 2007, the committee met a number of times, including twice in August and twice in October. Three of its eight meetings during the time period from April to December 2007 were devoted to the Bank's hedged and unhedged exposure to the USRMM, reflecting the serious nature of the issue.

[92] The Audit Committee was also a standing committee of the Board with responsibility for reviewing the Bank's financial statements, disclosure and reporting and its compliance with legal and regulatory requirements. Like the Risk Management Committee, it met frequently during

the relevant period. It held two special meetings during the period from May 30, 2007 to February 27, 2008.

[93] The Disclosure Committee, discussed below, was composed of CIBC management, with representation from all major departments. It met after the end of each fiscal quarter to review CIBC's draft public disclosures, to test the accuracy of those disclosures and to review them where necessary.

[94] At the top of the governance structure, of course, was the Board of Directors. There were seventeen Board members during the relevant period, including McCaughey, who was the only member of management on the Board. Not surprisingly, the Board was an impressive group of business people. As will be apparent, the Board met frequently during the Class Period as the subprime crisis unfolded.

[95] I have described earlier the general legal requirements applicable to all public issuers of securities in Ontario. CIBC observed these requirements through the Class Period in performing annual and quarterly financial reporting and disclosure obligations. It was also required to make timely disclosure of material information, including material changes to its business, operations or capital.

[96] In each quarter before the end of the fiscal year, and at the end of the year, CIBC was required to file its financial statements and its MD&A with securities regulators and provide them to its shareholders. These were certified by the CEO and CFO, reviewed by the Audit Committee and approved by the Board. Although the quarterly financial statements were not required to be audited, they were reviewed by E&Y. The annual statements were audited by E&Y.

[97] Coincident with the release of the quarterly and annual financial statements and MD&A, CIBC issued a news release, summarizing the information contained in those materials. On the same day, members of management participated in earnings conference calls with analysts to discuss the financial results and to answer questions. In the event of material changes or developments outside the regular reporting cycle, CIBC would issue news releases or, where necessary, file material change reports.

[98] It is not surprising that an entity such as CIBC had an elaborate and sophisticated process for the preparation of quarterly and annual financial statements and for the disclosure of statutorily-mandated information to shareholders and financial markets.

[99] The preparation of these documents was managed by the Chief Accountant's Division, with input from the various business units of the Bank. As the financial statements and MD&A were prepared, they were reviewed by a Disclosure Committee composed of senior management including the Controller, Chief Accountant, senior representatives of Legal and Compliance, business heads and others with primary responsibility for financial reporting and disclosure, along with representatives of E&Y. This committee, relying on input from various business units and functional units including Finance, Risk Management, Legal, Tax and Investor Relations, was charged with the responsibility of ensuring the accuracy and completeness of the disclosures.

[100] Following this review, the CEO and CFO were required by Canadian and U.S. securities laws to certify the accuracy of the statements and the MD&A and the effectiveness of CIBC's controls relating to financial reporting and disclosure.

[101] The statements and the MD&A were then reviewed by the Audit Committee of the Board. That committee received a report from the CFO summarizing the results and highlighting particular information as well as a report from the auditors commenting on management's approach and conclusions. Finally, the financial statements and relevant quarterly and annual reports were reviewed and approved by the Board.

[102] In the event of material changes outside CIBC's regular reporting cycle, the CFO was charged with responsibility for determining whether there had been such a change and for the requisite disclosure. This process could involve discussion with other members of management, the audit committee, the Board and outside legal and accounting advisors.

[103] I now turn to an examination of the key events at issue in this litigation, before and during the class period.

4. Key Events Before and During the Class Period

[104] The Class Period proposed by the plaintiffs begins on May 31, 2007, the date on which CIBC released its quarterly report for Q2 2007. It ends on February 28, 2008. In order to understand the issues on these motions, particularly the leave motion, it is necessary to examine the decisions and disclosures made by CIBC in the context of the subprime crisis as it unfolded, before and during the Class Period. To that end, I propose to examine the key events before the Class Period and during each quarter of the Class Period. Because the release of quarterly results generally occurred at the end of the first month of the following quarter, there will be some overlap between the reporting of the results of one quarter and the events of the next.

[105] In each quarter of the Class Period, I will identify the specific documents and statements that the plaintiffs allege contain misrepresentations.

(a) Events Prior to the Class Period Including Q2 2007 (February, March, April)

[106] Between May 2006 and January 2007, there had been reports in the US press suggesting that the trend of increasing housing prices was either reversing itself or leveling off and that mortgage defaults and foreclosures were on the increase. Even a leveling off of housing prices was problematic for those with investments in the subprime market, because the health of that market was so dependent on the year-over-year increase in home prices to enable subprime borrowers to re-finance before their higher interest rates were activated.

[107] CIBC acknowledges that there had been market declines during this time, but says that there was no reason to anticipate in Q2 2007 or even in Q3 2007 that there would be a serious and sustained housing market downturn across the United States. Moreover, CIBC's largely "senior" tranches of RMBS and CDOs were structured with the anticipation that there could be defaults at lower levels and they had built-in features to protect the senior levels.

[108] There were, however, signs of illiquidity in the RMBS and CDO markets. In fact, as noted above, CIBC found itself sitting in Q2 2007 with an unhedged portfolio of mortgage-backed assets that it had acquired and warehoused, with the intention of securitizing, but that it had been unable to sell without significant losses due to market conditions.

[109] Before the Class Period, CIBC had disclosed in its Annual Accountability Report for 2006 that it had acted as structuring and placement agent for CDOs. The report stated:

> We act as structuring and placement agent for certain asset-backed investment vehicles, known as CDOs. We receive market-rate fees for these activities. In addition, we may lend to, or invest in, the debt or equity tranches of these CDOs, and may act as counterparty to derivative contracts. In a number of transactions structured on behalf of clients, we first purchase the collateral at their request and warehouse them until the CDO transaction is completed. CIBC or a third-party manager typically manages the CDO's collateral, which generally consists of rated debt securities, on behalf of equity and debt investors. Any net income or loss is allocated to the CDO's equity investors; further losses, if any, are allocated to the debt investors in reverse order of seniority. The creditors of the CDOs have no recourse to our general credit. Although actual losses are not expected to be material, as at October 31, 2006, our maximum exposure to loss as a result of involvement with the CDOs was approximately $729 million (2005: $418 million). For this purpose, maximum exposure to loss is considered to be the amount of liquidity facilities provided to, and investments in, the CDOs.

[110] The same report disclosed that CIBC's securities portfolio included both mortgage-backed securities and asset-backed securities. There was, however, no "disaggregated disclosure" in the report of CIBC's exposures in the USRMM, in relation to either its unhedged positions or its hedged positions.

[111] At a meeting of the Risk Management Committee on April 4, 2007, Steven McGirr, the then Chief Risk Officer and Senior Executive Vice-President reported on what was described as an "emerging risk issue" in "structured credit transactions". He reported that:

> CIBC was taking on additional and new types of risk as it developed the business of warehousing and securitizing assets, waiting for its clients to repackage and sell off the pieces. At this point, the risk/reward ratios are fine but will be carefully monitored.

[112] This statement refers to CIBC's investment portfolio of RMBS and CDOs. It does not refer to its derivatives exposure. The minutes do not record any report or discussion of the risks associated with this portfolio, including the fact that it was unhedged and illiquid.

[113] According to the minutes of a meeting of the CIBC Board on April 5, 2007, the Chair of the Risk Management Committee reported on the committee's discussions the previous day concerning the emerging risk issues in structured credit transactions.

[114] Apart from these brief comments, there is nothing in the minutes of the CIBC Board or its committees, before the Class Period, to suggest that the Bank's exposure to the USRMM was on anyone's radar as a serious risk issue. As we shall see, this changed dramatically in Q3 2007.

(b) Q2 2007 Reporting

[115] On May 31, 2007, CIBC released its results for Q2 2007 and its MD&A for the quarter. This date marks the beginning of the Class Period.

[116] The report contained no separate reference to CIBC's investments sensitive to the USRMM. These were simply recorded as part of the aggregate values of CIBC's securities and derivatives portfolios. CIBC's evidence is that there was no reason for concern at the time in view of the "senior" nature of its positions and the investment grade ratings of its hedge counterparties, as confirmed by the rating agencies.

[117] The plaintiffs allege that the Q2 report should have provided "disaggregated" disclosure of its subprime exposure, both unhedged and hedged. They claim that CIBC:

- should have disclosed the concentration of credit risk related to its entire subprime portfolio of $11.5 billion;
- mis-stated its profit and loss for the quarter as a result of its inaccurate valuations of its unhedged positions and its hedged positions, in violation of GAAP; and
- should have disclosed the credit risk related to its concentrated exposure to the "monolines", in particular its $3.45 billion exposure to ACA, and failed to comply with GAAP requirements, discussed below, regarding disclosure of concentration of credit risk.

[118] The quarterly report was a core document.[6] The plaintiffs say that these shortcomings amounted to a failure to state a material fact. They point to the requirement that the MD&A discuss important trends and risks that have affected the financial statements and trends and risks that are reasonably likely to affect them in the future.

[119] CIBC held an earnings conference call on May 31, 2007 to discuss its Q2 2007 results, released earlier in the day. All four individual defendants participated in the call. Also on the call were nine analysts from various investment houses including Merrill Lynch, BMO Capital Markets, RBC Capital Markets and TD Newcrest.

[120] During the conference call, one analyst, Mark Ciccerelli, asked about a particular $330 million super senior tranche of a mezzanine CDO called "Tricadia 2006-7", which was collateralized by US subprime mortgages and which he understood CIBC had purchased. He asked:

> [G]iven its mezzanine structure and the performance of 2006 vintage mortgages, it is not impossible that this kind of exposure could be a complete loss. So my first question is, do you have other exposures like this and if so how many transactions, what is the total exposure, and what is the magnitude of the mark-to-market loss that you recognize on these exposures in this first quarter or the second quarter...

[121] The plaintiffs allege that instead of answering these questions directly, Brian Shaw ducked them and misrepresented CIBC's risk arising from its subprime exposures. Shaw's response to the question included the following:

> I guess I would probably say to the extent we have exposure in this space it tends to be more synthetic than direct CDO exposure. We do not see this as a major revenue contributor to CIBC. We are fairly – as I think I indicated in my earlier comments, we're actually looking to end value the credit structuring area of our capability. <u>I guess I would just conclude by saying in summary our risks in this space are not at all major.</u> [Emphasis added]

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[6] A "core document" is defined in s. 138.1 of the *Securities Act* and includes interim and annual financial statements and an MD&A. The subject is discussed in more detail in Part VI.

[122] When Ciccerelli continued to press, saying that his question was concerned with credit exposure, "given the performance of the subprime in the US", Shaw replied in part:

> Well, I guess I would just make a couple of observations. First of all, to the extent that the US subprime market has been a featured topic in the financial press, I think if you look carefully, you will find that in the RMBS space, it has been pre-06 and post-06 deals that have fared better than '06 vintages. The one you reference [Tricadia] is not an '06 vintage.
>
> Secondly, the way we get to a Tricadia, is we amalgamate a variety of CDOs that are reasonably well rated, and the ultimate position is a highly rated security. So, as I said, <u>we don't view this as a major credit item at all for us</u>, and the results are very much normal course.
>
> … So, as I say<u>, it is not a major issue for us in either a revenue area but certainly not a major risk issue.</u> [Emphasis added]

[123] Later in the call, Ciccerelli asked about CIBC's total exposure on its holdings of super senior tranches composed of mezzanine securities backed by subprime mortgages. Instead of answering this question on the conference call, Woods suggested that he and Brian Shaw would contact Ciccerelli after the conference call "and see if we can help".

[124] The plaintiffs say that in the course of this call, CIBC and the individual defendants misrepresented CIBC's exposure to the USRMM and failed to disclose the extent of its exposure. They say that the statements that "our risks … are not at all major" and "it is … not a major risk issue", were untrue statements of material fact. They also say that there was a misrepresentation by omission in failing to state a material fact "necessary to make a statement not misleading in the light of the circumstances in which it was made".

[125] Brian Shaw's evidence is that this statement fairly and reasonably represented what CIBC knew at the time about expected future risks. Moreover, he said that the statement was accurate at the time he made it, in view of the AAA ratings of the underlying investments and the high quality of CIBC's counterparties. He deposed as follows in his affidavit:

> .. the statement was accurate at the time I made it. The majority of CIBC's unhedged positions in issue were AAA rated by rating agencies and not expected to experience material losses. The

> hedged positions were doubly protected against any loss because not only were the positions AAA rated, they were further protected through "hedges" or protection from institutional counterparties who were rated, by rating agencies, as A or better in terms of their credit-worthiness. The positions that the Claim focuses on also represented a small percentage of CIBC World Markets' business and contributed relatively small amounts of revenue, as I indicated on the call. Accordingly, my understanding, as shared by others at CIBC in May 2007, was that these positions did not represent a "major risk issue" at the time. The future changes in the financial markets, which subsequently occurred, were not foreseeable at the time.

[126] This appears to be the plaintiffs' only complaint with respect to a statement made by Shaw.

(c) Events During Q3 2007 (May, June, July)

[127] The third quarter of 2007 for CIBC, May, June and July, saw continuing declines in the subprime market, decreased liquidity and increased interest in the financial press concerning CIBC's potential exposure to that market. By the end of June and into July 2007, there was recognition at the Board level that CIBC had a serious problem on its hands.

[128] In the face of increasing market illiquidity for positions sensitive to the USRMM, downgrading of some bonds by the rating agencies, and falling market indices, CIBC and other banks, auditors and regulators were, in the words of CIBC's Chief Accountant, Francesca Shaw, "scrambling to understand and address the financial reporting and disclosure issues that arose in relation to positions sensitive to the USRMM in light of current market conditions." CIBC was sufficiently concerned about its evaluations that E&Y was engaged to review the valuation processes during the May 2007 month end.

[129] It is interesting that Ms. Shaw describes the Bank as "scrambling" to grapple with its reporting obligations at the time. It reflects the fact, which CIBC acknowledges, that valuing CIBC's subprime positions was extremely challenging in the absence of an active market. If you own shares in an actively traded public company, it is pretty easy to determine their value by looking at the stock market price. But if, at the time, you owned a particular bond based on a tranche of an RMBS, which no one was buying or selling, how could you tell what it was really

worth? It was difficult for CIBC to value the unhedged positions and the hedged positions because no one was trading in the underlying securities. And if the positions could not be accurately valued, what sort of disclosure was the Bank required to make?

[130] There are indications in the minutes of the CIBC Board and its various committees throughout the Class Period that CIBC's positions in the USRMM may have been acquired without a full appreciation of these risks and without appropriate risk management measures having been put in place. There may not have been sufficient stress testing to determine how these positions would be affected by the extreme market conditions that were ultimately experienced during the Class Period. The fact that CIBC was "scrambling" to deal with valuation and disclosure issues suggests that these shortcomings may also have impacted CIBC's ability to value and report on its exposures. I will return to these concerns later in these reasons.

[131] At its meeting on May 30, 2007, the Risk Management Committee carried out its annual review of the "Asset Securitization Business", which would include the unhedged investment portfolio sensitive to the USRMM. It was reported that this aspect of the business continued to provide "a steady stream of revenues for CIBC" and that:

> The credit quality of the portfolio was very high, with 95% of the program structured to a AAA credit quality. There were no credit issues to report.

[132] This observation reflects the reliance that CIBC placed on the rating agencies' assessment of the risk attached to the securities. The minutes indicate that a director raised a question about U.S. subprime mortgage exposure in the CIBC sponsored commercial paper conduits, but the exact question, and the answer, are not recorded.

[133] There was nothing, however, in the minutes of the meeting of CIBC's Board on May 31, 2007 to suggest that the Bank's subprime exposure was a matter of concern at that time. There is a note that the Audit Committee had participated in an educational session on the valuation of financial instruments and of CIBC's accounting and disclosure analysis compared to that of its peers.

[134] There were tremors felt in financial markets on June 12, 2007 when S&P put $7.3 billion worth of 2006 year RMBS issues on "downgrade watch". A few days later, concern

intensified about the health of the subprime market with the collapse of two Bear Stearns subprime hedge funds on June 17, 2007.

[135] In mid-June of 2007, speculation began to appear in the financial press concerning the extent of CIBC's subprime exposure. An article in the U.S. publication *Grant's Interest Rate Observer* suggested that CIBC might have a "hypothetical" CDO exposure of $2.6 billion.

[136] On June 22, 2007, the Globe and Mail reported that the CIBC had "denied speculation that it might have significant exposure to the U.S. subprime mortgage market." CIBC spokesperson Stephen Forbes was quoted as having said that the report of a $2.6 billion exposure was not accurate.

[137] The media reports must have been of concern to the Board in view of the absence of any prior discussion of the USRMM issue at the Board level or in CIBC's statutory disclosure. Undoubtedly prompted by these reports, Kilgour, who had just taken over from McGirr as CIBC's Chief Risk Officer, prepared a report dated June 25, 2007 and titled "CIBC-Sub prime exposure", to the Chair of CIBC's Risk Management Committee and to McCaughey and the Board. The report noted that there had been recent press commentary suggesting that CIBC's exposure "could be as much as US$2.6 billion." The fact that the report was provided to the Board indicates that the newspaper report must have generated considerable concern amongst Board members concerning the Bank's exposure to the emerging subprime crisis. The report was followed by significant Board and committee activity in the following weeks.

[138] The memorandum summarized CIBC's "direct exposure" through its long positions in the RMBS and CDO markets and its "indirect exposure" through its derivatives positions that were hedged by credit protection purchased from monoline insurers. It noted that CIBC's direct exposure came from its holdings of "warehouse assets" and "CDO tranches". These holdings represented a total notional exposure of $1.662 billion, some of which were "subprime or mid prime". The memorandum indicated that the more senior tranches in this portfolio were not projected to incur realized losses under either rating agency forecasts or under "stressed conditions, with higher levels of default than expected." However, it noted that the tranches might ultimately experience material erosion of value under "meltdown" conditions.

[139] The memorandum then set out CIBC's indirect exposure, "whereby positions in primarily in super-senior AAA CDO tranches are offset by credit protection on the same assets purchased from monoline Insurers (themselves rated A-AAA)." The memorandum stated that the notional aggregate subprime related exposure was about US$9 billion and that "losses would be realized if an underlying CDO tranche were to experience a realized loss, and the insurer were to fail on its obligation."

[140] Under the heading "Management Action", the memorandum indicated that some of CIBC's direct positions were being marketed for sale and that a detailed analysis was being conducted to determine the value of the "super senior tranches" of the CDOs and of the exposure to the obligations hedged through the "Single A monoline" (ACA). It noted that the ABX and TABX indices "have experienced material declines in value, reflecting both the deterioration in housing market fundamentals and supply/demand imbalance." It indicated that an analysis was being undertaken to determine the creditworthiness of the counterparties from which CIBC had purchased credit protection.

[141] Kilgour's memorandum concluded with the following description of the circumstances that had affected CIBC's position in this market:

> The deteriorating US housing market, weak underwriting standards during 2006, and the use of excessive leverage by some market participants, have contributed to deteriorating mark to mark valuations, and very limited liquidity, for multiple structured credit assets. The extent of realized losses for many assets will be determined only some years in the future, however the clearing price for assets now is heavily influenced by the concern that hedge funds will be forced sellers.

[142] Pausing here for a moment, it is significant that Kilgour's memorandum, dealing with "Management Action", referred to a "detailed analysis" being conducted by the Bank to determine the value of the "super senior" CDO tranches and the strength of the ACA hedge. These are, of course, two of the three issues identified by the plaintiffs in this action. Ultimately, as we know, CIBC disclosed about six months later that the value of the "super senior" tranches was severely compromised and that the ACA hedge was essentially worthless. The plaintiffs' experts say that CIBC should have known this, and disclosed it, by May 31, 2007. To state the

obvious, it would be difficult for CIBC to make disclosure of any losses or risks associated with its subprime positions if it was still coming to grips with the valuation of those positions.

[143] After its initial reports in June 2007, the financial media continued to speculate about CIBC's subprime investments. On July 9, 2007, in an article provocatively entitled *Garbage In, Carnage Out*, *Barron's* suggested that CIBC's subprime exposure might be more than $2 billion. In another report, published through Reuters on July 9, entitled *Speculation Swirls over CIBC's Subprime Exposure*, a CIBC spokesman was quoted as stating that the Globe and Mail story on June 22, 2007 citing CIBC's denial of the $2.6 billion figure still "reflects the situation."

[144] The following day, on July 10, 2007, in response to these reports, CIBC issued a news release, authorized by McCaughey and Woods, containing the following statements:

> Recent media reports have estimated that CIBC has US$2.6 billion exposure to the U.S. sub-prime real estate mortgage market.
>
> CIBC has both hedged positions through insurance as well as unhedged positions. CIBC does not disclose individual securities positions but confirms its previous statements to the media that its unhedged exposure to this sector is well below US$2.6 billion.
>
> The majority of the securities held are AAA-rated, the highest rating category

[145] The plaintiffs say that this news release contained a misrepresentation, because it left investors with the impression that CIBC's hedged exposure was not material. They say that by this time, the state of the subprime market was such that both CIBC's income and capital were affected. They also say that CIBC failed to make timely disclosure of these facts and that this omission amounted to a misrepresentation.

[146] The July 10, 2007 news release by CIBC did not end speculation about CIBC's involvement in the subprime market. The following day, July 11, 2007, *Veritas* issued a research report that began: "The same question is on everyone's lips: How much subprime exposure does CIBC have?"

[147] On July 12, 2007, S&P downgraded some 498 of the 612 RMBS issues that it had placed on credit watch in June. While these downgrades were largely confined to lower rated

RMBS and CDO tranches, and did not extend to the higher-rated tranches that made up most of CIBC's positions, it was a matter of considerable interest in the financial press.

[148] The media reports and Kilgour's memo of June 25, 2007 were no doubt of ongoing concern to CIBC's Board. There was no Board meeting scheduled in July. Accordingly, to address these concerns, CIBC President and CEO McCaughey sent an email memorandum to the Board on July 13, 2007. He described the deterioration in the subprime mortgage market, CIBC's exposure to that market and its search for risk management strategies. He stated, in part:

> ENVIRONMENT:
>
> The most prominent development in the economic environment has been the sub prime mortgage market deterioration.
>
> Although we mostly have highly rated securities, there is increasing focus on the underlying real economy trends in this sector (i.e. default rates and foreclosures). Those trends are not positive at this time and indicate caution is required. Accounting standards sometimes require markdowns to securities under certain stress conditions regardless of the current loss experience. We are experiencing those conditions with an effect on our business results.
>
> . . .
>
> CDO EXPOSURE:
>
> You received a briefing note from Ken Kilgour and we have a Risk Management Committee meeting early next week to update. We also expect to update the [Risk Management Committee] and the board in August. Detailed data will be presented at that time.
>
> ...
>
> Our CDO exposure is mainly rated as senior investment grade (mostly AAA). That is an important factor but we have a large portfolio and the market has become very illiquid with signs of distress in this sector. This is leading to markdowns in security carrying values. . .
>
> There is an ongoing management discussion of risk mitigation strategies. The current environment does not lend itself to direct mitigation (outright sale or direct hedge) at this time. We are

> exploring increasing our Macro (indirect and less precise but directionally correlated) hedge protection.

[149] Pausing again, this memorandum from the President and CEO of the Bank could be interpreted as recognition, within a few weeks of the outset of the Class Period, that the fact that CIBC's portfolio was AAA (or "super senior", or "highly rated" or "senior investment grade") was less important than, in McCaughey's words, the "underlying real economy trends". This, of course, relates to one of the fundamental disagreements between the plaintiffs and CIBC on this motion. CIBC says that it reasonably relied on the senior ratings of its positions, just like everyone else did. The plaintiffs say that CIBC should have realized that the ratings were meaningless and that the "underlying real economy trends", market illiquidity, signs of distress and inability to hedge, made its valuations unreliable.

[150] McCaughey's memorandum of July 13, 2007 was followed by two and a half weeks of intense activity at the Board committees and, ultimately, at the Board itself.

[151] On July 17, 2007, the Risk Management Committee held a meeting. It was attended by several Board members, and both McCaughey and Kilgour gave presentations. The purpose of the meeting was, according to the minutes, to brief the committee on CIBC's exposure to the USRMM and to update it on the impact, "if any," on the Bank's earnings for Q3 2007.

[152] In his presentation, McCaughey reviewed CIBC's public statements in the previous weeks concerning its exposure to the USRMM and discussed the potential impact on CIBC if the subprime market continued to deteriorate. He explained that the illiquidity in the market had resulted in discounting in the value of some of CIBC's positions. The minutes indicate that McCaughey "discussed instances where management relied primarily on rating agency reports, the level of expertise of employees in the business unit, any gaps relating to the execution of existing policies and limits and current practices for clearing remnants."

[153] These observations suggest that the directors on the Risk Management Committee had expressed concerns about the circumstances under which CIBC's subprime positions had been acquired, the wisdom of reliance on the rating agencies, and the underlying value of CIBC's positions.

[154] Woods reported that management had engaged E&Y to conduct an evaluation of CIBC's valuation processes and that E&Y had agreed with management's valuation of the assets as of June 30, 2007.

[155] Kilgour's presentation at the meeting dealt with CIBC's hedged and unhedged exposure to the USRMM. As the plaintiffs note, Kilgour stated on cross-examination that it was necessary to describe both the hedged and unhedged exposure in order to give the committee the "complete picture".

[156] The presentation summarized CIBC's subprime exposure, direct and indirect, summarized the mark to market history and market conditions, among other things. It gave a description of CIBC's "indirect sub prime exposures", noting that CIBC acted as an intermediary between two counterparties, selling credit protection of CDOs with subprime exposure to one party and purchasing protection from another party. It stated that CIBC was monitoring one of its counterparties, namely ACA. It described ACA as "an 'A' rated company with material sub-prime exposure", noting that its underlying exposure to ACA included seven CDOs with exposure to subprime RMBS.

[157] Under "Market Conditions", the presentation noted:

> During May and June, market conditions have deteriorated sharply:
>
> --Two Bear Stearns hedge funds with leveraged RMBS & CDO exposures were in danger of collapse; in order to prevent the sale of collateral, Bear Stearns extended loans to one fund.
>
> --Liquidity for RMBS linked assets has substantially reduced, in particular for more structured transactions.
>
> --Standardized indices of RMBS linked securities (the ABX) were introduced in 2006 and provide a level of price discovery."
>
> --In July the rating agencies downgraded large numbers of subprime linked RMBS, as well as CDOs including RMBS, and placed others on negative watch, leading to continuing negative tone...

> Liquidity to exit the majority of our positions does not exist in current markets, although a small number of 'warehouse' assets have been sold…
>
> The modeling of individual CDOs is highly complex, given multiple underlying assets, and CDO specific cash flows; detailed analysis of our positions is continuing.

[158] It is apparent that the Risk Management Committee was concerned about the reports of McCaughey and Kilgour and about the implications of the valuation difficulties for the Bank's disclosure obligations. The minutes indicate that "[T]he directors and management engaged in a lengthy and robust discussion." The Chairman of the Board is reported to have:

> … asked management to keep the Board updated on the situation, including but not limited to information on marked-to-market valuations, reserves, stress testing, CIBC's communications and disclosure process, mitigation efforts and policy and execution matters.

[159] The issues of valuation and disclosure are, as I have noted, central to this proceeding.

[160] The plaintiffs point to this presentation as evidencing CIBC's awareness of the rapid deterioration in the subprime market in May and June and of the particular significance of its "indirect" hedged exposure to that market. They say that although Kilgour acknowledged that it was necessary to describe the hedged position in order to give the committee the "full picture", the same full picture was not being disclosed to investors.

[161] In anticipation of the upcoming full Board meeting at the beginning of August, a confidential memo dated July 27, 2007, was prepared for the Board of Directors. It was entitled "Background Memo on CIBC's exposure to U.S. Sub-Prime and Mid-Prime Residential Mortgages." It contained a detailed primer on the subprime mortgage market, an explanation of CIBC's hedged and unhedged exposures to that market, and a summary of the important accounting issues related to valuing the positions.

[162] The memorandum described both the US$1.7 billion direct exposure to the subprime market due to holdings of CDOs and RMBS and the "US$9 billion of other CDOs with subprime exposure [that was] insured/hedged." It discussed the impact of various loss scenarios on CIBC's direct exposures. It also noted that CIBC was "closely monitoring" ACA, which had material

subprime exposure, noting that its share price had decreased significantly (in fact, it was ACA Capital Holdings Inc., ACA's parent's share price that had declined) and that ACA's rating was being reviewed by S&P. It noted that if ACA's credit rating was downgraded, a further credit valuation adjustment would be required, resulting in a charge to CIBC's income.

[163] The Risk Management Committee met again on August 1, 2007. The primary purpose of this meeting was to update the Committee on the status of CIBC's subprime exposure and to review its potential impact on the Bank's earnings for Q3 2007.

[164] The subject of the rating agencies was a matter of some concern. The minutes record that McCaughey addressed CIBC's reliance on the reports of rating agencies and "any gaps relating to the execution of CIBC's policies and limits." Kilgour also responded to questions from directors concerning "management's reliance on rating agencies with respect to structured credits." Additionally, there was a discussion of counterparty credit risk and the credit ratings of the counterparties and the underlying assets.

[165] According to the meeting minutes, "the directors and officers engaged in a healthy and robust discussion." It is probably fair to suggest that this expression is a code for "the directors asked management some tough and probing questions". One can infer that these included questions about how the subprime positions were acquired, whether there were gaps in the execution of policies, whether it was appropriate to place reliance on the ratings agencies and whether there had been an adequate assessment of the risks associated with the positions and the credit risks associated with CIBC's counterparties.

[166] At its August 1, 2007 meeting, the CIBC Board was given a special presentation concerning CIBC's exposure in the subprime market. The presentation was entitled "US Sub Prime Mortgage Product CIBC Exposures – update since July 11". The presentation noted the following events:

> • the deterioration of market conditions during July and mounting concerns regarding underwriting standards in 2006 and the short term performance of recent subprime mortgage pools;
>
> • the downgrade by the credit agencies of "large numbers of subprime linked RMBS as well as CDOS, including RMBS";

• the "very limited" liquidity of RMBS linked assets;

• the fact that indices like the ABX had once been actively traded and had since "fallen dramatically";

• the broadening of subprime concerns into a "more general contraction of credit."

[167] The minutes record that Brian Shaw, Woods and Kilgour all spoke. Shaw gave an overview of CIBC's structured credit business, including the CDO products, and explained the "market pressures on sub-prime mortgage products over the last several months." He identified "internal factors" that had contributed to CIBC's subprime exposure, including:

- gaps in implementing certain structured credit business operating and reporting procedures;
- the narrow scope of stress testing, in particular, during rapidly deteriorating markets; and
- reliance on highly rated senior components of the CDO capital structure.

[168] Shaw also discussed management's "learnings" of the "potential risks associated with the structured credit business in a stressed environment."

[169] This discussion is another indication that CIBC may have acquired its positions without adequate stress testing and without a complete appreciation of the risks associated with its positions.

[170] The plaintiffs argue that the ratings given by the rating agencies were not reliable indicators of the risks attached to these positions. They will also argue that CIBC's difficulties in valuing its positions, which have been alluded to on several occasions, was a manifestation of poor risk management and inadequate valuation methodologies.

[171] In speaking to the Board during that presentation, Woods noted the precipitous drop of the stock price of ACA's parent corporation from $15 to $6. He remarked that CIBC would have to take markdowns in the event of a downgrading of ACA by the S&P. He stated, "[A] significant downgrade does not appear imminent, but if it came there is always the possibility of

a liquidity challenge at ACA, which could ultimately leave us exposed for the entire mark to market shortfall we have with them, currently US$375 million."

[172] Woods explained to the Board the difficulties that CIBC was having in valuing its exposures. He highlighted the challenges that CIBC was having in determining "fair value of its trading securities in the USRMM and the challenges associating with the models associated with the valuation of the derivatives."

[173] He also noted that CIBC had been in discussions with the Office of the Superintendent of Financial Institutions (OSFI) and with the U.K. regulator, the Financial Services Authority (FSA). OSFI had expressed concerns about CIBC's oversight of its structured credit business. The FSA had requested a review by an outside expert of CIBC's controls and processes in the structured credit area.

[174] Woods concluded by stating that CIBC's current intention was to have a special meeting of the Audit Committee on August 9, 2007 and to issue a press release on August 13, 2007, prior to the normal Q3 reporting date of August 31, to comment on the write downs that would be taken in Q3. Woods stated that although this was not legally required, "we think this will be a good step to take from an Investor Relations point of view."

[175] The minutes of the Board meeting also indicate that Kilgour had discussed a number of "remediation steps" that management proposed to take in the short and long term. These included:

- retaining external advisors to assist in assessing and monitoring these credit risks;
- improving aggregation and reporting of asset classes and concentrations in the structured credit risks;
- developing better methods for measuring and assessing counterparty credit risks; and
- using external advisors to assist in establishing best practices.

[176] There was further discussion at the Board meeting continuing on August 2, 2007. The minutes record a "lengthy discussion", in response to directors' questions and comments, about

the size of CIBC's CDO portfolio, the sectors underlying it, and the potential derivative exposure for other asset classes. In response, Shaw gave a general summary of CIBC's hedged structures credit positions, the amount and nature of larger hedges, and the identity of the larger hedged counterparties. The minutes record that "[T]he directors discussed the nature of credit protection, its role for CIBC's risk mitigation strategy and related Board reporting."

(d) Q3 2007 Reporting

[177] Up to the end of July 2007, CIBC had disclosed that it held both hedged and unhedged positions in the USRMM. However, it had not disclosed the extent of its exposures, other than that its securities portfolio was "well below US$2.6 billion." Financial analysts continued to lament the absence of more specific information. On August 3, 2007, BMO issued a report expressing concern about CIBC's lack of comment on its potential losses from its CDO exposures.

[178] Standing back for a moment, it is appropriate to consider what CIBC had disclosed to the public by the end of Q3 (July 31, 2007) and what was known by its senior management and its Board.

[179] As of the end of Q3, prior to the disclosure of CIBC's Q3 results, CIBC's only disclosure of its subprime exposure had been the media release of July 10, 2007. In this media release, CIBC had confirmed that it had both hedged and unhedged exposure, and that its unhedged exposure was "well below US$2.6 billion." The release also stated that the majority of the securities were AAA rated, "the highest rating category".

[180] By the end of July 2007 or at the very beginning of August 2007, CIBC, its management and its Board and Board Committees had engaged in six weeks of intensive examination and discussions of the Bank's subprime positions. It is clear that the issue was of great concern to the Board and to senior management at that time and the discussions involved the regulators in both Canada and the U.K.

[181] Serious issues had been raised, by directors and apparently by senior management, concerning the acquisition of CIBC's positions, the risk management processes employed, the reliance on the rating agencies, the narrow scope of stress testing, the dramatic declines in the

indices, the valuation of the underlying assets, the viability of ACA, the difficulties in arriving at appropriate valuations, and potential gaps in CIBC's operating and reporting procedures. Again, these are some of the very issues the plaintiffs raise in this action.

[182] There are, as well, some indications that senior management and the Board were concerned that CIBC's procedures for the valuation of its subprime credit risks were in need of improvement.

[183] On August 13, 2007, after the end of its Q3 on July 31, 2007 and before the release of its quarterly report which took place on August 30, 2007, CIBC issued a media release report with its anticipated Q3 results. The release was authorized by McCaughey and Woods. The decision to pre-release the results was prompted, in part, by the size of a $290 million before tax mark to market write down that was taken on the unhedged position. In this release, CIBC disclosed the full notional amount of its $1.7 billion unhedged position.

[184] The release described the write-downs that CIBC would be taking on its unhedged positions. While it also mentioned that CIBC had hedged positions, it did not provide disaggregated disclosure of those positions. It stated, in part:

> CIBC's expected third quarter results include mark-to-market writedowns, net of gains on related hedges, of approximately [CAD]$290 million ([CAD]$190 million after tax) in CIBC's Structured Credit business, on collateralized debt obligations (CDO) and residential mortgage-backed securities (RMBS) related to the U.S. residential mortgage market.
>
> . . .
>
> CIBC's exposure to the U.S. residential mortgage market before writedowns is approximately US$1.7 billion (excluding exposure directly hedged with other counterparties). CIBC's estimates that less than 60% of this exposure relates to underlying subprime mortgages, while the remainder is midprime and higher grade assets. The majority of the US $1.7 billion exposure continues to be AAA-rated, the highest rating category. The exposure has been mitigated by subprime index hedges of approximately US$300 million.

[185] The plaintiffs allege that this report was misleading, because it left investors with the impression that CIBC's hedged exposure was not material. They also say that there was a misrepresentation by omission in failing to state a material fact "necessary to make a statement not misleading in the light of the circumstances in which it was made".

[186] On August 30, 2007, CIBC released its Q3 2007 quarterly report for the period ending July 31, 2007. The report contained the following statement concerning CIBC's exposure to the USRMM:

> Exposures to U.S. residential mortgage market
>
> During the quarter, we had mark-to-market losses, net of related hedges, of $290 million ($190 million after-tax) on CDOs and RMBS related to the U.S. residential mortgage market. As at July 31, 2007 our exposure to the U.S. residential mortgage market was approximately US$1.7 billion (excluding exposure directly hedged with other counterparties). We estimate that less than 60% of this exposure related to underlying sub-prime mortgages, while the remainder was mid-prime and higher grade assets. The exposure has been mitigated by sub-prime index hedges of approximately US$300 million.

[187] The plaintiffs say that, like the August 13, 2007 news release, this statement continued to mislead by failing to disclose CIBC's hedged exposure, in the face of ongoing deterioration of the subprime market. As well, they say that CIBC's profit and loss results for the quarter were mis-stated because of CIBCs flawed valuation of its investments and its hedges.

[188] The plaintiffs argue that the MD&A did not comply with the requirements to discuss important trends and risks that have affected the financial statements and trends and risks that are reasonably likely to affect them in the future. They also assert that there was a misrepresentation by omission in failing to state a material fact 'required to be stated' and 'necessary to be stated'. They add that there was a failure to comply with GAAP requirements regarding disclosure of concentration of credit risk, as well as an overstating of income as a result of improper valuation of subprime exposed position and reference assets. They also say that CIBC failed to take a

proper credit valuation adjustment (CVA)[7] on its positions hedged with ACA, to take into account the possibility that ACA would default on its obligations.

[189] Francesca Shaw, on behalf of CIBC, says that management recommended disclosure in the Q3 MD&A that would highlight the losses in the unhedged positions. Management concluded that no such disclosure was required concerning the hedged positions, other than the fact that it held such positions. It decided, in her words:

> … further detail was not material given that the negative marks on the reference obligations were completely offset by the positive marks on the hedges, subject only to the CVA on the hedges of $4 million; accordingly, the only profit and loss impact associated with the hedged positions was the CVA of $4 million. This conclusion was reinforced by CIBC's review of other banks' disclosure, none of which had disclosed the amount of their hedged positions sensitive to the USRMM.

[190] The disclosure concerning the Q3 results, the financial statements and the MD&A were reviewed by the Disclosure Committee on August 27, 2007 and were considered by the Audit Committee on August 29, 2007. Representatives of E&Y were in attendance at both meetings. On August 30, 2007, the full Board met on a conference call for the purpose of considering the approval of the Q3 results.

[191] All the individual defendants participated in CIBC's earnings conference call on August 30, 2007, discussing CIBC's Q3 results with a group of seven analysts, most of whom had been present on the earlier call.

[192] During that call, Kilgour made the following comment:

> Turning to slide 55, I would like to make some brief remarks regarding certain topical risks. As a reminder, our exposure to the US residential mortgage market through residential mortgage-backed securities and collateralized debt obligations is as described in our August 13 press release. CIBC's underwriting exposure in the leveraged buyout area is minimal and actively managed. Our pre-correction underwriting commitment to this space amounts to less than 0.6% of the bank's assets with no covenant light

[7] A CVA, discussed below, is a valuation of the risk of default by the counterparty.

> exposure. <u>Our exposure to hedge funds is minimal and collateralized.</u> [Emphasis added].

[193] A few minutes later in the call, Brian Shaw stated:

> The majority of the write-down occurred in the latter stages of July and coincided with the rapid deterioration in the market during that period. In light of the unprecedented volatility and deterioration in the US residential real estate market, we have not initiated any new activity in this segment of our structured credit business. We will continue to review the overall conditions and risks in this market on an ongoing basis to ensure that any future activities remain consistent with CIBC's overall goal of delivering sustainable performance over the long term.

[194] Slide 55, referred to by Kilgour, was available to persons participating in the conference call. It was entitled "Topical Risk Issues". It described five issues, including:

- "U.S. sub-prime mortgages",
- "Exposure to U.S. residential mortgage market through RMBS and CDOs",
- "leveraged buy out underwriting commitments",
- "Hedge fund trading and lending exposure, including prime brokerage"
- and "non-bank sponsored asset-backed commercial paper".

[195] Opposite the second heading, "Exposure to U.S. residential mortgage market through RMBS and CDOs", was the statement "As previously disclosed in August 13th news release". Opposite the fourth heading, "Hedge fund trading and lending exposure, including prime brokerage", there was the statement "Minimal, Collateralized".

[196] The plaintiffs say that this presentation was a misrepresentation by omission, because it failed to state a material fact "necessary to make a statement not misleading in the circumstances in which it was made."

[197] The evidence of Kilgour and of Francesca Shaw is that the plaintiffs have misinterpreted Kilgour's statements and the slide. Kilgour states that his statement that "CIBC's

underwriting exposure in the leveraged buyout areas is minimal and actively managed" had nothing to do with CIBC's hedged and unhedged positions. It had to do with leveraged buyouts, that is, corporate acquisitions that were financed in whole or in part by debt of the target corporation.

[198] Similarly, his statement, "[o]ur exposure to hedge funds is minimal and collateralized," was, according to Kilgour, nothing to do with CIBC's exposure to the USRMM. It referred, instead, to CIBC's investments in hedge funds, which are a particular type of investment enterprise. Kilgour's evidence is that, considering the sophistication of the analysts who were parties to the conference call, there is no likelihood that a hedge fund would have been confused with a hedged position, so as to cause a listener to understand that he was saying that CIBC's hedged exposures were minimal and collateralized.

[199] On August 30, 2007, Woods was also interviewed on the Business News Network (BNN) concerning CIBC's Q3 2007 interim financial results. The relevant portions of the interview are as follows:

> BNN: How are you positioned if there is an economic downturn because of these credit crunch related issues?
>
> Woods: Yeah. We've cut back our risk quite a bit – particularly in the world markets area. So, we are pretty close to shore in most of our risk positions. We have what's turned out to be an unfortunately large exposure, as you know, in the U.S. residential real estate mortgage business. We've hedged up $300 million of that – so, our main challenge is to mitigate that risk over the next little while. But, apart from that, we are running very low value at risk numbers and feeling pretty good about those positions.
>
> BNN: What about the transparency of collateralized debt obligations? Are you reviewing that issue within the Bank? Are you reviewing any exposure at all to structured products?
>
> Woods: Well, we've reviewed it. We've been involved in the CDO market for about 10 years where for clients we structure these deals. When the residential real estate market in the U.S. started to decline in June – July, we upped our efforts at looking at all of the CDO books. <u>We have very low exposure right now</u>. Certainly, because this is very topical, we will enhance the disclosure as all banks will. But you know, a year or so ago, this product was

> viewed as no higher risk than many other products, but certainly, this has been a wakeup call for anybody involved in the more complex parts of the CDO business. [Emphasis added]
>
> ...
>
> Well, as I say, we have looked extensively at all of our positions. You know, in hindsight, should we have seen signals that that part of the market was going to deteriorate? Sure, anyone in the business could have done a better job in that area. But to be frank, a year ago this was no higher a risk business from the risk management assessment as many other businesses. In fact, it was less than many of the equity businesses we have – but, certainly, it's a wakeup call for everybody that you've got to be extremely vigilant on what's known as the "tail risk". You know, the 1% probability that liquidity or markets will deteriorate. So, it's something, you know, we're certainly going to focus on.

[200] The plaintiffs claim that Woods misrepresented CIBC's subprime exposure as "very low" and failed to disclose its $9.8 billion hedged exposure. They say that this was an untrue statement of material fact or, alternatively, misrepresentation by omission.

[201] Woods' evidence is that his statements reflected the information that he had at the time and his own reasonably held views. He says that his statements have been taken out of context, that the plaintiffs omitted several statements, in which he pointed to the difficulty in predicting how bad conditions would become in the subprime market.

(e) Events During Q4 2007 (August, September, October) and Part of Q1 2008

[202] The subprime market continued its decline during Q4 2007, August, September and October, 2007. The developments were not positive for CIBC. In Q1 2008 (November and December 2007 and January 2008), the situation worsened.

[203] On August 6, 2007, in an article about CIBC's counterparty ACA, entitled *Subprime's Ultimate Time Bomb*, *Barrons* suggested that the AAA securities guaranteed by ACA were vulnerable to loss, because the underlying securities backing them were only BBB. More significantly, on August 9, 2007, BNP Paribas, the largest bank in France, froze redemptions on three of its investment funds, valued at US$2.2 billion, because it was unable to value the funds due to illiquidity in the subprime market.

[204] A special meeting of the Audit Committee took place on August 9, 2007 to consider the issuance of the news release concerning CIBC's Q3 2007 anticipated earnings per share and to comment on its USRMM exposure.

[205] Woods noted at the Audit Committee meeting that CIBC's CDO write-downs were higher than analysts had expected. Although there was no legal requirement to issue a media release, management believed that it would be positive from the perspective of investor relations. McCaughey stated that in light of market conditions, robust disclosure was appropriate regardless of the effect on the stock price.

[206] The meeting was attended by representatives of E&Y, including Steve Zammitti, who reported on the recommendations that E&Y had made concerning the methodology used by CIBC to value its positions. The minutes record:

> Mr. Steve Zammitti, E&Y, provided a summary of the audit-related pricing work that E&Y had performed related to CIBC's CDO and residential mortgage-backed securities (RMBS) positions in May and June, including their own independent tests of management's valuations, and noted that CIBC had recently adopted a number of recommendations made by E&Y coming out of that work. He reported that one important distinguishing difference between CIBC and other key players in the CDO market was that others had employed the use of highly complex models in valuing their positions. He noted that it would be a useful exercise for CIBC to determine the feasibility of establishing similar models. Mr. Zammitti noted that E&Y would be doing similar procedures on the July 31, valuations.

[207] This note is an indication that CIBC's valuation methods were in need of improvement and were not consistent with those employed by some of its peers.

[208] The minutes do not record any discussion of CIBC's hedged position, presumably because there was no intent to disclose it.

[209] As noted above, a news release was issued on August 13, 2007 that disclosed mark-to-market losses of US$290 million (before tax) on CIBC's $1.7 billion unhedged direct exposure, but made no mention of CIBC's hedged exposure.

[210] At a meeting of the Audit Committee on August 29, 2007, Woods reported on Q3 2007. Under the heading "Exposures to the US Residential Mortgage Market (USRMM)", his report stated:

> The sharp deterioration in the USRMM, particularly since the late winter (2007), and the recent turmoil in the related collateralized debt obligations (CDOs) and residential mortgage-backed securities (RMBS) markets had an impact on CIBC as a result of its exposure to this market.
>
> In order to stem speculation on our exposures and to provide the market with timely and relevant information we issued a number of press releases since mid-July.
>
> **CIBC's Exposure -**
>
> We have both hedged and unhedged exposure to the USRMM. Our exposure is to the subprime, midprime, and higher grade components of the market and is indirect through our positions in CDOs and RMBS. Our hedged exposure of approximately $US9.2 billion, as at July 31, 2007, represents credit protection we sold and covered specifically with credit protection purchased from insurance companies and other financial institutions (intermediation trades).
>
> As at July 31, 2007, our unhedged exposure totalled approximately US$1.7 billion of notional, comprising undrawn commitments, securities and derivatives. We estimate that less than 60% of the underlying assets (the actual residential mortgages) that support these vehicles and securities to be of the subprime classification.

[211] A representative of E&Y attended the Audit Committee August 29, 2007 meeting and expressed the view that management's fair value estimations of the RMBS and CDO investments were reasonable in the circumstances. The representative also opined that the valuation process "appropriately considered the impact of market conditions and reduced liquidity on the valuation of CIBC's RMBS and CDO investments as at July 31, 2007."

[212] The plaintiffs say that in contrast to this full disclosure of CIBC's unhedged and hedged positions that Woods gave to the Audit Committee, CIBC's Q3 2007 report, publicly filed one day later, failed to disclose the extent of the hedged exposure.

[213] At a Board Meeting on August 30, 2007, Woods advised the Board that while the ABX indexes were improving, it was appropriate to disclose in the report to shareholders for Q3 2007 that mark-to-market write-downs for CDOs and RMBS were approximately $290 million before tax. The minutes record that Shaw gave the Board a detailed review of the business strategy of CIBCWM. He also discussed CIBC's hedged investing, the positions held by counterparties including the monolines, and the impact of the current market conditions on the monolines. The minutes concluded with a note that the directors had asked that they be given an overview relating to counterparty risk at a future Board meeting.

[214] The minutes do not record any discussion of whether disclosure of CIBC's hedged position was necessary.

[215] At the Risk Management Committee's meeting on August 29, 2007, there were discussions of CIBC's direct exposure to the USRMM and the counterparty credit risks associated with its indirect exposure. There was also ongoing discussion about the difficulties since June in obtaining market data for the valuation of CIBC's unhedged portfolio, the problem of finding acceptable proxies to value these exposures and the move to the incorporation of ABX spread information into the valuation process. Kilgour reported that CIBC "was in the process of retaining outside resources with respect to developing new models" for valuation.

[216] It is interesting to note that at the same time as CIBC was disclosing to the public that it had sustained net after tax losses of $190 million on its unhedged position, and was making no disaggregated disclosure of its hedge position, it was acknowledging internally that there had been a "sharp deterioration" in the USRMM and that it had yet to develop new models for the valuation of its positions.

[217] A special meeting of the Risk Management Committee was held on October 5, 2007. McCaughey explained to the Committee the difficulties being experienced in the valuation of CIBC's exposure to RMBS and CDOs based on the market indices. It is apparent that the valuation issue continued to trouble CIBC.

[218] Another topic of discussion was the monoline insurers, such as ACA. Kilgour noted that CIBC's exposure to two of the monolines, ACA and XL, exceed $1 billion each "as a result

of the changes to the mark-to-mark [sic] valuations, and the adoption of a more conservative approach to estimating potential future exposures". He stated that "significant efforts" were being made to model the potential future losses that the monolines were likely to incur from the transactions on which CIBC had purchased credit protection. Kilgour further conveyed that preliminary results from an "external source" had indicated that a "base case" loss of $300 million could be incurred. He said that downgrades by rating agencies of RMBS underlying the "super senior" tranches on which CIBC had purchased protection could have implications for future losses by the monolines. McCaughey then confirmed that the valuations would not impact earnings at year end, but if one of the counterparties to a hedged position defaulted, it would affect earnings.

[219] Another special meeting of the Risk Management Committee, held on October 31, 2007 indicated the ongoing challenges CIBC faced. Kilgour reported to the committee that the mark-to-market valuations had continued to deteriorate and that the mark-to-market losses for Q4 had increased to about $410 million. There was also a discussion of the decline in the value of the ABX index and presumably the effect that this would have on the valuation of CIBC's positions. There was discussion concerning the disclosure expected to be made in the Q4 results. The committee offered suggestions to management "to assist shareholders and analysts in understanding those results."

[220] It was also reported that CIBC's exposure to two of its counterparties, XL and ACA, continued to increase and that CIBC's primary regulator, OSFI, had been alerted, indicative of the serious nature of these concerns.

[221] The minutes of a meeting of the Audit Committee on October 31, 2007 record that Woods reported on the latest estimate of write-downs on CIBC's RMBS and CDO portfolio was $410 million but noted that "independent quotes" from dealers had not yet been obtained. He noted that determining fair market value for October would be challenging, because the ABX indices had gone down further and that it was difficult to find hedging due to the absence of bids in the market.

[222] On November 9, 2007, after the October 31 year end, S&P announced that it was putting ACA on credit watch with negative implications. This raised two questions for CIBC:

> (a) whether the credit watch announcement should be disclosed and
>
> (b) whether it should be recognized in the financial statements by an adjustment in the CVA on the positions insured by ACA, to reflect the change in CIBC's internal rating of ACA.

[223] After considering a variety of factors, management concluded that this announcement did not require disclosure. This was discussed at the Audit Committee at a special meeting, at which E&Y was present. The Audit Committee agreed with management and approved its decision.

[224] In the latter part of November and into December 2007 and January 2008, the impact of the subprime crisis on the Bank's positions, its reporting obligations and its share price required a great deal of attention on the part of CIBC management. Indeed, the subprime crisis dominated discussions at the Board and the Risk Management Committee as well as other committees.

[225] At a meeting of the Board on November 1 and 2, 2007, the chair of the Risk Management Committee reported on CIBC's increased exposure to ACA and the need to dramatically increase ACA's credit limit. He advised the Board that Management "was doing extensive research to verify the underlying asset values and mark-to-market values." This observation highlights the valuation and disclosure challenges that CIBC continued to face at the time.

[226] A special meeting of the Audit Committee was held on November 16, 2007 to review anticipated Q4 2007 results, particularly those due to the deterioration of the structured credit market. There was another discussion of whether a valuation adjustment was required as a result of CIBC's exposure to ACA in light of S&P's announcement on November 9 that it had put ACA on credit watch with negative implications. The Committee ultimately agreed with management's recommendation that, in light of the fact that ACA had not been downgraded, it was not necessary to make the valuation adjustment or to disclose that ACA was a significant hedge counterparty.

[227] A special meeting of the Board was held on November 27, 2007. The status of ACA and the effect on CIBC's financial results appear to have dominated the discussion. The

November 9, 2007 "Creditwatch" statement by S&P concerning ACA and a range of potential scenarios was discussed. The minutes record that the Board and management continued their discussion about possible disclosure by CIBC concerning its ACA exposure.

(f) 2007 Year End Reporting

[228] CIBC stock took a beating in November, 2007, resulting in a drop in share price of approximately 10%. The plaintiffs say that this occurred, because word leaked to the market that CIBC had a multi-billion dollar hedged exposure to the USRMM, in addition to its direct exposure.

[229] CIBC released its Q4 2007 and Fiscal 2007 results on December 6, 2007, providing for the first time disaggregated disclosure of both the hedge and unhedged positions. The MD&A stated, in relation to the hedge positions, "Management has assessed the credit exposure relating to these contracts in determining their fair value. Market and economic conditions relating to these counterparties may change in the future, which could result in significant future losses".

[230] CIBC also issued a news release on December 6, 2007, based on its MD&A, which stated, in part:

> In the U.S., real estate finance and merchant banking reported good results, with other areas showing improvement. The good performance in these areas was offset by the mark-to-market write-downs CIBC recorded in its structured credit business related to the U.S. residential mortgage market.
>
> As at October 31, 2007, CIBC's net unhedged exposure to CDOs and RMBS related to the U.S. residential mortgage market was approximately $741 million. Mitigating this exposure are subprime index hedges of notional $283 million, with a fair value of $119 million. Conditions in the U.S. residential mortgage market have continued to deteriorate since year-end. We estimate that mark-to-market write-downs will be approximately $225 million ($150 million after-tax) for November. Partially offsetting this were gains on credit derivative hedges of approximately $45 million ($30 million after-tax).
>
> In addition we have exposures to the U.S. subprime residential mortgage market through derivative contracts which are hedged with investment-grade counterparties. As at October 31, 2007, the

> notional amount of these hedged contracts was $9.3 billion and the related on-balance sheet fair value was $4.0 billion. Management has assessed the counterparty credit exposure relating to these contracts in determining fair value. Market and economic conditions relating to these counterparties may change in the future, which could result in significant future losses.

[231] The plaintiffs say that with the release of these results, CIBC made partial disclosure of material information that it had previously failed to disclose and that it made "partial misleading corrections" to its prior misrepresentations. They say that this release disclosed, for the first time, the extent of CIBC's hedged subprime exposure and the magnitude of the potential losses in both its hedged and its unhedged positions. They say, however, that CIBC continued to overstate its income by failing to take appropriate write-downs due to the exposure of its hedged positions, particularly those attributable to its positions hedged with ACA. Accordingly, they claim that CIBC continued to overstate its income by hundreds of millions of dollars, if not billions of dollars.

[232] The Q4 earnings conference call was held on December 6, 2007. McCaughey, Woods and Brian Shaw participated in the call. The plaintiffs claim that CIBC continued to understate the severity of the risks inherent in its hedged exposure and the health of its counterparties:

[233] McCaughey made the following statements:

> Let me start with our unhedged exposure. As we have disclosed today, our gross unhedged exposure at October 31 was approximately US$1.6 billion. Against this amount we have recorded mark-to-market write-downs of US$860 million, offset by write-downs on assets sold of US $41 million, leading us to a remaining unhedged exposure of US$784 million as of October 31, 2007. This remaining unhedged exposure is directionally mitigated by the remaining value of the ABX hedges of US$174 million. Conditions in the US residential mortgage market have continued to deteriorate in the new year and the month of November, and we estimate that we would incur further mark-to-market write downs on this portfolio in the first quarter.
>
> In addition to our unhedged exposure, we have also disclosed today US $9.8 billion of hedged credit derivatives exposure to the US subprime residential mortgage market. Over 90% of the rated underlying assets are AAA-rated securities, and the average subprime component is about 60%. We have protection offsetting

> the US$9.8 billion through credit default swaps. 47% of our hedged exposure is spread across five AAA-rated financial guarantors. Although the financial performance of these guarantors has received some scrutiny, all five have maintained their AAA rating, none have been downgraded, one has been recapitalized by its parent banks, and many of the others are partially or fully owned by other financial institutions. These financial guarantors represent a very important part of the US and global financial system, and we believe they will continue to play an important role in the future.

[234] Woods made the following statements:

> Slide 52 provides a breakdown of our CDO/RMBS positions that have exposure to US subprime and that are hedged with counterparties. You can see that all but US$3.5 billion notional is hedged with AAA and AA counterparties. As Gerry said, the A-rated counterparty has recently been placed on credit watch. It has begun discussions with its rating agency and with its counterparties, including CIBC. It is too early to tell what the outcome of these discussions will be.
>
> One possible outcome could be a recapitalization, possibly involving the counterparties. This would likely result in CIBC taking a counterparty credit reserve in excess of the small reserve that was in place as of October 31. If a downgrade occurred, CIBC would have to take a larger counterparty credit reserve. Even in an extreme outcome however, we would anticipate that our capital ratios would still be comfortably above our published targets.

[235] Woods contends that his statements made during this conference call should be considered in the context of the disclosures made by CIBC on that date and on November 9, 2007. He says that, considered in this context, his statements on the earnings call were accurate.

[236] Confirmation of CIBC's exposure on the release of CIBC's quarterly and year-end results on December 6, 2007 was followed by a 5.4% drop in the share price that day and a further 3.5% drop the following day. The plaintiffs claim that between December 6 and 19, 2007, the share price fell 18.3%.

[237] On December 19, 2007, S&P announced that it had downgraded ACA from its A rating to CCC. The downgrade had the effect of triggering collateral posting obligations which ACA was contractually obliged to make under its CDS contracts with CIBC and its other

counterparties. ACA was incapable of fulfilling these obligations, and accordingly, it was virtually certain to default on billions of dollars of CDS contracts.

[238] CIBC issued a news release that same day, confirming that ACA was a hedge counterparty with respect to approximately US$3.5 billion of its USRMM exposure and stating that there was "a reasonably high probability that [CIBC] will incur a large charge in its financial results for the First Quarter ending January 31, 2008." The release stated:

> Following Standard and Poor's announcement today that it had reduced the credit rating of ACA Financial Guaranty Corp. from "A" to "CCC", CIBC confirmed that ACA is a hedge counterparty to CIBC in respect of approximately U.S. $3.5 billion of its USRMM exposure.
>
> It is not known whether ACA will continue as a viable counterparty to CIBC. Although CIBC believes it is premature to predict the outcome, CIBC believes there is a reasonably high probability that it will incur a large charge in its financial results for the First Quarter ending January 31, 2008.
>
> As CIBC disclosed on page 52 of its Investor Presentation dated December 6, 2007, the mark of the hedge protection from the "A-rated" counterparty (ACA) as at October 31, 2007 was U.S. $1.71 billion. As at November 30, 2007, this mark was US$2.0 billion. If the charge in the First Quarter were to be U.S. $2.0 billion (US$1.3 billion after tax) CIBC currently projects its Tier 1 capital ratio to remain in excess of 9% as at January 31, 2008.

[239] On that same date, CIBC and 29 other ACA counterparties entered into a standstill agreement, until January 18, 2008, to see whether some arrangement could be made. The agreement was later extended to February 19, 2008.

V. ANALYSIS OF PLAINTIFFS' COMPLAINTS AND DEFENDANTS' RESPONSE

[240] The plaintiffs make three basic complaints of misrepresentation and non-disclosure.

[241] First, they say that CIBC's exposure to the USRMM was a material fact that should have been disclosed in its Q2 and Q3 quarterly reports in a disaggregated form. In addition, they say that CIBC's statements in their earnings conference calls and news releases in May, July and August contained misrepresentations and were misleading because they concealed or misrepresented this exposure.

[242] Second, they say that CIBC overstated its income in its Q2, Q3, Q4 because it failed to record write-offs that it should have taken as a result of the diminished value of its subprime investments and the increased credit risk associated with the counterparties who had guaranteed its hedged position.

[243] Third, they allege that CIBC failed to disclose the significant concentration of credit risk associated with its hedge counterparty, ACA.

[244] In this section, I will examine the plaintiffs' arguments and evidence on these issues and the defendants' responses. As a preamble to this discussion, I will identify the expert witnesses adduced by the parties, particularly the expert accounting evidence, as accounting questions are at the core of the underlying disclosure and valuation issues.

[245] Each side has assembled an outstanding team of expert witnesses.

[246] On the plaintiffs' team, the key experts are:

> (a) Professor Gordon Richardson, a chartered accountant, holds the position of the KPMG Professor of Accounting at the Rotman School of Management at the University of Toronto. He has been a member of the Academic Advisory Council of the Canadian Institute of Chartered Accountants, advising the Accounting Standards Board on emerging areas of standard setting. He has published extensively on accounting issues, including those related to derivatives and structured finance.
>
> (b) Dr. Donald van Deventer is the founder and CEO of Kamakura Corporation (Kamakura) and Dr. Robert Jarrow, the Managing Director and Director of Research of Kamakura. Kamakura specializes in financial consulting, risk information and financial risk management. Both individuals have extensive work and scholarly experience with the financial products at issue in this proceeding, including CDOs, CDS, and derivatives, and with risk management in relation to such products, value at risk, credit ratings and the subprime crisis.
>
> (c) Mr. Peter Lozier has first-hand experience with CDOs and RMBS since their inception in the late 1980s. He also has twenty years experience in the creation, valuation and distribution of asset-backed securities and derivatives, including CDOs and CDSs, at top-tier Wall Street firms, including Morgan Stanley,

Citigroup and Barclays Capital. At these firms, he was personally involved in the creation and distribution of mortgage-backed securities and related products, including mortgage derivatives swaps and other structured financial products. In 1997, he became a principal in a small hedge fund.

(d) Ms. Diane Urquhart is an economist and financial analyst with experience in senior management positions in the securities business. She held the position of Managing Director of Research and Institutional Equities at Burns Fry (the predecessor of BMO Nesbitt Burns) and a similar position at Scotia Capital.

[247] On the defendants' side, there are an equally impressive group of experts:

(a) Mukesh Bajaj is a financial economist, specializing in the study of capital markets and the valuation of financial instruments. He is the President of AFE Consulting, a consulting firm specializing in financial analysis relating to legal and regulatory matters. He has been engaged as an expert on hundreds of matters involving securities and related issues and has testified as an expert witness in more than 40 cases.

(b) Professor Daniel Thornton, a chartered accountant, holds the Chartered Accountants of Ontario Professorship in Financial Accounting at Queen's University in Kingston, Ontario. He has extensive experience in relation to the development, interpretation and application of GAAP, in particular in relation to financial instruments and mark-to-market accounting. He has considerable experience with accounting standards. He served for four years, from 1999 to 2003, as a member of the Accounting Standards Board of Canada, which sets and codifies Canadian accounting standards in the CICA handbook. These standards serve as the primary source of GAAP. Professor Thornton is currently a member of the Canadian Accounting Standards Oversight Council and served previously for two terms as a member of the Academic Advisory Board of the Canadian Accounting Standards Board.

(c) David A. Brown is a partner in the Davies Ward Phillips & Vineberg firm, a former chair of the Ontario Securities Commission and a highly respected securities and commercial lawyer.

[248] Not surprisingly in a case such as this, each party extols the virtues of its own experts and excoriates the opponent's experts. Each side challenges the experience, reasoning and

conclusions of the other side. The experts themselves are critical of their colleagues retained by the other party. Each side has landed some blows and fended off others. Neither side has landed a knockout punch, in my view.

[249] At the end of the day, however, on virtually all issues, I am unable to say, applying the requisite low threshold, that there is no possibility that the evidence of the plaintiffs' expert witnesses will not be accepted in preference to some or all of the evidence of the defendant's witnesses.

1. First Complaint: Failure to Disclose Disaggregated Subprime Exposure

[250] The plaintiffs' first major complaint is that CIBC's exposure to the USRMM was a material fact that should have been disclosed in a disaggregated form in its Q2 and Q3 2007 quarterly reports. That is, they argue that the subprime exposure was so significant that it should have been described as a separate component in each of the securities and derivatives portfolios.

[251] CIBC's position, in contrast, is that:

- its disclosure was entirely appropriate;
- it was a market leader in terms of the nature and extent of its disclosures; and
- its disclosure evolved appropriately during the Class Period as the emerging credit crisis brought the values of its positions into question.

[252] I will begin by setting out the relevant standards of disclosure. I will then elaborate on the submissions of the parties and the evidence relied upon.

(a) The Relevant Standards

[253] The CICA Handbook, at paragraph 3861.58, refers to an entity's obligation to disclose its exposure to "credit risk", including significant concentrations of credit risk:

> 3861.58. For each class of financial assets, both recognized and unrecognized, an entity should disclose information about its exposure to credit risk, including:

> (a) the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and
>
> (b) significant concentrations of credit risk. [emphasis added]

[254] Credit risk includes the risk of default on a security such as bonds or derivatives. Concentration of credit risk refers to a risk of loss as a result of the entity's exposure to a particular debtor, country, sector or industry.

[255] The determination of whether a credit risk is "significant" is stated in the Handbook to be "a matter for the exercise of judgment by management, taking into account the circumstances of the entity and its debtors" (HB, s. 3861.66). The Handbook indicates that such credit risks may:

- involve "a significant exposure to loss in the event of default by other parties" (HB, s. 3861.66)
- "...arise from exposure to a single debtor or groups of debtors having a similar characteristic such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions". (HB, s. 3861.67)

[256] CIBC also points to U.S. GAAP as a source of authoritative guidance to assist in determining whether a concentration of credit risk is "significant" for the purpose of disclosure under the Canadian GAAP (HB, s. 3861.58(b)). The U.S. Financial Accounting Standards Board (FASB) Statement of Position 94-6 provides as follows:

> .21 Financial statements should disclose the concentrations described in paragraph .22 if, based on information known to management prior to issuance of the financial statements, *all* of the following criteria are met:
>
> a.The concentration exists at the date of the financial statements.
>
> b. The concentration makes the enterprise vulnerable to the risk of a near-term severe impact.
>
> c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term. (emphasis in original)

[257] "Near term" for this purpose is defined as "A period of time not to exceed one year from the date of the financial statements". [emphasis added] "Severe impact" is defined as follows:

> A significant financially disruptive effect on the normal functioning of the entity. Severe impact is a higher threshold than material. Matters that are important enough to influence a user's decisions are deemed to be material, yet may not be so significant as to disrupt the normal functioning of the entity. Some events are material to an investor because they might affect the price of an entity's capital stock or its debt securities, but they would not necessarily have a severe impact on (disrupt) the enterprise itself. The concept of severe impact, however, includes matters that are less than catastrophic. [emphasis added]

[258] The parties also refer to the requirements of the MD&A form, which requires disclosure of "material information that may not be fully reflected in financial statements", including "important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future [emphasis added]". The form provides that materiality for this purpose is to be determined based on the test: "Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated? [emphasis added]".

(b) Positions of the Parties and Evidence

[259] The plaintiffs say that the amount and nature of CIBC's subprime exposure and the risk to CIBC as a result of this exposure were material facts that ought to have been disclosed. They say that there was a confluence of circumstances and facts that would have been considered critically important to an investor. The circumstances and the information that they say should have been disclosed, included the following:

> (i) CIBC had long exposure to subprime mezzanine CDOs of $11.5 billion;
>
> (ii) CIBC's exposure was to mezzanine CDOs comprised of largely BBB rated RMBS;

> (iii) CIBC had unhedged exposure of $1.7 billion;
>
> (iv) CIBC could not exit or hedge its direct positions without suffering a punitive loss as a result of illiquidity in the market;
>
> (v) CIBC had hedged $9.8 billion of its subprime exposure with counterparties who were, to varying degrees, exposed to the same market and were highly leveraged;
>
> (vi) CIBC had hedged $3.45 billion of its subprime exposure with ACA, an A-rated monoline insurer with limited claims-paying ability. ACA was highly leveraged and far in excess of its credit limit. It faced the certain risk of insolvency if it was downgraded below A-, in which case it would face collateral calls that it would be unable to meet; and
>
> (vii) CIBC was unable to hedge its counterparty credit exposure to ACA.

[260] As I have noted earlier, there was no disaggregated disclosure of CIBC's exposures to the USRMM, either hedged or unhedged, in its Q2 2007 report. The Q3 report, disclosed the unhedged securities position under the heading "Exposures to U.S. residential mortgage market". It stated, "As at July 31, 2007, our exposure to the U.S. residential mortgage market was approximately US$1.7 billion (excluding exposures directly hedged with other counterparties)". There was no disclosure of the hedged positions. I will discuss later the plaintiffs' allegations concerning the failure of CIBC to disclose is subprime exposure in news releases and conference calls.

[261] The plaintiffs' expert, Professor Richardson, deposed that CIBC's active and extensive involvement in the subprime market exposed it to significant credit risk and counterparty default risk. He said that in these circumstances, CIBC should have made disaggregated disclosure – that is, it should have separately reported its securities and derivatives positions that were sensitive to the USRMM. He also deposed that CIBC should have disclosed, no later than the end of Q2 - April 30, 2007 - that its maximum exposure to credit risk was $11.458 billion and that $3.5 billion of its hedged position was with ACA, an A-rated monoline insurer, creating a significant concentration of credit risk. He said that in failing to do this, CIBC contravened the GAAP disclosure requirements set out in s. 3861 of the CICA Handbook.

[262] In addition, there is the evidence from the Kamakura experts and Mr. Lozier that CIBC knew or ought to have known of the increasing risks associated with its exposure to the USRMM. There is also the evidence from Ms. Urquhart, who states that the enormous size of the bank's exposure to the USRMM should have been disclosed to investors by no later than the start of the Class Period.

[263] CIBC replies that the plaintiffs' assertions are being made with the benefit of hindsight and that the subprime crisis could not have been foreseen and was not foreseen by CIBC any more than it was foreseen by the regulators, ratings agencies, other financial institutions and investors.

[264] They say that in Q2, the unhedged positions were primarily highly-rated senior positions that had not experienced loses or downgrades and the hedged positions had reference obligations that were super senior and the hedge counterparties were highly rated and investment grade. A near-term severe impact from these positions could not have been foreseen and no other bank in the world foresaw it or made disaggregated disclosure.

[265] CIBC's position, through Mr. McDonough, is that as of April 30, 2007, it did not have a crystal ball to "foresee that an unprecedented credit crisis was in prospect some months down the road". He points out that there was not a single North American or European bank that was taking a different view of the materiality and disclosure of its subprime risk at the time. He says that, at that time, the fair value write-downs on the unhedged positions and on the mark-to-market valuations of the reference obligations for hedged positions was "immaterial relative to CIBC's financial position as a whole", and there was only a very minor credit value adjustment on the investment grade monoline hedge counterparties. His point is, looking at the information CIBC had at the time, and following procedures that were reasonable and consistent with best practices, there was no reason to make radical changes in its assessments of its positions.

[266] The plaintiffs, CIBC says, are treating the "notional" $9.8 billion value of the hedged position as though it was a liability that had to be disclosed when, at the time, there was no reason to discount the value of the hedge. They further note that GAAP, as elaborated on by the FASB, requires the disclosure of a concentration of credit risk if (a) the concentration makes the enterprise vulnerable to the risk of a near-term severe impact <u>and</u> (b) it is at least reasonably

possible that the events that could cause the severe impact will occur in the near term – that is, within a year. CIBC says that these established circumstances simply did not exist during the Class Period and that CIBC's judgment calls were within a range of judgments that could reasonably have been made in the circumstances.

[267] CIBC further explains that the Q3 adverse market conditions and the downgrades in July 2007 led it to take write-downs on its unhedged positions and to provide disaggregated disclosure of its unhedged positions and to disclose that it also had a hedged exposure. It could not have been foreseen at that time that there was a reasonable possibility of a severe impact on CIBC's business in the near term or that it would be "reasonably likely" to affect the financial statements in the future. In order for this possibility to occur, there would have been a default on <u>both</u> the super senior reference obligation <u>and</u> a default by the investment grade counterparty on the hedge.

[268] CIBC's expert witnesses support its position. The evidence of Professor Thornton is that CIBC's disclosures during the Class Period expanded in scope and specificity to convey in a timely way to readers of its financial reports the material effects of market events on the positions. In his opinion, CIBC exercised appropriate judgment in assessing the materiality of its exposure for disclosure purposes and in determining the level of detail that it disclosed about the positions in accordance with GAAP.

[269] Dr. Bajaj expressed the opinion that CIBC made timely and accurate disclosure about its hedged and unhedged positions associated with the USRMM. In his opinion, these positions were accurately disclosed at the outset of the Class Period as part of CIBC's overall trading securities and credit derivatives, and there were no circumstances before or at the start of the Class Period to require that CIBC make disaggregated disclosure of its positions.

[270] Dr. Bajaj opines that the decline of the fair value in CIBC's positions was not foreseeable at the outset of the Class Period. It was primarily attributable to the unforeseen global credit crisis that erupted on August 9, 2007, when BNP Paribas announced that it was freezing redemptions on its investment funds. CIBC considered the impact of this growing crisis and within a few days – on August 13, 2007 – it disclosed its unhedged positions exposed to subprime CDOs and RMBs. It was among the first major bank to do so. As the crisis intensified,

it announced its hedged positions with exposure to subprime CDOs and RMBS on December 6, 2007. Again, it was one of the first banks to do so. On December 19, 2007, immediately after S&P's downgrade of ACA, CIBC announced that it would likely incur a large write down in its next fiscal quarter (Q1 2008) as a result of the downgrade. It was the first of the major banks with positions hedged through ACA to announce a downgrade.

[271] In Dr. Bajaj's opinion, CIBC was not required to separately disclose its hedged position in the USRMM, because its positions were largely related to the AAA-rated super senior tranches, which historically had a very low loss record, and to its counterparties were all investment grade.

2. **Second Complaint: CIBC overstated its income in its Q2, Q3, Q4 Disclosures**

[272] The plaintiffs' second major complaint is that CIBC failed to appropriately report the accounting losses that it incurred as a result of its subprime exposure during the Class Period. They say that reductions in the value of the hedged and unhedged positions were not properly taken, with the result that CIBC over-stated its income in its Q2, Q3 and Q4 2007 and fiscal 2007 financial statements.

[273] There are two components to the plaintiffs' complaint under this heading:

> (a) CIBC over-valued its subprime exposed positions and the related reference assets and by so doing, failed to record the losses it suffered as a result of the decline in fair value of those assets. GAAP required that the assets be recorded at their fair value. The plaintiffs say that instead of relying on market data, such as the ABX and the TABX indices, to value these assets, CIBC used more subjective and less reliable information, with the result that the assets were over-valued.
>
> (b) CIBC failed to apply an appropriate CVA to its hedge counterparties, notably ACA, with the result that its hedge positions were overvalued and its income was overstated. The plaintiffs say that CIBC failed to properly record the losses that it had incurred as a result of the reduced credit-worthiness of its hedge counterparties. It continued to rely on historic default rates instead of objective market information.

(a) The Relevant Standards

[274] GAAP requires that a company report its trading securities and derivative positions in its financial statements at their "fair value". The fair value of the positions has to be determined or "marked to market" each quarter, and the changes in the fair value must be reflected in the earnings for the period. If the value goes down, write-downs have to be made, which will be reflected as deductions from earnings. Such write-downs are accounting losses as opposed to realized losses. A loss would be realized if the positions were actually sold or were subject to a default. The plaintiffs say that CIBC failed to take timely and adequate write-downs in the fair value of its unhedged and hedged positions during each quarter of the Class Period, with the result that its income was overstated during these periods.

[275] In the case of the unhedged RMBS and CDOs in the securities portfolio, a "marked to market" analysis has to be done in each quarter, with any decline in the value of the portfolio being reflected in a deduction from earnings.

[276] In the case of the hedge positions, as long as the hedge counterparty (i.e., the entity that had sold the protection to CIBC) had good credit and could pay in the event of default, any decrease in the value of the long exposure (i.e., the reference asset that is the subject of the hedge) would be offset by an increase in value of the hedge, with the result that there would be no impact on earnings. However, accounting principles require that the valuation of the hedge must take into account the risk of default by the counterparty. This is referred to as a "credit valuation adjustment" or "CVA".

[277] To value the hedge position, therefore, it was necessary to take into account two sides of the equation. First, CIBC had to value its exposure to the underlying reference assets, the CDOs on which it had sold protection in the form of a CDS swap. This would show its exposure in the event of a default of the reference assets. Then, it had to value the CDS that it had purchased from its counterparty, which was to provide a guarantee in the event of default of the same reference assets. This in turn depended on the creditworthiness of the counterparty – hence the need to make a CVA to account for counterparty credit risk.

[278] In slightly more technical terms, this process involved:

(a) marking the reference assets to market;

(b) calculating the corresponding mark (called a "gross mark") on the hedge position in relation to the reference assets (which, in the prevailing market, usually resulted in positive mark, because of the corresponding decline of the reference asset) and

(c) calculating the credit risk associated with the hedge counterparty and deducting the resultant CVA from the gross mark.

This process produced the fair value of the hedge position. As the CVA increased in the accounting period, the value of the hedge position would decrease and the difference would be a charge against income for the period.

[279] Where there is an active market for securities, GAAP indicates that the actual price at which the security trades on the market is the best evidence of fair value. In the case of a security listed on a stock exchange, for example, the fair value on any given date can be readily ascertained from the stock index. The problem confronting CIBC and other financial institutions with subprime exposure during the Class Period was that there was no active market for RMBS and CDOs. Thus, finding a "market" value was difficult or impossible.

[280] GAAP requires that where there is no active market, a "valuation technique" must be used (HB, s. 3855.73). This may include reference to recent arm's length market transactions, the current value of another substantially similar input, discounted cash flow analysis and option pricing models (HB, s. 3855.A47).

[281] GAAP also required, effective November 2007, that the valuation technique make maximum use of inputs observed from the market or "market observables", relying "as little as possible on inputs generated by the entity" (HB, s. 3855.74, effective November 2007). GAAP establishes a hierarchy of inputs for determining fair value, with:

- level 1 inputs being quoted prices in an active market for identical assets or liabilities,
- level 2 inputs being quoted prices in markets for comparable assets and liabilities, and

- level 3 inputs, being "inputs for the asset or liability that are not based on observable market data" ("unobservable inputs") and would include the reporting entity's own analysis of underlying economic data (HB, s. 3862.27A).

GAAP recognizes that the choice of inputs is a matter requiring the exercise of judgment.

[282] The plaintiffs' position on this issue is that CIBC failed to use an appropriate valuation technique. They say that if CIBC had used a proper technique, it would have recorded cumulative fair value write downs of US$0.769 billion, $2.38 billion and $3.92 billion in the last three quarters of fiscal 2007. As a result of its failure to do so, the plaintiffs say, CIBC's income for these quarters was overstated.

(b) Valuation of Unhedged Positions

[283] During the Class Period, CIBC relied primarily on "broker quotes" or "proxy quotes" to determine the fair value of its unhedged positions. These were non-binding quotes obtained from third party brokers who were familiar with the particular instruments or quotes on comparable securities. They were regarded as level 2 inputs, or market observables, although their non-binding quality could call their reliability into question.

[284] As I have noted earlier, CIBC acknowledges that the illiquidity of markets and other factors made valuations challenging during the Class Period and that it, other financial institutions, and their auditors were struggling with the valuations.

[285] CIBC's valuation process was done by the Pricing Committee, which recommended fair value marks on a monthly basis. CIBC says that it did not ignore the ABX and TABX indices in valuing its positions, but points out that these indices were not designed as valuation tools. The developer of the indices, a company called Markit, has stated in this regard:

> The ABX may be a standardized and liquid tradable index but it was not designed to be uncritically extrapolated to the broader [asset backed securities] market, and it was certainly not designed as a valuation tool for individual securities…

[286] Moreover, due to the bear market for subprime securities, the indices would tend to understate the value of the securities. For these reasons, CIBC did not reference its values

directly to the indexes. It considered cash flow modeling and the valuations of its own internal traders, but its primary valuation technique was broker quotes.

[287] CIBC's valuation methodology was endorsed by E&Y, which it engaged for assistance in May, 2007. E&Y attended several meetings of the Pricing Committee in connection with the review of the Q3 statements, the audit of the fiscal 2007 statements and the review of the Q1 2008 statements. E&Y made recommendations concerning the valuation methodology, which CIBC implemented, and it expressed the view that CIBC's methodology was appropriate.

[288] CIBC's experts support the methodology used to value the subprime positions. Dr. Bajaj expressed the opinion that it was not appropriate to use the ABX/TABX indices for the purposes of valuation, because they were not designed for valuation purposes. He also opined that it would not have been appropriate to transpose index information to CIBC's positions, which had unique collateral and credit enhancement features. In his view, CIBC's valuations were the product of reasonable judgments, using appropriate methods and available information. A similar opinion was expressed by Professor Thornton.

[289] The plaintiffs' experts say that CIBC's methodology did not comply with GAAP and was flawed. Professor Richardson says that CIBC should have made appropriate use of "Level 2 inputs" observed from market prices and based on the ABX and TABX indices, and therefore failed to comply with Handbook, s. 3855, and GAAP. Kamakura agrees that the indices were important valuation tools and points out that at various times, CIBC has treated them as reliable guides to valuation and even acquired a short position on the ABX index in July 2007 in an attempt to hedge the subprime exposure in its investment portfolio.

[290] There is no question that valuation of the RMBS and CDOs was a challenge during the Class Period – a challenge that CIBC acknowledges was bedeviling the banking industry and its auditors. This was due, in part, to the difficulty in determining the value of the assets in the underlying pools, for which there was little public data. This, coupled with the "Byzantine" nature of the instruments with their complex layers of contractual protection, made it extremely difficult to predict cash flows. With the USRMM in decline, values of the mortgage-based assets were constantly changing. Due to the illiquidity of the markets, there was a lack of level 1 inputs and even level 2 inputs, requiring resort to less reliable sources of valuation.

[291] There are indications in the minutes of the Risk Management Committee and the Board that the risks associated with CIBC's subprime positions may not have been well understood by senior management – and even less so by the Board – at the outset of the Class Period. The evidence suggests that management's and the Board's appreciation of these risks evolved significantly from the time of Kilgour's memorandum of June 25, 2007 to the December 6, 2007 release of the 2007 fiscal results. The evidence also indicates that CIBC's valuation methodologies were revised and enhanced during the Class Period and eventually resulted in more meaningful disclosure.

(c) Over-Valuation of Hedge Positions

[292] The plaintiffs allege that CIBC over-stated its income during the Class Period by failing to take into account the risk of default by the counterparties on its hedged positions.

[293] The plaintiffs' experts Richardson and Kamakura say that in determining the CVA, CIBC should have taken into account various "market observables", including CDS credit spreads, the decline in the share price of ACA's parent corporation and the impact of the declining ABX and TABX indices on ACA's positions in the USRMM. CIBC allegedly violated GAAP (HB, s. 3855.73) by failing to make maximum use of inputs observable from markets.

[294] CIBC says that there was an "evolution" in the methodology that it used to calculate CVA during the Class Period. It had traditionally used a methodology referred to as the "historic probability of default".

[295] Until the end of fiscal 2007, CIBC used a mathematical model which calculated CVA based on:

(i) the projected exposure in the event of default;

(ii) the probability of default; and

(iii) the loss flowing from default.

[296] To determine the probability of default by the counterparty, CIBC used an internally-developed risk rating for the counterparty coupled with the historic loss experience over the

credit cycle for investments or entities with the same risk rating. The ratings used by CIBC were similar, but not identical, to the ratings used by the rating agencies, such as S&P and Moody's. The rating agencies (which had in most cases provided the initial ratings for the underlying bonds) had access to private information concerning the underlying assets that was not always available to CIBC. For that reason, CIBC made increasing use through 2007 of the external ratings in the development of its own internal ratings and, from that, its own CVAs.

[297] Simply by way of example, if the counterparty had been initially rated AAA, and entities with such ratings had historically had a 0.5% (zero point five percent) probability of defaulting on their obligations in the near term, and the counterparty was subsequently downgraded to an A rating, with, hypothetically an historic probability of default of 2%, the CVA to be applied to the hedge with this counterparty would be adjusted to reflect the increased risk of default. A corresponding charge against income would be made.

[298] CIBC's traditional approach to CVA was changed near the end of 2007, as a result of input from E&Y. In November and December 2007, in connection with CIBC's year-end financial statements, E&Y noted that some institutions were moving to a valuation approach that looked to "market credit spreads" on CDS referencing obligations of the counterparty or groups of counterparties. The price charged by the market to insure the obligations of the party would reflect the market's overall assessment of the risk attached to that counterparty. This methodology produced higher probabilities of default that the methodology traditionally used by CIBC and others. Ultimately, after further investigations of the matter, E&Y advised CIBC in early February 2008 that a number of US investment banks were using the credit spread approach. This new methodology was implemented by CIBC effective January 31, 2008, to be used in connection with the Q1 2008 statements. It had the effect of producing higher default probabilities for ACA, and thus a higher CVA, than the results under the historical probability of default methodology. This in turn resulted in a reduction in value of the hedge position and a charge against income.

[299] CIBC notes that E&Y confirmed that CIBC's historic methodology up into fiscal year end 2007 was consistent with the general practice of Canadian and foreign financial institutions. Its CVA adjustments at year end 2007 were reviewed by E&Y and were considered to be

reasonable. The change in methodology was made after extensive due diligence to reflect advice from its auditors and to get in line with an emerging practice in the financial reporting of other institutions. It also notes that both Professor Thornton and Dr. Bajaj considered that CIBC's CVA methodology was appropriate in the circumstances.

[300] The plaintiffs' experts contend that CIBC overstated its income for Q2, Q3 and Q4 of 2007 and Q1 of 2008 by failing to record cumulative fair value write downs due to the "collapse" of the ACA hedge by the end of Q2 or Q3 2007. Professor Richardson says that CIBC violated GAAP and specifically Handbook, s. 3855.73, by failing to incorporate monoline credit spreads into its CVA analysis of ACA no later than Q3 2007. He says that reliance on historic rates of default was inappropriate due to the collapse of the USRMM. It was his opinion that ACA was in "extreme financial distress" by September 2007 and a full CVA should have been taken on the hedge position with it by Q4 2007. He says that taking a CVA of only $17 million on what was then a $1.7 billion market loss related to ACA was an "especially severe violation" of GAAP (HB, s. 3855.66).

[301] Kamakura echoes Professor Richardson's opinion. It says that ACA was "visibly in a high degree of distress by the end of 2007". It says that the declining price of the shares of ACA's parent corporation was information that should have been taken into account in determining the credit risk associated with ACA. Kamakura says that CIBC should also have used the ABX and TABX indices to accurately value ACA's underlying assets and that it placed too much emphasis on ACA's single A rating. It points out that the fact that ACA was ultimately downgraded from A to CCC, a drop of twelve rating notches, demonstrates that the S&P rating was wildly out of line.

[302] With respect to the CVA adjustment, the plaintiffs say that the same standard applies – HB, s. 3855.73. They say that instead of considering monoline credit spreads, CIBC looked at historic default rates.

[303] The plaintiffs also raise the issue of whether the November 9, 2007 announcement by S&P that it was putting ACA on credit watch with "negative implications" was a subsequent event which should have been disclosed under HB, s. 3820.03, as part of the quarterly disclosure.

[304] They also say that since CIBC had itself downgraded ACA, they should have known that it was only a matter of time before S&P lowered its own rating.

[305] CIBC's transactions with ACA were subject to "collateral posting" requirements, which required ACA to post collateral to secure its obligations in the event of either (a) a downgrade of ACA's S&P rating from its then current A rating to below A-; or (b) actual losses within the assets underlying reference obligations covered by ACA reaching pre-set thresholds. ACA had similar collateral posting requirements with other counterparties.

[306] CIBC's evidence is that during Q3, it was closely monitoring its positions with ACA. During that time, it concluded that material losses on those positions were not reasonably likely, given ACA's exposure was to AAA tranches and CIBC's view that there was only a remote risk of default on the underlying obligations. This conclusion was fortified, CIBC says, when S&P confirmed, in early August, that ACA met the requirements of an investment grade counterparty. CIBC maintained its internal investment grade ratings for ACA through Q3 2007 and its total CVA on the ACA hedge positions was $0.4 million in Q2 and $2.8 million in Q3.

[307] That being said, CIBC was aware that the credit equivalent exposure for ACA was substantially in excess of its $30 million credit limit. In light of the illiquidity of the market, there was nothing much CIBC could do except increase ACA's credit limit, and hope the situation would improve.

[308] The situation got measurably worse through Q4 2007 (ending October 31). The credit equivalent exposure to ACA at the end of September 2007 had "ballooned" to $1.3 billion as a result of the mark-to-market value of the reference obligations being driven down and the application of the CVA. Risk Management prepared a credit assessment of ACA with a view to (a) increasing its credit limit to $1.9 billion, "having regard to the market conditions that had caused the Credit Equivalent of ACA to balloon and the absence of available alternatives, due to market conditions, to mitigate the exposure" and (b) downgrading ACA's internal risk rating which would have the effect of increasing the CVA on the ACA positions, thereby reducing the value at which these positions were carried on the balance sheet. This was approved by the Risk Management Committee in October 2007. In effect, a counterparty that had started out with a

credit limit of only $30 million had its credit limit increased to $1.9 billion essentially because CIBC had no alternative but to expand the credit limit.

[309] Nevertheless, the downgrade of ACA due to CIBC's internal rating resulted in an increase of the CVA on the ACA hedge positions to just $17 million in Q4, which was up from $2.8 million in Q3 and $0.4 million in Q2.

[310] On November 9, 2007, S&P put ACA's "A" rating on credit watch, with negative implications. This was followed on December 19, 2007 with what Mr. McDonough describes as "still more surprising (given the magnitude [of the downgrade])" announcement that S&P had downgraded ACA to a CCC rating. This led to CIBC downgrading its own internal rating to a level below the S&P rating. On December 19, 2007, after the S&P downgrade, ACA signed a forbearance agreement with thirty counterparties, including CIBC, whereby the counterparties agreed not to make collateral posting calls until January 18, 2008. This date was extended and there was ultimately a restructuring of ACA.

[311] At the end of Q1 2008, the gross mark-to-market value of the ACA hedge positions was approximately $2.2 billion. CIBC took a CVA against those positions in the same amount, effectively writing off the value of all those positions.

[312] There is a conflict in the evidence concerning the creditworthiness of ACA during the Class Period, viewed objectively in light of the evidence available at that time. Kamakura says that ACA was a distressed "shell", whereas CIBC says that, viewed *ex ante*, as opposed to *ex post facto*, CIBC's assessment was reasonable and was consistent with the judgments made by other sophisticated professionals, including financial analysts, the other 29 counterparties who had hedged positions with ACA, and S&P, which had intimate knowledge concerning ACA's creditworthiness.

[313] The plaintiffs have adduced expert evidence through Professor Richardson and Kamakura that:

> (a) CIBC should have disclosed its concentration of credit risk to ACA of a notional value of $3.5 billion at the outset of the Class Period and should have been closely monitoring its exposure throughout the period;

> (b) CIBC's exposure to a single institution was well above normal standards and was critical information that should have been disclosed to investors – it is noteworthy, in this regard, that at the Risk Management Committee meeting on October 31, 2007, it was reported that CIBC's exposure to two of its counterparties, including ACA, had increased and that this had been reported to the Superintendent of Financial Institutions – indicative of the serious nature of the concern;
>
> (c) In view of the credit spreads on ACA, which CIBC should have been monitoring and incorporating in its CVA analysis much earlier than January 2008, CIBC should have appreciated that there was a high probability that ACA's credit rating would be downgraded below A, thereby triggering collateral posting obligations that ACA would have no chance of meeting, with a certainty of default.

[314] CIBC takes issue with the plaintiffs' assertion that ACA was in a highly distressed state by July 31, 2007 and was merely a "shell" by the end of Q2 2007 or Q3 at the latest. It says that the CVA it took on the hedge positions insured with ACA was the result of extensive due diligence, aided by E&Y, and demonstrated a good faith attempt to reach an informed conclusion on the issue. It says that the valuation of its hedged and unhedged positions is quintessentially a matter of judgment for which there is no single "right" answer. In the final analysis, it says that the risks related to these highly rated positions was missed by all the players – the rating agencies, the financial institutions and the investors, all of whom thought that there was an insignificant chance of impairment of such highly rated assets.

[315] While CIBC may have been in good company, events have shown that it was stunningly and staggeringly wrong. It ended up losing in excess of $2 billion due to the default of an institution that had a credit limit of only $30 million at the outset of the Class Period. The condition of ACA got progressively worse as the Class Period continued, reflecting the fact that it was exposed to the very risks that CIBC was attempting to hedge against. As will become apparent, it is my view that the evidence establishes a reasonable possibility that the plaintiffs will succeed on this issue and the conflict in the expert evidence is a matter that should be resolved at trial.

3. Third Complaint: Concentration of Credit Risk

[316] The plaintiffs' third complaint is that, contrary to GAAP, CIBC failed to disclose the concentration of credit risk associated with ACA. It says that ACA was itself exposed to the risks that CIBC had hedged against. Thus, the very circumstances that would give rise to a need to call on the hedges with ACA would diminish ACA's capacity to respond to the call.

[317] The relevant principles are expressed in HB, s. 3861.66-68:

> Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature and financial position of the business and they result in a significant exposure to loss in the event of default by other parties. Identification of significant concentration is a matter for the exercise of judgment by management, taking into account the circumstances of the entity and its debtors …
>
> Concentrations of credit risk may arise from exposures to a single debtor or to groups of debtors having a similar characteristic, such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. Characteristics that may give rise to a concentration of risk include the nature of the activities undertaken by debtors, such as the industry in which they operate, the geographic area in which activities are undertaken and the level of creditworthiness of groups of borrowers. …
>
> Disclosure of concentrations of credit risk includes a description of the shared characteristic that identifies each concentration and the amount of the maximum credit risk exposure associated with all recognized and unrecognized financial assets sharing that characteristic.

[318] ACA had guaranteed CIBC's exposure to $3.5 billion of CDS, which had referenced assets largely comprised of AAA-rated tranches of CDOs. ACA was first approved by CIBC as a counterparty in 2005 and was initially internally rated as "investment grade" and was given a credit limit of $25 million, which was increased to $30 million in 2006. After that time, its risk ratings were monitored and the CVA was also monitored and the limit was increased. CVA was calculated on a quarterly basis.

[319] I have described earlier the decline in the circumstances of ACA during the Class Period. It is apparent by as early as February 2007, CIBC knew that its exposure to ACA was well in excess of ACA's $30 million credit limit and that it had no ability to exit the positions hedged by ACA. The situation continued to deteriorate from April through to July 2007, and by the time of the meeting of the Risk Management Committee in mid-July, CIBC knew that its exposure to ACA was substantial and was getting worse.

[320] Professor Richardson expresses the opinion that CIBC should have disclosed, no later than April 30,2007, that it had a significant concentration of credit risk through its $3.5 billion hedge with ACA, which he describes as "only single 'A' rated and vastly undercapitalized."

[321] I will return to the plaintiff's complaints when I discuss the application of the leave test.

VI. THE MOTION FOR LEAVE

1. Part XXIII.1 of the *Securities Act*

[322] Part XXIII.1 of the *Securities Act* came into effect on December 31, 2005. Section 138.3(1) creates a statutory cause of action for misrepresentation in the secondary securities market in favour of any person who acquires or disposes of the securities of an issuer between the time the document containing the representation was released and the time the misrepresentation was corrected. This provision has no regard to whether the person relied upon or even knew of the misrepresentation.

[323] In order to commence an action under s. 138.3, leave of the court must be obtained. Leave is only to be granted if the court is 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 (s. 138.8).

[324] In this section, I will discuss the history of this statutory remedy and the relevant statutory provisions. I will then discuss and apply the test for leave. Finally, I will consider the defendants' argument that the plaintiffs' claim is time-barred.

(a) The Origins of the Statutory Remedy

[325] An understanding of the history and origins of the statutory remedy serves as a guide to the interpretation of the test for leave to commence an action.

[326] This history was outlined by Lax J. in one of the first cases to consider the new provision, *Ainslie v. CV Technologies Inc.* (2008), 93 O.R. (3d) 200, [2008] O.J. No 4891 (S.C.J.) at paras. 7-13. It was also discussed extensively by van Rensburg J. in *Silver v. Imax Corp.* (2009), 66 B.L.R. (4^{th}) 222, [2009] O.J. No. 5573 (S.C.J.), leave to appeal ref'd, 2011 ONSC 1035, [2011] O.J. No. 656 (Div. Ct.) (*Silver v. Imax (Leave)*) at paras. 225-238. I do not propose to retrace the ground so thoroughly mapped by my colleagues.

[327] Suffice to say, the genesis of the statutory remedy was a report by a federal task force in 1979 and a proposal by the Ontario Securities Commission in 1984. However, the idea of a statutory remedy really gained traction in the report of the "Allen Committee" established by the Toronto Stock Exchange in the early 1990s, which recommended a limited degree of statutory civil liability for misleading continuous disclosure by a reporting issuer. The Allen Committee's final report was released in 1997.

[328] The Allen Committee report was supported by the Canadian Securities Administrators (CSA). The CSA established a committee that produced draft legislation in 1998 and 2000. It proposed a statutory civil cause of action for secondary market misrepresentation, whether or not an investor had actually relied on the misrepresentation, along with defences for various participants based on their responsibility for the disclosure, liability caps and proportionate liability based on the defendant's share of responsibility, subject to certain exceptions. It also proposed that there be a "screening mechanism", which would require the court to determine whether the action was being brought in good faith and had a reasonable possibility of success.

[329] In its report dated November 3, 2000, the CSA outlined the key features of the proposed remedy, including the "screening mechanism". It observed, at pp. 1-2:

> One of the risks of creating statutory liability for misrepresentations or failures to make timely disclosure is the potential for investors to bring actions lacking any real basis in the hope that the issuer will pay a settlement just to avoid the cost of

> litigation. To limit unmeritorious litigation or strike suits, plaintiffs would be required to obtain leave of the court to commence an action. In granting leave, the court would have to be satisfied that the action (i) is being brought in good faith, and (ii) has a reasonable possibility of success. [emphasis added]

[330] The expression, "reasonable possibility of success", came from the Ontario Law Reform Commission, *Report on Class Actions* (1982), which had recommended that the certification procedure include a preliminary merits test to determine whether the action had a "reasonable possibility of success". The report stated at page 324: "The preliminary merits test that we propose would require a standard of proof that is not as strict as a *prima facie* case test, but more than simple proof that a triable issue exists". While this proposal did not find its way into the *C.P.A.*, the preliminary merits test was adopted by the CSA in its draft legislation and was ultimately incorporated in Part XXIII.1 of the *Securities Act*.

[331] As van Rensburg J. observed in *Silver v. Imax (Leave)*, at para. 232, the CSA noted the concern of public issuers that the statutory remedy could promote "strike suits" – unmeritorious claims commenced for the purpose of pressuring public issuers into substantial settlements in order to avoid improbable, but potentially devastating, exposure. The CSA stated that the screening mechanism was designed "not only to minimize the prospects of an adverse court award in the absence of a meritorious claim but, more importantly, to try to ensure that unmeritorious litigation, and the time and expense it imposes on defendants, is avoided or brought to an end early in the litigation process."

[332] As Lax J. noted in *Ainslie*, at para. 12, the CSA concluded that,

> ...irrespective of whether it was believed that the proposed legislation would result in strike suits, a screening mechanism was necessary in order to prevent corporate defendants from being exposed to proceedings "that cause real harm to long-term shareholders and resulting damage to our capital markets."

[333] Lax J. concluded that the history of the enactment and its legislative purpose should inform its interpretation. She stated, at para. 15:

> The section [the leave provision of s. 138.8] was not enacted to benefit plaintiffs or to level the playing field for them in prosecuting an action under Part XXIII.1 of the Act. Rather, it was

> enacted to protect defendants from coercive litigation and to reduce their exposure to costly proceedings. No onus is placed upon proposed defendants by section 138.8. Nor are they required to assist plaintiffs in securing evidence upon which to base an action under Part XXIII.1. The essence of the leave motion is that putative plaintiffs are required to demonstrate the propriety of their proposed secondary market liability claim <u>before</u> a defendant is required to respond. Subsection 138.8(2) must be interpreted to reflect this underlying policy rationale and the legislature's intention in imposing a gatekeeper mechanism.

[334] The interpretation and application of the leave provision is one of the central issues in this case. I will discuss it in more detail below.

(b) The Statutory Cause of Action

[335] Section 138.3 confers the statutory cause of action for misrepresentation in the secondary market:

> 138.3(1) Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of the issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or the company relied on the misrepresentation, a right of action for damages against,
>
> (a) the responsible issuer;
>
> (b) each director of the responsible issuer at the time the document was released;
>
> (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document.

<u>Authorized, Permitted or Acquiesced</u>

[336] Subsection 138.3(2) gives a similar right of action against the issuer, directors and officers who authorized, permitted or acquiesced in the release of a "public oral statement" made by a person with authority to speak on behalf of the issuer, relating to the business or affairs of the issuer that contains a misrepresentation.

[337] I will discuss the "authorized, permitted or acquiesced" issue later in these reasons.

Misrepresentation

[338] A "misrepresentation" is defined in s. 1(1) as:

> (a) an untrue statement of material fact, or
>
> (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.

[339] A "material fact", when used in relation to issued securities, means:

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

Leave of the Court

[340] As noted above, no action may be commenced under s. 138.3 without leave of the court, and leave can only be granted where the court is 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 (s. 138.8(1)) [emphasis added].

Core and Non-Core Documents

[341] The statute differentiates between misrepresentations made in different types of documents and in public oral statements. It distinguishes between "core documents" and "non-core documents". Core documents are defined to include the issuer's annual and interim financial statements and MD&As (s. 138.1). Non-core documents are documents, as defined by s. 138.1, other than core documents.[8] An issuer and its directors and each officer of the issuer who

[8] Section 138.1: " …document" means any written communication, including a communication prepared and transmitted only in electronic form, (a) that is required to be filed with the Commission, or (b) that is not required to be filed with the Commission and, (i) that is filed with the Commission, (ii) that is filed or required to be filed with a government or an agency of a government under applicable securities or corporate law or with any exchange or quotation and trade reporting system under its by-laws, rules or regulations, or (iii) that is any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer.

authorized, permitted or acquiesced to the release of the document have liability for a misrepresentation in these core documents, subject to a defence of "reasonable investigation" set out in s. 138.4(6), discussed below.

[342] The burden of proof on the plaintiff is higher in the case of non-core documents and public oral statements than in the case of core documents. In the case of non-core documents and public oral statements, section 138.4(1) provides that in order to establish liability, the plaintiff must prove that the issuer, officer or director:

> (a) knew, at the time that the document was released or public oral statement was made, that the document or public oral statement contained the misrepresentation;
>
> (b) at or before the time that the document was released or public oral statement was made, deliberately avoided acquiring knowledge that the document or public oral statement contained the misrepresentation; or
>
> (c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation.

[343] To summarize, in the case of non-core documents or public oral statements, the plaintiff has the burden of proving that the issuer, the officer or director either had knowledge of the misrepresentation, was willfully blind, or was guilty of gross misconduct.

Assessment of Damages

[344] The statute contains a formula for the assessment of damages of shareholders who acquired the securities after the misrepresentation, depending on how many days elapsed after the public correction of the misrepresentation before they disposed of their securities (s. 138.5(1) and (2)). Damages do not include any amount that the defendant proves is unrelated to the misrepresentation (s. 138.5(3)). Liability is several among defendants, based on the party's responsibility for the damages. Liability will, however, be joint and several where a defendant, other than the responsible issuer, authorized, permitted or acquiesced in the making of the misrepresentation (s. 138.6).

Liability Cap

[345] One of the important features of the legislation, designed to protect the issuer, its directors and its ongoing shareholders from crippling liability, is a cap on damages. The cap available to the issuer is the greater of 5% of the issuer's market capitalization and $1 million. The cap available to directors and officers of the issuer is the greater of $25,000 and 50% of the aggregate of the director or officer's compensation from the issuer (s. 138.7). The cap will be lost if the plaintiff proves that the officer or director authorized, permitted or acquiesced in the making of the misrepresentation, while knowing that it was a misrepresentation.

Limitation Period

[346] Section 138.14 contains a three year limitation period for the commencement of an action under s. 138.3. The defendants rely on this provision to say that the action is out of time.

Reasonable Investigation Defence

[347] The statute provides a defence of "reasonable investigation". The defence is 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, he, she or 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: s. 138.4(6). The full text of the subsection is:

> (6) A person or company is not liable in an action under section 138.3 in relation to,
>
> (a) a misrepresentation if that person or company proves that,
>
> > (i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and
> >
> > (ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation;

[348] Subsection 138.4(7) provides that in determining whether the investigation was reasonable or whether the person or company is guilty of gross misconduct under s. 138.4(1), the court shall consider all relevant circumstances, including:

> (a) the nature of the responsible issuer;
>
> (b) the knowledge, experience and function of the person or company;
>
> (c) the office held, if the person was an officer;
>
> (d) the presence or absence of another relationship with the responsible issuer, if the person was a director;
>
> (e) the existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations;
>
> (f) the reasonableness of reliance by the person or company on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts;
>
> (g) the period within which disclosure was required to be made under the applicable law;
>
> (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; and
>
> (k) in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.

[349] I will discuss the interpretation and application of the leave test in the next section.

2. Interpretation and Application of the Leave Test

[350] As noted earlier, there are two aspects of the leave requirement – the court must be satisfied – the onus being on the plaintiff – first, that the action is being brought in good faith and second, that there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff. Subsection 138.8 contemplates that this inquiry is evidence-based, but as Lax J. found in *Ainslie*, the onus rests with the plaintiff and never shifts.

[351] There is little precedent for the interpretation of the statutory leave requirements. The parties have referred to three principal authorities, *Silver v. Imax (Leave)* and *Dobbie v. Arctic Glacier Income Fund*, 2011 ONSC 25, [2011] O.J. No. 932 (*Arctic Glacier*), in Ontario, and *Round v. MacDonald, Dettwiler and Associates Ltd.*, 2011 BCSC 1416, [2011] B.C.J. No. 1980 in British Columbia. To this list can be added the decision of the Québec Superior Court in *121851 Canada Inc. v. Theratechnologies Inc.*, 2012 QCCS 699, [2012] J.Q. No. 1529. These authorities are discussed below.

[352] As regards the general interpretative principle to be applied to the statutory leave test, I respectfully adopt the comments of van Rensburg J. in *Silver v. Imax (Leave)* at paras. 293 to 294, to the effect that the legislation is remedial and that it should be interpreted to facilitate access to the courts by shareholders with legitimate claims:

> The statutory cause of action for secondary market misrepresentation also serves a dual purpose, of permitting the recovery of damages by a shareholder, and as a deterrent to breach of a reporting issuer's continuous disclosure obligations under the *OSA*.
>
> Similarly, the statutory cause of action was introduced as remedial legislation; that is, in recognition of the obstacles to pursuing claims for secondary market misrepresentation under common law. Accordingly, the leave test prescribed by the legislature should be interpreted so as to permit access to the courts by shareholders with legitimate claims.

[353] These observations were also adopted by Tausendfreund J. in *Arctic Glacier* at para. 106.

(a) Good Faith

[354] In *Silver v. Imax (Leave),* van Rensburg J. described the "good faith" requirement at para. 308 as follows:

> ... I interpret "good faith" in the context of s. 138.8, to require the plaintiffs to establish that they are 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 and not for an oblique or collateral purpose. "Good faith" involves a consideration of the subjective intentions of the plaintiffs in bringing their action, which is to be determined by considering the objective evidence.

[355] This observation was also adopted by Tausendfreund J. in *Arctic Glacier* at para. 112. He also noted, at para. 111, the definition of "good faith" in B. Garner, ed., *Black's Law Dictionary*, 9th ed. (St. Paul: Thomson Reuters, 2009):

> A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards or fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage.

[356] In light of the history of the legislation, I interpret the good faith requirement as requiring the plaintiff to 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.

[357] There was no serious challenge to the good faith requirement in this case. I am satisfied that the requirement has been met. The plaintiffs meet the statutory requirement of having acquired CIBC shares during the Class Period. They depose that they bring the action in good faith to recover the losses that they and Class Members have suffered and "to ensure that the defendants are held accountable" for their alleged misrepresentations. They believe that there is a reasonable possibility that this action will be successful.

[358] The plaintiffs have retained experienced and very competent counsel with expertise in class actions and securities litigation. They have amassed a significant volume of evidence,

retained qualified and well-respected experts, and have manifested an intention and capacity to proceed with this litigation if leave is granted and the action is certified.

[359] I now turn to the examination of whether leave should be granted to pursue each of the alleged misrepresentations against each of the defendants. I will first discuss the test to be applied in determining whether the action has a reasonable possibility of success. I will then apply that test, considering first the alleged misrepresentations in the non-core documents and public oral statements and then in the core documents.

(b) Reasonable Possibility of Success

[360] CIBC acknowledges that the "reasonable possibility of success" requirement is meant to be a screening mechanism to protect Ontario issuers from the abuse of strike suits. It submits that to accomplish this legislative purpose, the test must be a meaningful hurdle to the commencement of the action and not simply a "speed bump". It suggests that the standard set in *Silver v. Imax (Leave)* and *Arctic Glacier* is too low, and that the more appropriate standard is to be found in *Round v. MacDonald, Dettwiler and Associates Ltd.*

[361] In *Silver v. Imax (Leave)*, van Rensburg J. described the test of "reasonable possibility of success at trial" as having a "relatively low threshold" and requiring a consideration of all the evidence put forward by the parties concerning the alleged misrepresentations and the defences asserted (at para. 25). Later in her reasons, at para. 324, she noted that the word "reasonable" in s. 138.8 should be interpreted as having two components – first, a measurement of the degree of possibility of success and second, a reasoned and logical possibility:

> The word "reasonable" as it is used in s. 138.8 captures both meanings. "Reasonable" is used instead of "mere" to denote that there must be something more than a *de minimis* possibility or chance that the plaintiff will succeed at trial. The adjective "reasonable" also reminds the court that the conclusion that a plaintiff has a reasonable possibility of success at trial must be based on a reasoned consideration of the evidence.

[362] Justice van Rensburg also noted that the context of the inquiry – which is based on documents rather than live evidence – shapes the analysis. She stated at paras. 326 and 327:

> In undertaking this evaluation the court must keep in mind that there are limitations on the ability of the parties to fully address the merits because of the motion procedure. There is no exchange of affidavits of documents, no discovery (although affiants may be cross-examined) and witnesses cannot be summoned ...
>
> As a result, the court must evaluate and weigh the evidence at hand, keeping in mind the restrictions of the motions process and what may be available to the parties in a trial. This does not mean that the court should speculate about what better evidence a party may advance when the matter reaches trial, or fill obvious gaps in a party's case; it does however require the court to assess the evidence realistically, having regard to which party has the burden of proof and access to evidence that may be brought forward at the preliminary stage, and paying attention to conflicts in the evidence that may not be capable of being determined in a motion, without a full assessment of a witness' testimonial credibility.

[363] She then stated at paras. 330-334:

> The statutory leave provision is designed to prevent an abuse of the court's process through the commencement of actions that have no real foundation, actions that are based on speculation or suspicion rather than evidence.
>
> The leave provision, working with the definition of the statutory cause of action and defences, requires plaintiffs to put forward the evidence they rely on as to the misrepresentation, and the extent of knowledge or participation required for non-core documents and liability for officers, and permits each proposed defendant to offer an account that may contradict the plaintiffs' allegations, or would fall within the terms of one or more of the defences afforded by the statute.
>
> The evidence must be considered at the leave stage to determine whether the plaintiffs' action, after the respondents have had the opportunity to put forward evidence to support their defences and the positions of the parties have been explored in cross-examination, has a reasonable possibility of success.
>
> In this regard it is not sufficient (as the respondents contend) to put forward defences which the plaintiffs must "overcome". Nor is the court required (as the plaintiffs assert) to leave any assessment of the defences to a trial. The court must consider all of the evidence put forward in the leave motion, including evidence supportive of any statutory defence. Because the onus of proof of a statutory defence is on the respondents, the court must be satisfied that the evidence in support of such a defence at the preliminary merits

> stage will foreclose the plaintiffs' reasonable possibility of success at trial.
>
> Considering all of the factors noted above, I have approached part two of the leave test by asking myself whether, on the evidence that is before the court on this motion -- that is the affidavits and transcripts of examinations, as well as the various documents that have been tendered as exhibits, and produced in response to undertakings and ordered to be produced during the cross-examination process -- as well as reasonable inferences to be drawn from such evidence, and considering the onus of proof for each of the cause of action and the defences, as well as the limitations of evaluating credibility in a motion, is there a reasonable possibility that the plaintiffs will succeed at trial in proving … [the various elements of the cause of action as well as whether there was a reasonable possibility that each respondent would not be able to establish at trial both elements of the defence of "reasonable investigation"].

[364] In *Arctic Glacier,* Tausendfreund J. considered the legislative history of Part XXIII.1, which led him to conclude that it was intended to provide a remedy that was impractical at common law, while at the same time protecting issuers from coercive, costly and abusive litigation. He referred to dictionary definitions of the words "reasonable" and "possibility" as well as the observations of van Rensburg J. in *Silver v. Imax (Leave)* at paras. 324, 326 and 330. He concluded, at para. 130:

> In my view, in assessing the existence of a reasonable possibility of success at trial, I must consider the relevant evidence, within the context of this motion. The applicable standard is more than a mere possibility of success, but is a lower threshold than a probability.

[365] The third case, *Round v. MacDonald, Dettwiler and Associates Ltd.*, to which I now turn, was an application by the plaintiff for leave to bring an action based on the secondary market liability provisions of the British Columbia *Securities Act*, R.S.B.C. 1996, c. 418, which are similar to Part XXIII.1. The application was dismissed on two grounds. First, Harris J., of the British Columbia Supreme Court found that there was no prospect of success at trial, because the facts giving rise to the cause of action took place before the legislation came into force. There was nothing in the legislation to indicate that it was to have retroactive or retrospective effect.

Second, the plaintiff had no cause of action because she had acquired the shares from the corporation's treasury and not in the secondary market.

[366] Justice Harris therefore concluded that it was not necessary to determine whether the cause of action had a reasonable possibility of success. He nevertheless addressed the submissions of the parties on that issue, with the express *caveat* at para. 13 that "...I think it better that a definitive decision on the meaning of the test for granting of leave await the case that calls for it."

[367] After reviewing the statutory provisions, particularly the requirement that each party file affidavit evidence on the motion, Harris J. stated, at para. 73 that the application of the test required the weighing, testing and analysis of the evidence in order to assess the merits of the action and to see whether it had a reasonable possibility of success:

> Taken together, several propositions emerge from these sections. First, the leave application involves a review of evidence. Each side is required to provide evidence of material facts upon which each intends to rely. Secondly, the analysis must involve a weighing and balancing of the evidence of each side. It is not sufficient for the court simply to rely on material filed by the plaintiff. Thirdly, the test involves an assessment of the merits of the proposed action on the evidence. The court must analyze the evidence to decide whether it is satisfied that the "reasonable possibility" test is satisfied. Fourthly, weighing and testing the evidence to determine whether there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff is different from the test involved in certification of class actions or the test for summary judgment. Given Ms. Round's argument, this last point deserves a little more analysis.

[368] He concluded, at paras. 76 and 77, that while the test requires the court to do more than simply screen out frivolous, scandalous or vexatious actions, it is meant to be "an initial hurdle and not a substitute for trial":

> Establishing a reasonable possibility of success at trial involves more than merely raising a triable issue or articulating a cause of action. Equally, it does not require a plaintiff to demonstrate that it is more likely than not that he or she will succeed trial. But it is clear, in my view, that the test is intended to do more than screen out clearly frivolous, scandalous or vexatious actions. An action

> may have some merit, and not be frivolous, scandalous or vexatious, without rising to the level of demonstrating that the plaintiff has a reasonable possibility of success.
>
> Beyond this I do not intend to venture. There are difficult questions embedded in the test and little existing guidance in the few cases in other jurisdictions that have considered the leave test in their equivalent statutes. In particular, although it is clear that the analysis involves a reasoned and significant assessment on the existing evidentiary record of both the plaintiff and defendants of the merits of the case and its prospects of succeeding at trial, this analysis necessarily occurs before any discovery. Although provision is made for cross-examination on affidavits, the application remains an initial hurdle and not a substitute for the trial. How one ought to weigh the potential of discovery to alter the prospects of success at trial or reshape the evidentiary landscape in the context of a leave application is a difficult question that does not need to be resolved here.

[369] These statements were entirely *obiter*. The examination of the test by Harris J. was circumscribed and did not include a consideration of either *Silver v. Imax (Leave)* or *Arctic Glacier*. That said, I do not disagree at all with the proposition that the "reasonable possibility of success" test sets a higher bar than "frivolous, scandalous or vexatious". Nor do I disagree with the proposition that a preliminary merits-based assessment must be tempered by a recognition that there has been no discovery and that the analysis is conducted on a paper record with all its attendant limitations.

[370] Of some assistance to the analysis is the decision of the Manitoba Court of Appeal in *A.J. v. Cairnie Estate* (1993), 105 D.L.R. (4th) 501, [1993] M.J. No. 351. That case dealt, in part, with the interpretation of the *Limitations of Actions Act*, R.S.M. 1987, c. L150, which permitted the court to extend the limitation period in certain circumstances. To merit such an extension, the plaintiff was required to adduce evidence that "would, in the absence of any evidence to the contrary, be sufficient to establish the cause of action…" The Court of Appeal held that this test could be equated to a "reasonable chance of success" and stated, at para. 45, that this means:

> … more than simply disclosing a cause of action sufficient to successfully resist an application to strike out the statement of claim. … It must be shown that there is something to the case so that if sent on to trial there is some realistic prospect that the action will succeed …

[371] The *A.J. v. Cairnie Estate* decision was referred to with approval in the most recent authority, the decision of the Québec Superior Court in *121851 Canada Inc. v. Theratechnologies Inc.*, above. In that case, which involved Québec securities legislation containing what the court described as a "mécanisme de filtrage" (filtering or screening mechanism) similar to s. 138.3 of the *Securities Act*, Blanchard J. observed that the corresponding leave provision of the Québec securities legislation did not require that there be a "trial within a trial" or a "mini trial". He concluded, however, that a plaintiff was required to do more than satisfy the test for a class action under s. 1003(b) of the *Code of Civil Procedure* that simply requires that "the facts alleged seem to justify the conclusions sought."

[372] The case before me appears to be the first instance outside Québec in which the rubber may really hit the road in the application of the leave test. In *Silver v. Imax (Leave)*, the entity had restated its financial statements, having admittedly failed to comply with GAAP, and there was ample evidence of a material misrepresentation. In *Arctic Glacier*, it was admitted that the core documents contained a misrepresentation. In *Round v. MacDonald Dettwiler and Associates Ltd.*, it was found that the legislation was not applicable and that the plaintiff had no cause of action in any event.

[373] I respectfully agree with van Rensburg J. and Tausenfreund J. that the leave requirement is a relatively low threshold. It is meant to screen out cases that, even though possibly brought in good faith, are so weak that they cannot possibly succeed. This is consistent with the purpose of the legislation – to screen out strike suits that are plainly unmeritorious. It is not meant to deprive *bona fide* litigants, with a difficult but not impossible case, from having their day in court. This interpretation is also consistent with the philosophy of our legal system that contentious issues of fact and law are generally decided after a full hearing on the merits.

[374] As this case illustrates, many of the issues surrounding disclosure obligations under the *Securities Act* involve the interaction of disclosure standards, accounting practices and regulatory requirements. Many of these matters are not within the ordinary knowledge of a lay-person and require expert evidence for their resolution. The questions of fact or questions of mixed fact and law are exceedingly complex. In my view, considering the purpose of the leave test and its legislative history, it would be unfair to the parties and to the court to expect the

motion judge to engage in a finely calibrated weighing process. It seems to me that I should simply ask myself whether, having considered all the evidence adduced by the parties and having regard to the limitations of the motions process, the plaintiffs' case is so weak or has been so successfully rebutted by the defendant, that it has no reasonable possibility of success.

[375] I note, in this regard, that the recent decision of the Court of Appeal in *Timminco* contemplates that it was the intention of the legislature that motions for leave under s. 138.3 would be heard and disposed of within three years of the misrepresentations. This time line is consistent with a process, in which the leave application is intended to be a screening mechanism, rather than a mini-trial on the merits.

[376] Following the approach outlined by van Rensburg J. in *Silver v. Imax Corp. (Leave)*, I propose to use the following analytical framework to determine whether this action has a reasonable possibility of success.

[377] I begin with the observation that although s. 138.8(1) speaks of whether the <u>action</u> has a reasonable possibility of success, each representation must be examined, in relation to each defendant, to determine whether the plaintiffs' claim in respect of that representation, has a reasonable possibility of success against that defendant. That analysis also requires that I determine whether there is a reasonable possibility that the defendant will not be able to establish the reasonable investigation defence – i.e., that the person conducted a reasonable investigation and had no reasonable grounds to believe that the document or statement contained a misrepresentation. The analysis should therefore proceed as follows:

> (a) identify the representation at issue;
>
> (b) determine whether it was a core document or a non-core document or public oral statement;
>
> (c) determine whether there is a reasonable possibility that the plaintiff will establish at trial that the document or statement contains a misrepresentation of material fact;
>
> (d) determine, in the case of each individual defendant, whether there is a reasonable possibility that the plaintiff will establish at trial that the defendant authorized,

> permitted or acquiesced in the release of the document or the making of the statement;
>
> (e) in the case of non-core documents or public oral statements, determine whether there is a reasonable possibility that the plaintiff will establish at trial that each individual defendant knew of the misrepresentation, deliberately avoided acquiring knowledge, or was guilty of gross misconduct in connection with the release of the document or the making of the misrepresentation;
>
> (f) determine whether there is a reasonable possibility that the defendants will not establish the reasonable investigation defence with respect to the misrepresentation – that is, that they conducted a reasonable investigation and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

[378] I will begin by examining the non-core documents and public oral statements, followed by the core documents. I will then turn to the defendants' knowledge of the alleged misrepresentations and then to the defence of reasonable investigation.

(i) Non-Core Documents and Public Oral Statements

[379] The plaintiffs say that there is a reasonable possibility that they will prove that CIBC and the individual defendants misrepresented the extent of the Bank's subprime exposure, in violation of the *Securities Act*, by making misleading statements in earnings conference calls, media releases and public oral statements that significantly understated or downplayed its subprime exposure. These are non-core documents and public oral statements, requiring proof not only that the defendants authorized, permitted or acquiesced in the release of the document or statement, but also that they either had knowledge, or were recklessly blind, or were guilty of gross misconduct in connection with the misrepresentation.

[380] Apart from denying misrepresentation in these non-core documents and statements, the individual defendants rely on the "reasonable investigation defence" contained in s. 138.4(6) of the *Securities Act*.

[381] They say that the statements that are the subject of the plaintiffs' complaint took place at the same time as the release of the financial statements and were consistent with them. They

say that the plaintiffs' basic complaint is that the statements did not comply with GAAP, because they did not properly disclose CIBC's subprime exposure, losses and concentration of risk. They say that there is no reasonable possibility that the individual defendants could be found not to have conducted a reasonable investigation into this matter.

[382] I have set out earlier the alleged misrepresentations made during the Class Period. I will now review the submissions of the parties with respect to each and will set out my conclusions.

May 31, 2007 Conference Call

[383] At issue during the May 31, 2007 conference call are Brian Shaw's statements that "our risks in this space are not at all major" and that the Bank's exposure to mezzanine CDOs on positions like Tricadia was "certainly not a major risk issue". The plaintiffs say that these statements were untrue and that none of the other individual defendants, who were all present on the call, provided any clarification or additional information.

[384] The plaintiffs say that, at the time these statements were made, CIBC knew that:

- it had $11.5 billion in total subprime exposure;
- the U.S. housing market had been deteriorating and was continuing to deteriorate;
- the market for RMBS and CDOs was illiquid;
- it had been unable to sell its warehoused RMBS in Q2 due to lack of liquidity and it had been unable to adequately hedge its position;
- its hedge positions were equally illiquid; and
- its largest hedge counterparty, ACA, had potential liquidity and solvency problems.

[385] The plaintiffs say that Mr. Shaw's statements were misrepresentations, because they omitted material facts that were necessary to make the statements not misleading in the light of the circumstances in which they were made.

[386] CIBC's position is that the plaintiffs have distorted the question and have distorted CIBC's obligation. The question posed in the conference call by Mr. Ciccerelli was not in relation to all CIBC's exposure to the subprime market, hedged and unhedged. It was in relation to CIBC's unhedged exposure in its securities portfolio only. CIBC's obligation in public oral statements was not to make "disclosure" – it was to ensure that its statements were not misleading. The failure to provide a "meaningful" statement is not actionable. Moreover, the statement that it was "not a major risk issue" was an accurate statement of CIBC's view at the time, whether one is speaking of the unhedged positions or the hedged positions. The unhedged positions were AAA-rated and no significant losses were anticipated. The hedged positions were not only AAA-rated, they had counterparties who were A-rated or better. CIBC says that, judged by what it knew at the time, the statements were accurate and were not a misrepresentation.

[387] I am satisfied, based on the expert evidence adduced by the plaintiffs, that there is a reasonable possibility that the plaintiffs will establish at trial that Mr. Shaw's statement was a misrepresentation, in light of the size and nature of the subprime assets held in CIBC's securities portfolio, their declining value and illiquidity, the limited ability to hedge the risk, and the conditions affecting the USRMM at the time. To describe this $1.7 billion portfolio, which appears on the evidence to have been acquired without adequate stress testing and appropriate risk mitigation measures, and which CIBC was unable to exit without sustaining large losses, as "not a major risk issue" at that time, could reasonably be found to be a misrepresentation.

[388] This conclusion is supported by Kilgour's memorandum of June 25, 2007, only three and a half weeks after the conference call. By that time, CIBC and the individual defendants knew that the Bank had a "long" direct exposure of $1.7 billion, which it was unable to dispose of or to effectively hedge due to the illiquidity of the market, that the indices had declined, that the housing market had deteriorated and that the real value of the so-called "super senior tranches" was difficult to ascertain. This information was, or ought to have been, known to Shaw at the time of the conference call. I will explain below my conclusion that there is a reasonable possibility that the plaintiffs will establish that the other participants in the call acquiesced in Shaw's statement, that the defendants knew that the statement was a misrepresentation and that the reasonable investigation defence will not be established.

July 10, 2007 News Release

[389] CIBC's media release dated July 10, 2007 responded to reports that CIBC had an exposure to the U.S. subprime market of $2.6 billion with the statement that its "unhedged exposure to this sector is well below US$2.6 billion". The plaintiffs say that this was a misrepresentation. They say that "[A]t the time it had a frozen position with $11.5 billion of total exposure, almost five times the speculated amount."

[390] The plaintiffs say that in failing to disclose its actual total subprime exposure, CIBC left investors with the impression that its hedged exposure was not material or that the combined hedged and unhedged exposure was less than $2.6 billion. In order to make the news release not misleading, they say, CIBC was required to disclosure its total subprime exposure.

[391] CIBC responds that the news release in fact confirmed that CIBC had both hedged and unhedged positions and that the statement concerning its unhedged exposure was true.

[392] In my view, there is no reasonable possibility that the plaintiffs will establish that the news release misrepresented CIBC's unhedged exposure. The news release was a voluntary disclosure. The release did not misrepresent the unhedged exposure, which was, in fact, well below US$2.6 billion. Nor was there a misrepresentation concerning the hedged exposure. CIBC disclosed the fact that it had a hedged exposure. It had no obligation to disclose the amount of that exposure.

August 13, 2007 News Release

[393] The plaintiffs say that while CIBC disclosed its unhedged exposure at $1.7 billion, it did not disclose its hedged exposure of $9.8 billion. This left investors with the impression that its exposure was not material or did not exceed $900 million – the difference between $2.6 billion and the $1.7 billion unhedged exposure that it did disclose.

[394] CIBC replies that the statement was plainly speaking of CIBC's unhedged exposure and specifically excluded its "exposure directly hedged with other counterparties".

[395] I agree with CIBC's position on this issue. The statement did not contain a misrepresentation. There is no reasonable possibility that the plaintiffs will establish that the statement was a misrepresentation.

<u>August 30, 2007 Earnings Conference Call</u>

[396] The plaintiffs' complaint relates to Kilgour's comment on the August 30^{th} conference call. Kilgour said, "Our exposure to hedge funds is minimal and collateralized."

[397] CIBC says that the plaintiffs have not identified any statement in this call that was inaccurate or misleading. It says that there was no obligation on CIBC to disclose anything about its positions on the call, simply an obligation not to say anything misleading.

[398] As counsel for Kilgour points out, the statement related not to CIBC's hedged or unhedged position in the USRMM but rather to investments in hedge funds, a particular type of investment. Kilgour was not challenged on his evidence to this effect in cross-examination. The context of the statement, and the slide to which it refers, bears this out. There is no reasonable possibility that the plaintiffs will establish that this statement was a misrepresentation.

[399] Although the plaintiffs plead allegations about the statements made by Shaw in the course of the August 30, 2007 earnings conference call, the issue is not being pursued. In any event, the statements appear to be factually accurate and could not be considered to be a misrepresentation.

<u>August 30, 2007 BNN Interview</u>

[400] The plaintiffs say that in both the August 30, 2007 conference call and in the BNN interview, CIBC and Woods continued to understate and downplay any concerns relating to the Bank's USRMM exposure. This occurred in spite of the facts that the subprime crisis had reach its "zenith" and that there was a considerable risk of loss associated with CIBC's as yet undisclosed hedged position, including the risk associated with the condition of ACA, the counterparty to which CIBC was most exposed.

[401] The defendants say that, in describing CIBC's exposure as "very low," Woods was accurately stating CIBC's reasonable belief at the time.

[402] The defendants note that the statements in question must be read in context, particularly taking into accounts Woods' statements about the uncertainties concerning the subprime market. They also note that Woods deposed that he believed the statements were accurate at the time he made them.

[403] Even looking at the entire interview in context, by August 30, 2007, Woods was aware of a whole range of information, presented and discussed at length at a number of Board and committee meetings, that highlighted the very troubling issue of CIBC's subprime exposure. This included:

- the discussions at the Risk Management Committee on July 17, 2007;
- the Board meeting on August 1, 2007, at which Woods himself spoke about the exposure in connection with ACA and the challenges of valuing CIBC's positions;
- the acknowledged "gaps" in CIBC's operating and reporting procedures in connection with the structured credits, the "narrow scope of stress testing" and management's failure to appreciate "the potential risks associated with the structured credit business in a stressed environment".

[404] In the circumstances, considering everything Woods knew at the time, there is a reasonable possibility that the plaintiffs will establish that Woods made a misrepresentation when he said, "[W]e have a very low exposure right now", in response to a question about the Bank's exposure to structured products. Earlier in the interview, in describing the hedged position, he said that the Bank was "feeling pretty good about these positions". These statements could be viewed as Pollyannaism in light of the discussions that had been taking place at the Board and in its committees prior to that date.

[405] I will discuss below the other issues related to the BNN interview, including the reasonable investigation defence.

<u>December 6, 2007 Earnings Conference Call</u>

[406] The plaintiffs complain that during the December 6, 2007 conference call, McCaughey "downplayed" the severity of the risk inherent in CIBC's hedged exposure and the viability of its

counterparties. Later in the conference call, however, Woods referred to the fact that CIBC had exposure of US$3.5 billion with one A-rated counterparty that had recently been placed on credit watch.

[407] CIBC says that, taken as a whole, in the context of the MD&A released the same day, McCaughey and Woods provided analysts with an accurate statement of CIBC's assessment of its hedge position, including the risk that ACA would be downgraded. The individual defendants say that these statements were factually correct and were not a misrepresentation. They say that the statements of Woods and McCaughey did not "downplay the severity of the risk inherent in [CIBC's] hedged exposure and the viability of its financial guarantee".

[408] I agree. In my view, there is no reasonable possibility that the plaintiffs will establish that this statement was a misrepresentation.

December 19 News Release

[409] As I have noted earlier, the December 19 news release was issued in light of S&P's downgrade of ACA. CIBC disclosed in the news release that ACA was a hedge counterparty with respect to $3.5 billion of CIBC's USRMM exposure and that there was a "reasonably high probability" that CIBC would take a large charge in its financial results for Q1 2008. The plaintiffs have not identified any misrepresentation in this release and there is no reasonable possibility of success on this issue.

[410] Although the statement of claim refers to misrepresentations after December 19, 2008, they were not pursued on the leave motion and I do not propose to address them.

(ii) Core Documents

[411] I now turn to the alleged misrepresentations contained in CIBC's core documents during the Class Period, namely:

(i) the May 31, 2007 Q2 report and MD&A;

(ii) the August 30, 2007 Q3 report and MD&A;

(ii) the December 6, 2007 Q4 and Fiscal 2007 report and MD&A.

[412] It will be recalled that the plaintiffs complain of three broad misrepresentations in these documents:

> (a) a failure to disclose the nature and extent of CIBC's subprime exposure in the quarterly reports for Q2 and Q3;
>
> (b) over-statement of CIBC's income in Q2, Q3, Q4 and fiscal 2007 by (i) overvaluing its subprime positions and reference assets; and (ii) failing to apply an appropriate CVA to its hedge counterparties, notably ACA; and
>
> (c) failing to disclose the significant concentration of credit risk associated with ACA.

[413] These are issues that will largely be determined by expert evidence. As I have noted, the experts on both sides, in spite of their impressive qualifications, have been the subject of criticism by the opposing party. The defendants challenge, in particular, the evidence of Professor Richardson, whom they portray as an ivory-towered academic with no practical experience in making the kinds of difficult valuation judgments that CIBC and the individual defendants were required to make during the Class Period.

[414] Arguments of this kind are difficult to weigh in the context of a motion and are best left to be made on an assessment of all the evidence at trial. In my view, there is a reasonable possibility that a trial judge will accept the evidence of the plaintiffs' experts.

[415] The plaintiffs' first complaint relates to the failure of CIBC to make disaggregated disclosure of its subprime positions. I have discussed the relevant standards and the conflict in the expert opinions on this subject. It is not my responsibility to resolve this issue. Considering the low threshold, it is my view that there is a reasonable possibility that a trial judge will accept the evidence of the plaintiff's experts. The evidence supports the existence of a "significant concentration of credit risk" as a result of CIBC's exposure to the subprime sector and of exposure that significantly exceeded that of any other Canadian bank. Moreover, it is reasonably possible that a judge will find that the concentration made CIBC vulnerable to a risk of severe impact <u>and</u> that the risk would occur in the near term, given the escalating subprime crisis. As events transpired, CIBC did experience a severe impact in the near term as a result of its substantial and inadequately hedged exposure.

[416] There is a reasonable possibility, in my view, that a trial judge will find that CIBC failed to disclose its significant concentration of credit risk because it failed to fully appreciate and value the nature and extent of the risks associated with its positions.

[417] This brings me to the plaintiffs' second complaint, the alleged overstatement of CIBC's income. I have summarized above the evidence pertaining to the two branches of this allegation, the over-valuation of CIBC's subprime positions and the failure to take an appropriate credit valuation adjustment on ACA.

[418] Once again, notwithstanding the conflict in the evidence, I find that the evidence as a whole gives rise to a reasonable possibility that the issue will be resolved in favour of the plaintiffs. There is evidence that CIBC's valuation methods, which are at the root of this issue, failed to accurately value its unhedged positions and the reference assets of its hedged positions. There is also evidence that its methodology for the calculation of CVA resulted in an understatement of its exposure. The evidence is consistent with the conclusion that CIBC was playing catch-up in its efforts to value its positions during most of the Class Period. The plaintiff has a reasonable possibility of proving that the disclosures ultimately made on December 6, 2007 and in Q1 2008 would have been made much earlier if CIBC had developed and applied appropriate valuation methodologies and that, as a result, CIBC overstated its income during the Class Period.

[419] Finally, for the reasons set out above, it is my view that there is a reasonable possibility that the plaintiffs will establish that CIBC failed to disclose its concentration of credit risk associated with its ACA hedge, a risk that ballooned, without adequate recognition in the financial statements, until it burst on December 19, 2007 after the S&P downgrade.

[420] CIBC and the individual defendants place great reliance on the fact that CIBC was not alone in its failure to anticipate the subprime crisis. The world's major financial institutions, the expert prognosticators and the financial press did not foresee the "tsunami" that was to come. They also say that CIBC was a market leader in disclosing its subprime exposure. That may be true, but CIBC, through Woods, acknowledged that the Bank and others in the business could have "done a better job" in detecting the warning signs, some of which have been identified by the plaintiffs and their experts, that the subprime market was likely to deteriorate.

[421] Woods also acknowledged that the events of Q3 2007 had been a "wakeup call" concerning "tail risk" – that is, the risk of unusual events that could have a severe impact on the investment – what Woods referred to as "the 1% probability that liquidity or markets will deteriorate". This raises the question of why this risk was not anticipated when CIBC acquired its subprime portfolio and why appropriate risk management strategies – including appropriate hedges – were not put in place at that time. It also raises the question of whether appropriate risk management strategies should have addressed the challenges of valuation and disclosure that would be encountered during the "worst case" scenario. The evidence suggests that CIBC was left struggling to respond to these challenges as the tidal wave of the subprime crisis was breaking on the beaches. Even once-in-a-century tsunamis can be anticipated. The degree of damage they can inflict make it all the more critical to anticipate and prepare for them. Had CIBC anticipated the tail risk, it could have prepared itself to the respond to the issues it would face in the heat of the crisis.

(iii) Materiality

[422] I have set out earlier the definitions of "misrepresentation" and "material fact". A material fact is a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.

[423] There is a reasonable possibility that the plaintiffs will establish that the facts contained in the misrepresentations I have identified were material. In a market obsessed with the deepening subprime crises, as evidenced by the questions from analysts and the media reports, there is little doubt that the disclosure of the nature and extent of CIBC's positions in the subprime market would reasonably be expected to have a significant effect on the market price of its securities. The issue was clearly of concern, and perhaps alarm, to the Board. There is little doubt that it would have been of concern to investors. This was demonstrated in November and December 2007 when the news broke and CIBC's share price fell dramatically. There is a reasonable possibility that disclosure earlier in the Class Period would have had the same effect.

(iv) The Individual Defendants' Knowledge, Authorization, Acquiescence

[424] The next question is whether the individual defendants "authorized, permitted or acquiesced" in the making of any of the representations at issue.

[425] In order for an officer to be found liable for a misrepresentation, it must be shown that he or she permitted or acquiesced in the release of the core or non-core documents or the public oral statements. The same test applies to directors in the case of public oral statements. This test does not ask whether the corporate officer or director, as the case may be, knew that the documents or statements contained a misrepresentation. This is a consideration under s. 138.4 (which requires proof of such knowledge, willful blindness or gross misconduct) to make a person or corporation liable for a misrepresentation not contained in a core document.

[426] The plaintiffs say that the requirement of "acquiescence" is a low threshold – they rely on *Katsigiannis v. Kottick-Katsigiannis* (2001), 55 O.R. (3d) 456, [2001] O.J. No. 1598 (C.A.), at para. 47, in which the Court of Appeal stated that "'[t]o acquiesce' is to agree tacitly, silently or passively to something ... acquiescence implies unstated consent". This is similar to the dictionary definition in *Concise Oxford English Dictionary*, 11^{th} ed. (Oxford University Press, 2006):

> accept or consent to something, without protest.

[427] The *Katsigiannis* decision was relied upon by the plaintiffs in *Arctic Glacier*, to support their proposition that acquiescence carries a very low threshold. The defendants in that case responded by referring to *JLL Patheon Holdings, LLC v. Patheon Inc.* (2009), 64 B.L.R. (4th) 98 (Ont. S.C.J.), to raise the threshold of acquiescence to a level of "implied consent". In the context of a third party proxy solicitation, the Court in *JLL Patheon Holdings* held at para. 49:

> ... the ordinary meaning of "acquiescence" upon which JLL relies carries with it the correlative that the party has at least some element of control over the act in question in the sense of being able to oppose successfully the occurrence of the legal consequences that flow from "acquiescence." This is captured by the reference to "implied consent" in the definition of "acquiesce" in *Black's Law Dictionary* 7th ed., which reads as follows: "To accept tacitly or passively; to give implied consent to (an act)." That concept is also present in the definition in the *Katsigiannis* decision.

[428] The plaintiffs also rely on the recent decision of the Ontario Securities Commission in *Coventree Inc. (Re)*, 34 O.S.C.B. 10209, which examined the liability of officers and directors

for a breach of securities law. Section 192.2 of the *Securities Act* provides that where a company has not complied with Ontario securities law, a director or officer who "authorized, permitted or acquiesced" in the non-compliance shall be deemed also to have not complied. The Commission found that the threshold for liability of an officer or director under that section is "relatively low" and that "merely acquiescing or passively consenting without protest will satisfy the requirements of that section" (at para. 767). In coming to that conclusion, it followed *R. v. Armaugh Corp.* (1993), 1 C.C.L.S. 87, [1993] O.J. No. 4360 (Ont. Prov. Div.) at para. 20, where the court had adopted the definition of "acquiesce" in *Webster's New World Dictionary* (3rd college ed.):

> ... acquiesce means to agree or consent quietly without protest. Authorize is defined in part as to give official approval or permission, to give power or authority, to give justification for and permit is defined as to allow, consent to tolerate, to give permission, authorize permission especially in writing, a document granting permission, licence, warrant.

[429] It is significant that s. 192.2 uses the same expression, "authorized, permitted or acquiesced", as s. 138.3(1)(c).

[430] In *Silver v. Imax (Leave),* van Rensburg J. found that two of the officers, Joyce and Gamble, the CFO and VP Finance and Controller respectively, had direct involvement in Imax's year end accounting and had signed the 10-K form, and that they had therefore permitted, authorized or acquiesced in the release of the document.

[431] In *Arctic Glacier,* Tausendfreund J. found that Larson and Cooley, two of the officers of a subsidiary of the responsible issuer had pleaded guilty in the United States to conspiracy of a commercial nature involving some of the corporate defendants and found that it was appropriate to conclude that they were "probably aware" that certain of the core documents at issue contained misrepresentations and that they had therefore acquiesced in the misrepresentations.

[432] Leitch J. granted leave to appeal this initial decision in *Arctic Glacier*. She stated at para. 76:

> I agree with Mr. Larson and Mr. Cooley that the record contains no evidence that they had any role in the corporate disclosure

> activities or public statements of the Income Fund. There is no evidence that they knew that the statements, including the alleged misrepresentations, were being made; that they participated in the formation of any such statements or had the opportunity to intervene, influence or reflect on such statements. I agree with Mr. Cooley that there is an absence of evidence as to what role a Vice-President of Marketing of an operating entity would have with respect to the release of information by an entity that he held no office in. I agree with Mr. Larson that the record contains no evidence that he had any role in the corporate disclosure activities or public statements of the Income Fund.

[433] She added at para. 81:

> I agree with the submission on behalf of Mr. Cooley and Mr. Larson that the decision of van Rensberg J. in *Silver v. Imax, supra* in para. 424 to 426, in relation to the individuals she referred to as "the remaining directors" conflicts with the decision of the motions judge, in that she found that individuals who were board members of the reporting issuer, but not on the audit committee and who had a "limited role in respect of the company's financial reporting" and were not "party to the discussions of the audit committee and did not see the reports provided to the audit committee" were individuals against whom leave would not be granted to commence an action, even though they had approved the impugned documents.

[434] Leitch J. therefore granted leave to appeal on, among other things, the question of whether the motion judge had erred in interpreting and applying the standard of "acquiescence" in s. 138.3(c) of the *Securities Act.*

[435] It seems to me that in interpreting the word "acquiesced" in s. 138.1(1) and (2), it is appropriate to consider its immediate textual context, that is, the words, "authorized, permitted or acquiesced". I should have regard to the principle, formerly described as *noscitur a sociis* – now referred to as the "associated words rule" – that words take their meanings from their surroundings. In *R. v. Goulis* (1981), 33 O.R. (2d) 55, [1981] O.J. No. 637 at p. 61 (C.A.), Martin J.A., speaking for the Court of Appeal, described the rule as follows:

> It is an ancient rule of statutory construction (commonly expressed by the Latin maxim, *noscitur a sociis*) that the meaning of a doubtful word may be ascertained by reference to the meaning of words associated with it: Broom, *A Selection of Legal Maxims*,

quite obvious that their positions required that they have extensive knowledge of the Bank's subprime positions and of the risks associated with them.

[439] I have found that there is a reasonable possibility that the plaintiffs will establish that the statements made by Shaw on the May 31, 2007 earnings conference call amounted to a misrepresentation. I also find that there is a reasonable possibility that the plaintiffs will be able to establish that the three other individual defendants who were present on the call knew that CIBC's unhedged subprime portfolio of US$1.7 billion was, in fact, a major risk issue and acquiesced in the making of the statement. They were all in a position to correct or qualify the statement and they did not do so.

[440] The issue of acquiescence does not arise in connection with the August 30, 2007 BNN interview as Woods was the only participant.

[441] Turning to the quarterly and annual reports, there is no question that McCaughey and Woods authorized the release of the quarterly reports and financial statements for Q2, Q3 and Q4 2007 and the annual report and financial statements for 2007. They signed certificates stating that the statements did not contain any untrue statement of material fact or omit to state a material fact and that the statements fairly presented the financial condition, results of operations and cash flow. They also certified their responsibility for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting and effectiveness of such controls.

[442] There is a reasonable possibility that the plaintiffs will establish that McCaughey and Woods authorized, permitted or acquiesced in the alleged misrepresentations contained in those statements.

(v) Knowledge, Willful Blindness or Gross Misconduct

[443] It will be recalled that s. 138.4 provides that, in the case of a non-core document or public oral statement, a person or company is not liable unless the plaintiff establishes that the person or company (a) knew that the statement contained a misrepresentation, or (b) was willfully blind, or (c) was guilty of gross misconduct. This question arises in relation to the May 30, 2007 earnings conference call and the August 30, 2007 BNN interview.

[444] In my view, there is a reasonable possibility that the plaintiffs will establish that CIBC and the individual defendants who were responsible for making or acquiescing in these statements knew that they contained the misrepresentations alleged. In light of everything that was known at the time of the May 31, 2007 conference call, as I have described earlier, the plaintiffs have a reasonable possibility of proving that the description of CIBC's exposure as "not a major risk issue", even if confined to its unhedged exposure, was either known to be false or that the defendants were willfully blind, in the sense that they deliberately avoided acquiring the necessary knowledge concerning the falsehood.

[445] Similarly, the plaintiffs have a reasonable statement by Woods in the August 30, 2009 BNN interview that CIBC's USRMM exposure was "very low" and this was either known to be false or was made with willful blindness.

(vi) Reasonable Investigation Defence

[446] The reasonable investigation defence is outlined above. The plaintiffs say that it is "arguable" that the due diligence defence under s. 138.4(6) does not apply to CIBC as the issuer or responsible issuer of securities. The plaintiffs note that the statutory provision states that the defence is available to a "person or company" and does not refer to the "issuer" or "responsible issuer", a term that is repeatedly used in Part XXIII.1. The plaintiffs ask the court to infer that if the legislature wished to extend the defence to an issuer, it would have said so explicitly. The simple answer to this allegation, it seems to me, is found in s. 183.4(15) which provides that "[A] person or company, <u>other than the responsible issuer</u> ...[emphasis added]" is not liable under s. 138.3 if the misrepresentation was made without their knowledge and consent and if they promptly notify the board and, if the representation is not corrected within two days, the OSC. The insertion of the words "other than the responsible issuer" clearly reflects the legislative intention that the issuer of the securities is entitled to the reasonable investigation defence.

[447] It is important to note that there are two requirements for the due diligence defence. The onus is on the person relying on the defence to establish <u>both</u> that he or she conducted a reasonable investigation <u>and</u> that he or she had no reasonable grounds to believe that the document or statement contained the representation. It is also important to recognize that at this

leave stage, we are simply considering whether there is a reasonable possibility that the defendants will not be able to establish one or both branches of the defence.

[448] As van Rensburg J. noted in *Silver v. Imax (Leave)* at para. 256, the defendants bear the onus of proving this defence on the balance of probabilities. In the context of the leave test, she concluded that the question was:

> … is there a reasonable possibility that such respondent will not be able to establish at trial both elements of the defence of "reasonable investigation"; namely:
>
> (i) that the respondent conducted or caused to be conducted a "reasonable investigation"; and
>
> (ii) at the time of the release of the document the respondent had no reasonable grounds to believe that the document contained the misrepresentation …

[449] Justice van Rensburg observed at paras. 361-364 that in the reasonable investigation component of the test, the court must consider the measures and systems in place to address the matters at issue, the policies and procedures, oversight and assurance measures, the roles and responsibilities of various persons in the process and the qualifications, knowledge, experience, roles and responsibilities of the individual defendants in connection with the matters at issue.

[450] In connection with the "no reasonable grounds" component of the defence, van Rensburg J. said that the court should also consider what the defendant actually knew, what someone in his or her position ought to have known, and whether that person knew or ought to have known that the statements were untrue.

[451] Justice van Rensburg was careful to note, in considering the reasonable investigation defence, that it was not appropriate or necessary for her to make specific findings. She held, at para. 385:

> The function of the court at the leave stage is not to determine the action on the merits, but to consider the evidence on a preliminary basis to evaluate whether the plaintiffs have a reasonable possibility of success. If the matter progresses to trial, the discovery process will expand the information and evidence that is ultimately available to the trial judge, who will in any event have

> the advantage of hearing the witnesses, including persons whose evidence may not have been before the court at the leave stage. The case may change substantially, as the matter proceeds toward trial.

[452] She therefore observed that any observations she might make on the evidence were preliminary and any findings of fact were only provisional. She concluded that the evidence was not sufficient to preclude the possibility of success at trial against the corporation, the individual defendants and Gamble.

[453] Later in her reasons, Justice van Rensburg suggested, at para. 423, that the onus was on the defendants to show on the leave motion that "their defence will of necessity succeed at trial".

[454] The plaintiffs in the case at bar put the test slightly differently, and say that to refuse leave on this basis

> … the court must be satisfied that the evidence in support of such a defence at the preliminary merits stage will foreclose the plaintiffs' reasonable possibility of success at trial. Put another way, the court must determine if there is a reasonable possibility that a respondent will not be able to establish at trial both elements of the reasonable investigation defence.

[455] I am not sure that there is any significant difference in these articulations of the test.

[456] To establish a defence of due diligence, the defendants rely on the evidence of their expert, Mr. David Brown, a former chair of the OSC, who was in fact the chair at the time the secondary market liability regime was implemented. He reviewed CIBC's disclosure system and the processes followed by CIBC in connection with the disclosures at issue. He concluded:

> 1. In my opinion, CIBC, its directors and officers, including the individual defendants, were fully committed to the development and constant refreshing of an accurate base of knowledge about CIBC's hedged and unhedged securities and credit derivatives positions with exposure to USRMM;
>
> 2. In my opinion, this commitment was backed by very robust, sophisticated and reliable systems for collecting and disseminating knowledge in a form understandable to the directors and senior officers; these systems were sufficiently agile to identify and assimilate in real time the new information and changing

> circumstances which arose during a rapidly changing market environment;
>
> 3. In my opinion, this information-gathering and dissemination system constituted an effective system of disclosure controls and internal controls over financial reporting that was adequate to ensure that CIBC could meet its continuous disclosure obligations as defined in the Securities Act;
>
> 4. In my opinion, appropriate use was made of this system to enable directors and senior officers, including the individual defendants, to fully understand the risks to CIBC's hedged and unhedged positions with exposure to USRMM and to fully understand in a timely manner the changes to that risk profile resulting from rapid changes to the credit derivatives market during the Class Period; and
>
> 5. In my opinion, the information disclosed by CIBC accurately reflected the directors' and senior officers' understanding of the relevant facts at the time disclosure was made.

[457] The plaintiffs have filed no evidence in response to Mr. Brown's opinion.

[458] The plaintiffs say, however, that for a number of reasons the defendants have failed to discharge their onus with respect to a reasonable investigation defence. They rely on the following evidence:

- the defendants were fully aware of the steep decline in the USRMM and of CIBC's significant exposure to that market, both hedged and unhedged, and its exposure to ACA, and these issues were discussed in the Board and committees throughout the Class Period;

- there is evidence, including observations by E&Y to management following its review of the May month end valuation procedures, which suggested that the valuation control process needed improvement, and a report of E&Y dated August 22, 2007 to the Audit Committee to the same effect;

- the evidence that CIBC's reliance on the historic probability of default methodology of calculating CVA was misplaced in the context of the subprime crisis;

- the minutes of the Board meeting dated August 1, 2007, suggest that CIBC's subprime exposure could be attributed to a

> lack of appreciation of the risks associated with the structured credit business "in a stressed environment", as well as "gaps" in operating and reporting procedures in that line of business, the "narrow scope of stress testing" during "rapidly deteriorating markets" and reliance on "highly rated senior components of the CDO capital structure";
>
> • the same report indicated that CIBC was involved in discussions with its regulator in the UK where the subprime derivatives business was being run and also with the regulator Canada "as well as internal improvements to develop stronger reporting, risk mitigation and control processes";
>
> • Woods' interview with BNN on December 6, 2007, in which he acknowledged that CIBC had "clearly underestimated" the subprime crisis and that it had to do a "better job".

[459] I accept the unchallenged evidence of Mr. Brown that CIBC had, in general, sophisticated and robust structures and processes for collecting and disseminating knowledge. I also accept that, in general, the individual defendants were entitled to rely on that system. However, the individual defendants had high level management positions and those positions carried knowledge of or ready access to every aspect of the Bank's business. The individual defendants were fully aware of the disclosures at issue. There is a reasonable possibility that the individual defendants will not establish that were unaware of the deficiencies in the Bank's knowledge base concerning the risks associated with its sub-prime positions and of the limitations attached to its ability to value those risks and, therefore, to properly disclose them. I will elaborate on this conclusion.

[460] To meet its continuous disclosure obligations under the *Securities Act* in relation to its exposures to the USRMM, it was necessary at the outset of the Class Period for CIBC and its senior officers to fully understand the nature and extent of those exposures, the risks associated with those exposures, and the impact of rapid changes in the USRMM and the credit derivatives market. Going into that period, it was essential that CIBC have an accurate base of knowledge about its positions, about how to value these positions and about how changes in the market would affect its valuations of its positions and hence its disclosure obligations.

[461] The evidence as a whole satisfies me that there is a reasonable possibility that the evidence will establish that CIBC's knowledge was wanting in relation to its USRMM positions,

the USRMM market, the risks associated with its positions, the appropriate valuation methodologies and the limitations of those methodologies. There is a reasonable possibility that the evidence will show that CIBC placed too much reliance on the rating agencies and on the ultimately illusory "super senior" rating of most of its positions.

[462] The evidence could ultimately support the conclusion that although its overall structures, systems and processes were sound, CIBC found itself in the middle of a rapidly escalating crisis, for which it was ill-equipped. In particular, I find that there is a reasonable possibility that the plaintiffs will establish that CIBC had acquired its subprime positions without applying appropriate risk management principles, including appreciation and management of the risks of valuing and disclosing those positions in the circumstances that transpired. In other words, the same circumstances that got CIBC into the subprime mess made it difficult for it to appreciate – and therefore to disclose to investors – just how bad a mess it was in.

[463] If CIBC failed to equip itself with the appropriate tools to assess and control the risks associated with its subprime investments and to accurately value those investments in the collapsing market of the Class Period, its ability to make appropriate judgments about the disclosure of its positions would necessarily be impaired. There is a reasonable possibility that the plaintiffs will be able to establish not only that CIBC's disclosures and valuations were flawed, but that they were flawed because CIBC and the individual defendants had not acquired, at the outset of the Class Period, the knowledge and resources necessary to make reasoned judgments and evaluations as the subprime crisis unfolded. Put another way, there is a reasonable possibility that the reasonable investigation defence will fail, because the CIBC and the individual defendants will be unable to establish that they conducted a reasonable investigation prior to making the statements at issue.

[464] All this is to say that it may not be a defence for CIBC to say that it was in the company of other leading financial institutions in missing the warning signs of the subprime crisis, in placing too much emphasis on the rating agencies and in failing to account for tail risk.

[465] There is a reasonable possibility that the plaintiffs will establish that the disclosures ultimately made by CIBC should have been made at an earlier time and possibly as early as the beginning of the Class Period. There is a reasonable possibility that they will establish that,

knowing of the deficiencies in CIBC's systems and the risks attached to the Bank's positions, the individual defendants took a calculated risk not to disclose the information.

[466] The second aspect of the reasonable investigation defence requires the defendants to establish that at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation.

[467] I am satisfied that there is a reasonable possibility that the defendants will be unable to establish this in relation to the two public oral statements (the May 31, 2007 conference call and the August 30, 2007 BNN Interview) and the quarterly and annual reports at issue.

[468] There is a reasonable possibility that the plaintiffs will establish at trial that a reasonable investigation would have revealed, by the time of the May 31, 2007 conference call, that circumstances existed and were known to CIBC and the individual defendants, that made CIBC's exposure a "major risk issue". There is a reasonable possibility that CIBC and the individual defendants will be unable to establish that Shaw and the other Individual Defendants were not aware that the representations made in the conference call was untrue.

[469] For the same reasons, there is a reasonable possibility that Woods and CIBC will not be able to establish that they conducted a reasonable investigation in connection with the BNN interview, in which Woods stated that CIBC's USRMM exposure was "very low".

[470] McCaughey and Woods certified that to their knowledge, CIBC's financial statements for Q2, Q3, Q4 and fiscal 2007 did not contain "any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading". They also stated that the statements "fairly present in all material respects the financial condition, results of operations and cash flows of CIBC".

[471] McCaughey and Woods had intimate knowledge of CIBC's positions and there is a reasonable possibility that the plaintiffs will establish that they knew that the quarterly and fiscal 2007 financial statements and MD&As misrepresented the Bank's condition.

(c) *Conclusions on the Leave Test*

[472] In summary, for the foregoing reasons, but for the conclusion I have reached in the next section with respect to the limitation period, I would have granted leave to pursue the following claims:

> *(a)* the claim against CIBC and Brian Shaw in connection with the May 31, 2007 earnings conference call and against the three individual defendants who acquiesced in the statements made by Mr. Shaw;
>
> *(b)* the claim against CIBC and Woods in connection with the August 30, 2007 BNN interview;
>
> *(c)* the claim against CIBC, McCaughey and Woods in connection with the core documents, namely Q2, Q3, Q4 and fiscal 2007 financial statements and reports.

[473] For the reasons that follow, I have concluded, with considerable regret, that the plaintiffs' claim is time-barred and, as a result, the statutory misrepresentation claim has no reasonable possibility of success and leave should not be granted.

3. <u>The Limitation Period</u>

[474] On February 16, 2012, the penultimate day of the original hearing of this motion, the Court of Appeal released its decision in *Timminco.* The Court of Appeal held that s. 28 of the *C.P.A.* does not operate to suspend the limitation period applicable to the statutory cause of action for misrepresentation under s. 183.3 of the *Securities Act*, until such time as leave has been granted. The action was therefore found to be time-barred.

[475] Counsel for the individual defendants aptly described the decision, at that time, as a "thunderbolt". It had important implications not only for this action, but also for pending and future actions seeking leave to assert the statutory remedy for misrepresentation in the secondary market. Indeed, it has resulted in a motion being brought by the defendants to strike the claim in *Silver v. Imax*, post-certification and leave, in view of the fact that the limitation period expired in that case while the matter was under reserve.

[476] As a result of *Timminco*, counsel requested an opportunity to make further submissions on the issue of whether this action is also time-barred. Additional factums and authorities were delivered and further argument was heard on April 5, 2012.

[477] My analysis of this issue will begin with the statutory provisions. I will then examine the *Timminco* decision, followed by the history of this proceeding and the submissions of the parties.

[478] Finally, I will set out my analysis of the issues. I will begin by asking whether the circumstances of this case make it distinguishable from *Timminco*. I will then examine each of the arguments made by the plaintiffs in support of their submission that the limitation period has been, or should be, extended, in the circumstances of this case. I have concluded that the action is time-barred and that nothing in the circumstances of this case or in *Timminco* permits the extension of the limitation period.

(a) The Statutory Provisions

[479] Section 138.14 of the *Securities Act* provides, generally, than an action shall not be commenced under s. 138.3 more than three years after the date of the documentary or oral misrepresentation at issue:

> No action shall be commenced under section 138.3,
>
> (a) in the case of misrepresentation in a document, later than the earlier of,
>
> > (i) three years after the date on which the document containing the misrepresentation was first released, and
> >
> > (ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation;
>
> (b) in the case of a misrepresentation in a public oral statement, later than the earlier of,
>
> > (i) three years after the date on which the public oral statement containing the misrepresentation was made, and

(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in another province or territory of Canada in respect of the same misrepresentation; and

(c) in the case of a failure to make timely disclosure, later than the earlier of,

(i) three years after the date on which the requisite disclosure was required to be made, and

(ii) six months after the issuance of a news release disclosing that leave has been granted to commence an action under section 138.3 or under comparable legislation in another province or territory of Canada in respect of the same failure to make timely disclosure.

[480] Section 28 of the *C.P.A.* provides that the limitation period applicable to a cause of action asserted in a class proceeding is suspended in favour of a class member on the commencement of the class proceeding and resumes running against the class member upon the occurrence of any one of several events, including the class member opting out, the action being abandoned, settled or discontinued with the approval of the court, or the action being decertified.[9]

(b) Timminco

[481] In *Timminco*, the Court of Appeal held that s. 28 of the *C.P.A.* is inapplicable to a proceeding seeking leave to assert the remedy under s. 138.3 because, until such time as leave has been granted, it cannot be said that the cause of action has been "asserted" within the

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[9] 28. (1) Subject to subsection (2), any limitation period applicable to a cause of action asserted in a class proceeding is suspended in favour of a class member on the commencement of the class proceeding and resumes running against the class member when, (a) the member opts out of the class proceeding; (b) an amendment that has the effect of excluding the member from the class is made to the certification order; (c) a decertification order is made under section 10; (d) the class proceeding is dismissed without an adjudication on the merits; (e) the class proceeding is abandoned or discontinued with the approval of the court; or (f) the class proceeding is settled with the approval of the court, unless the settlement provides otherwise. (2) Where there is a right of appeal in respect of an event described in clauses (1) (a) to (f), the limitation period resumes running as soon as the time for appeal has expired without an appeal being commenced or as soon as any appeal has been finally disposed of.

meaning of s. 28. The claim was found to be time-barred, because leave had not been granted within the three-year period.

[482] In that case, a proposed class action had been commenced on May 14, 2009, alleging misrepresentations in the secondary securities market between March 17 and November 11, 2008. The statement of claim pleaded causes of action in negligence and negligent misrepresentation and stated that the plaintiffs would seek an order granting leave to assert a cause of action under s. 138.3 of the *Securities Act*. In February, 2011, with the three year limitation period due to expire in nine months, the plaintiff, who had not yet brought a motion seeking leave under s. 138.3, brought a motion for an order declaring that the limitation period under s. 138.14 of the *Securities Act* had been suspended by operation of s. 28 of the *C.P.A.*

[483] Perell J. granted the order sought. He found that the reference in s. 28 of the *C.P.A.* to a cause of action being "asserted" was sufficient to include a case in which the plaintiff's intention to pursue the s. 183.3 remedy was referred to in the statement of claim in the putative class action that had been commenced. It was his view that there was no logic to suspending the limitation period in the case of actions commenced under Part XXIII of the *Securities Act* (dealing with misrepresentations in the primary market in a prospectus, offering memorandum or take-over bid circular, where leave is not required), but not in actions claiming misrepresentation in the secondary market under Part XXIII.1.

[484] The Court of Appeal heard the appeal on November 2, 2011 and gave judgment February 16, 2012, allowing the appeal and dismissing the plaintiff's motion for an order that the limitation period was suspended.[10] As a result, the plaintiff's claim under s. 183.3 was time-barred. So too, presumably, were the claims of any other class members who may have relied on the action to protect their own claims.

[485] The Court of Appeal defined the issue as whether the plaintiff's "mention" in his statement of claim of his intention to seek leave was sufficient to say that the cause of action had been "asserted" under s. 28 of the *C.P.A.*, so as to suspend the limitation period. Referring to

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[10] An application for leave to appeal to the Supreme Court of Canada was filed on April 16, 2012: [2012] S.C.C.A. No. 157.

dictionary definitions of "mention" and "assert", the court found that "assert" is a more forceful concept than "mention" and means to "invoke or enforce a legal right."

[486] The Court of Appeal, speaking through Goudge J.A., concluded, at paras. 18 and 20, that the statutory cause of action could not be "invoked as a legal right" until such time as leave had been granted. Therefore, it held that the limitation period could not be suspended until leave was granted:

> Without leave having been granted, a s. 138.3 cause of action cannot be enforced. It cannot be invoked as a legal right. Section 138.14 says as much. Thus, giving the suspension provision in s. 28(1) of the *CPA* its ordinary meaning, the s. 138.3 cause of action cannot be said to be asserted in the respondent's class proceeding since no leave has been granted.
>
> ...
>
> Thus, in my view as applied to the s. 138.3 cause of action, the grammatical and ordinary meaning of the s. 28(1) suspension provision is that without leave being granted the cause of action cannot be said to be asserted in a class proceeding.

[487] Goudge J.A. held that this interpretation was consistent with the statutory context of s. 28(1) of the *C.P.A.*, with the purpose of that section and with the purpose of s. 138.14 of the *Securities Act.* He noted that the failure to seek leave or the dismissal of the leave application was not listed in s. 28(1) as a factor that would cause the limitation period to resume running, even though s. 28(1) mentions a number of factors that do so.[11] He concluded that it could not have been the intention of the Legislature to permit the limitation period to be forever suspended by the mere mention of the intent to seek leave, even where the plaintiff did not pursue the request for leave.

[488] Goudge J.A. also found that this interpretation was consistent with the purpose of s. 28(1) of the *C.P.A.*, because the plaintiffs' action gave class members no possibility of access to justice for their s. 138.3 cause of action since leave to assert the cause of action had not been granted. He found that the result served the purpose of s. 138.14 of the *Securities Act*, which is

[11] While legislation is, of course, "always speaking", it is noteworthy that s. 138.3 of the *Securities Act* post-dated the *C.P.A.* by thirteen years, so it is not surprising that s. 28(1) of the *C.P.A.* contains no reference to the *Securities Act* limitation period.

intended to ensure that secondary market claims are pursued expeditiously. Goudge J.A. stated, at para. 26:

> Section 138.14 was clearly designed to ensure that secondary market claims be proceeded with dispatch. That requires the necessary leave motion to be brought expeditiously. To suspend that limitation period with no guarantee that the s. 138.3 cause of action, including the prerequisite leave motion, will be proceeded with expeditiously is inconsistent with that purpose.

[489] Goudge J.A. summarized his conclusions at para. 28:

> In summary, I conclude that for a s. 138.3 cause of action to be asserted in a class proceeding, so as to trigger the suspension provision in s. 28(1) of the *CPA*, leave must be granted. Since the respondent has not obtained leave, s. 28(1) has not been activated.

[490] It is perhaps unfortunate that the outcome in *Timminco* appears to have turned on the distinction between "mentioned", a term used by Perell J. and "asserted", the term used in s. 28(1) of the *C.P.A.* Goudge J.A. focused on this distinction in concluding that "asserted "is the more forceful term. In this case, the parties spent a vast amount of time and resources, including eight days before me, invoking on the one hand, and vigorously opposing on the other, the plaintiff's legal right to pursue the *Securities Act* claim.

[491] In the absence of the binding authority of *Timminco*, I might have held that s. 138.3 was "invoked as a legal right" in this case when the plaintiffs pleaded in the statement of claim that they claimed "an order, pursuant to section 138.8 of the *Securities Act* … granting leave to proceed *nunc pro tunc* with the within action under s. 138.3 of the *Securities Act.*" I might have held that the plaintiffs were not simply mentioning the remedy, but were in fact invoking it, thereby "asserting" the cause of action within the meaning of the *C.P.A.* Such an interpretation has, it would seem, been rejected by *Timminco.*

[492] In *Timminco*, as in this case, the plaintiff stated in the statement of claim his intention to pursue the remedy under s. 183.3. The only difference is that in this case, the plaintiff expressed an intention to seek leave *nunc pro tunc* if the limitation period expired before the motion for leave had been heard, as has in fact occurred. In *Timminco*, the plaintiff had brought a motion for a declaration that the limitation period had been suspended by s. 28 of the *C.P.A.*

[493] I will consider whether this case can be distinguished from *Timminco.* In order to address this question, and the parties' submissions, it is necessary to first examine the history of this proceeding.

(c) The History of this Proceeding

[494] The history of this proceeding can be summarized as follows:

> May 31 to December 6, 2007: This was the period during which alleged misrepresentations occurred, thereby defining the commencement of the three year limitation period in s. 138.14 of the *Securities Act.*
>
> July 22, 2008: This action was commenced under the *C.P.A.* by statement of claim, claiming damages for fraudulent and negligent misrepresentation, negligent mismanagement of CIBC, and oppression under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. The statement of claim also pleaded a claim under s. 138.3 of the *Securities Act* and requested, in the prayer for relief, an order pursuant to s. 138.8, granting leave to proceed with that action *nunc pro tunc.*
>
> February 5, 2009: There was a case conference at which the defendants expressed their ongoing concerns about the plaintiffs' proposed amended statement of claim. Specifically, they were concerned about the suitability of the claims for negligent misrepresentation and oppression, as well as the inclusion of individual officers and directors of CIBC. There was a discussion of a schedule leading up to the certification and leave motions, under which the plaintiffs proposed that the motions would be argued in October, 2009. Due to continuing unresolved issues about the pleadings, no schedule was set.
>
> February 6, 2009: A Fresh as Amended Statement of Claim was delivered.
>
> May 8, 2009: Following negotiations between counsel with respect to the content of the statement of claim, an agreement was reached on or about May 8, 2009, whereby the plaintiffs agreed to remove the negligent mismanagement claim and to discontinue the action against four of the original eight individual defendants. In exchange, the defendants agreed that they would forego any preliminary motions to stay or strike the action, or any of the remaining claims in the action, and would proceed to the contested motions for leave and certification.

October 1, 2009: The plaintiffs delivered a draft amended pleading, but the defendants had continued concerns. These were ultimately resolved and resulted in a Second Fresh as Amended Statement of Claim, dated January 11, 2010.

January 7, 2010: There was a case conference at which the issue of scheduling was discussed, with the plaintiffs proposing a leave and certification hearing in "late November or early December 2010". However, because the plaintiffs had not delivered their leave and certification motion records, it was considered premature to set a schedule.

January 21, 2010: The plaintiffs delivered a notice of motion seeking leave to proceed with the s. 138.3 claim *nunc pro tunc*.

January to March, 2010: There were continued discussions between counsel with respect to scheduling of the leave and certification motions. Counsel for the plaintiffs proposed a hearing during the week of December 6th or 13th, 2010. Counsel for the defendants were not available for those weeks and suggested a hearing date in late February, 2011. The plaintiffs' counsel responded saying "we need to have the case heard in December … Our clients will be prejudiced by delays." Defendants' counsel responded that a delay of two months would not be prejudicial and said "the matter has not proceeded in a manner that would suggest urgency."

March 17, 2010: A case conference was held. Shortly thereafter, the parties agreed on a schedule for completion of the plaintiffs' record and delivery of the defendants' responding material, leading up to the leave and certification motions being heard in the week of March 21, 2011.

January 15, 2011: The plaintiffs' record in support of their motions was completed. It was ultimately agreed that it would be impossible to meet the scheduled motion date of March 21, 2011 and a new schedule was set, leading up to the certification and leave motions being heard in February, 2012, as they ultimately were.

[495] It is fair to say that this action has moved slowly. The action was initially filed July 22, 2008, some eight months after the last alleged misrepresentation. Approximately three and a half years elapsed between the commencement of the action and the hearing of the motions.[12]

[12] The time it has taken this action to reach a hearing is not at all unusual for a complicated and substantial class proceeding and leave applications. The materials are generally voluminous. In some cases, including this one, the

That said, there has never been any doubt about the intention of the plaintiffs to seek leave under Part XXIII.1 of the *Securities Act* and a great deal of time, effort and resources have been expended to develop a substantial record. Although progress has been slow, the plaintiffs have faced some challenges along the way. Their conduct cannot be described as dilatory, unless measured against an absolute yardstick of three years from the date of the misrepresentations to the date of the order granting leave. Nor can it be said that the defendants have suffered prejudice as a result of the delay.

[496] From the outset, this action has been under case management, initially by Cullity J., who held the first case conference in September, 2008, then by Lax J., then by me, beginning in the autumn of 2009. At no time during the case management process was an issue raised concerning the potential expiry of the limitation period prior to the hearing of the leave motion.

[497] There is no dispute that, until the release of *Timminco*, the limitation period was not the subject of discussion between the parties or counsel. Nor had it been raised before the court. It simply never came up. There is nothing in the communications between counsel, leading up to the certification and leave motions, to suggest that either party had considered the possibility that the limitation period for an action under s. 138.3 might expire if the certification and leave hearing did not occur and leave was not granted before December 6, 2010. There is nothing, however, in the evidentiary record that would permit me to conclude that the defendants agreed, expressly or impliedly, to the extension or waiver of the limitation period or lulled the plaintiffs into a false sense of security. There is nothing in the conduct of the defendants that would preclude them from taking the position they now take – that the limitation period has expired.

(d) The Submissions of the Parties and Analysis

[498] The defendants say that the result of *Timminco* is that nothing short of the commencement of an action asserting a claim under s. 138.3 of the *Securities Act*, <u>after leave has been obtained</u>, can suspend the limitation period for the plaintiffs or other class members pursuant to s. 28 of the *C.P.A.* They assert that neither the commencement of an action without

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defendants have mounted a substantial evidentiary defence, sometimes requiring responding materials from the plaintiff and cross-examinations. Requiring the leave application to be brought, argued and decided within three years of the misrepresentations at issue may present counsel and the court with some challenges.

leave, nor the pendency of a motion for leave, have any effect on the running of the limitation period. They submit that the claim under s. 138.3 of the *Securities Act* is time-barred, because leave was not granted within three years of the making of the statements at issue in this proceeding. The defendants say that because of the expiry of the limitation period, the s. 138.3 claim has no reasonable possibility of success and leave should not be granted.

[499] The plaintiffs distinguish *Timminco* on its facts and assert several reasons why the circumstances of this case take it outside *Timminco.* Counsel for the plaintiffs say that the class will suffer inestimable prejudice if they are not permitted to pursue their claim and that the defendants have suffered no prejudice as a result of the motion having been heard outside the three-year period. Their principal submissions are as follows:

> (a) *Timminco* is distinguishable from this case, because there was no request in *Timminco* for an order *nunc pro tunc;*
>
> (b) the plaintiffs have always requested that leave be granted on a *nunc pro tunc* basis and the court can and should grant leave on that basis;
>
> (c) the "special circumstances" doctrine should apply to extend the limitation period; and
>
> (d) the defendants are precluded from relying on the expiry of the limitation period by virtue of the doctrines of estoppel by convention and waiver.

[500] I will discuss each of these submissions below.

(i) <u>*Is Timminco Distinguishable?*</u>

[501] The plaintiffs say that *Timminco* is distinguishable, because in that case, no request had been made for leave *nunc pro tunc*. In this case, from the very outset, through the amendments to the statement of claim and in the notice of motion, the plaintiffs have always stated that they will be seeking leave *nunc pro tunc*. The plaintiffs say that this case is also distinguishable because the court in *Timminco* was being asked to make an open-ended declaration that the limitation period had been suspended, with no assurance that a leave motion would ever be brought. Here, in contrast, the court is being asked to grant leave and to certify the action and there is no question that the action will go forward if leave is granted.

[502] The plaintiffs also say that in *Timminco,* the Court of Appeal did not address the potential application of the "special circumstances" doctrine to extend the limitation period, presumably because the appellants did not raise the issue.

[503] As the plaintiffs note, in *Timminco* the plaintiff had not even served a motion for leave under the *Securities Act.* In contrast, in this case, the plaintiffs served the motion for leave within the limitation period and have demonstrated a consistent intention to pursue the statutory claim.

[504] Part of the concern of the Court of Appeal in *Timminco* was that a plaintiff might simply "assert" the *Securities Act* claim, thereby suspending the limitation period, and then do nothing, leaving the action to languish, to the detriment of class members. That is clearly not what occurred here. In this case, the plaintiffs are well advanced in their case against CIBC. They have retained reputable experts, amassed a large body of evidence and conducted examinations of some of the key witnesses.

[505] Thus, another factual distinction between this case and *Timminco* is that here there has been a consistent intent on the part of the plaintiffs to proceed with the leave motion. This responds to the concern expressed by the Court of Appeal that the limitation period might be suspended indefinitely, even where the plaintiff evinces no intention of pursuing the s. 138.3 claim. Unfortunately, as I will explain below, this distinction does not permit me to avoidthe Court of Appeal's clear and binding decision that, without leave having been granted, the cause of action has not been "asserted" so as to enable the plaintiffs and the class to take advantage of the suspension of the limitation period under s. 28 of the *C.P.A.*

[506] I will discuss below the implications of the plaintiffs' request for leave *nunc pro tunc* and the special circumstances, estoppel and waiver arguments made by the plaintiffs. Apart from these issues, I see no way to distinguish *Timminco*.

(ii) *The Nunc Pro Tunc Jurisdiction*

[507] The plaintiffs rely on the fact that in the statement of claim and in their notice of motion for leave, they requested leave to pursue the s. 138.3 claim *nunc pro tunc.* They say that there is no question that the court has jurisdiction to grant an order *nunc pro tunc*: *Re New Alger Mines Limited* (1986), 54 O.R. (2d) 562, [1986] O.J. No. 144 (C.A.); *Degroote v. Canadian Imperial*

Bank of Commerce (1998), 37 O.R. (3d) 651, [1998] O.J. No. 395 (C.A.); *Gallo v. Beber* (1998), 116 OAC 340, [1998] O.J. No. 5357 (C.A.). As I have noted, they submit that *nunc pro tunc* relief was not sought in *Timminco,* making that case distinguishable.

[508] The defendants respond that since neither the commencement of an action without leave nor the pendency of a motion for leave affect the limitation period, there is no magic in the use of the words *nunc pro tunc* that converts a time-barred action into a living and breathing one. The defendants say that the purpose of the limitation period in s. 138.14, as confirmed in *Timminco*, is to "ensure that secondary market claims be proceeded with dispatch" and that granting leave *nunc pro tunc* would offend that very purpose.

[509] In my view, *nunc pro tunc* and "special circumstances", discussed below, are simply two ways of giving effect to the court's discretionary jurisdiction to extend a limitation period in appropriate circumstances. The question is whether such jurisdiction exists in this case.

[510] I accept that the court has inherent jurisdiction to prevent an injustice and to validate proceedings that would otherwise be defective due to a slip or oversight: *Hogarth v. Hogarth*, [1945] 3 D.L.R. 78 (Ont. H.C.), aff'd. [1945] 3 D.L.R. 750 (Ont. C.A.). In some cases, this jurisdiction can also be invoked to validate an action that has been commenced without the requisite leave having been granted: *McKenna Estate v. Marshall* (2005), 37 R.P.R. (4^{th}) 222, [2005] O.J. No. 4394 (S.C.J.).

[511] This is not the case of a slip, strictly speaking. The plaintiffs make it clear that they were aware of the limitation period from the outset and that they made a conscious decision to address the issue by seeking leave *nunc pro tunc.* In other words, they realized that they might not obtain leave within the three year period, and they assumed that the court had jurisdiction to extend the limitation period and that the discretion would be exercised in their favour by granting leave *nunc pro tunc.*

[512] In *Timminco*, as I have observed, the statement of claim included an assertion to the effect that the plaintiff intended to deliver a notice of motion seeking leave to assert the statutory cause of action in Part XXXIII.1 of the *Securities Act.* The decision of the Court of Appeal is inconsistent with the notion that the inclusion of this language was sufficient to preserve the

limitation period. It seems to me that the inclusion of similar language in this action, with the added words *nunc pro tunc*, cannot change the result.

[513] The plaintiffs refer to *Nor-Dor Developments Ltd. v. Redline Communications Group Inc.*, 2011 ONSC 591 (S.C.J.), which was an action claiming, among other things, remedies under s. 138.3 of the *Securities Act.* Realizing that the limitation period might expire before leave had been granted, the plaintiffs brought a motion seeking permission to file their proposed action under Part XXIII.1 before the leave motion was heard. Rady J. accepted the submission of the defendants that she had no jurisdiction under rule 2 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 or s. 12 of the *C.P.A.* to grant substantive, as opposed to procedural, relief. She noted that s. 138.14 of the *Securities Act* provides that no action may be <u>commenced</u> before leave has been granted. Rady J. suggested that if leave was ultimately granted, it might be appropriate to ask that the order be made *nunc pro tunc*, in order to regularize what the plaintiffs had done prior to that date. This observation was clearly *obiter* and made without the benefit of the Court of Appeal's subsequent decision in *Timminco.*

[514] I have concluded that it would be inconsistent with *Timminco* to find that the plaintiffs' request for an order *nunc pro tunc* gives the court a basis on which to revive the limitation period that has expired due to the failure to obtain leave within three years. I will elaborate on my reasons in the next section.

(iii) <u>*The "Special Circumstances" Doctrine*</u>

[515] The plaintiffs argue that *Timminco* is not applicable to this case, because it did not address the court's jurisdiction to extend the limitation period by the application of the "special circumstances" doctrine. They point to a number of factors, peculiar to this case, which would militate in favour of the application of the special circumstances doctrine.

[516] There is nothing in the reasons of the Court of Appeal in *Timminco* to suggest that the court contemplated that the s. 138.14 limitation period might be extended because of special circumstances or the exercise of the court's discretion. There was simply no discussion of the subject. There were some circumstances in that case that might have prompted such a discussion, including that the case involved a novel issue of law, as the Court of Appeal acknowledged in its subsequent decision on costs: *Sharma v. Timminco Limited*, 2012 ONCA 322 at para. 4. As

well, the limitation period had not expired at the time of the original motion before Perell J. It expired between the original judgment of Perell J. and the judgment of the Court of Appeal. It was clear by that point that the plaintiff was intent on pursuing the claim and it seems to me that if the Court of Appeal thought it had jurisdiction to extend the limitation period, it would have been an appropriate case in which to do so. The fact that the subject was not even discussed suggests that the Court of Appeal considered the limitation period to be absolute.

[517] The defendants say that the special circumstances doctrine has no application to claims under the *Securities Act.*

[518] CIBC acknowledges that the court has an inherent discretionary power to relieve against the consequences of a failure of a party to meet time or notice requirements, including granting orders *nunc pro tunc* to prevent an injustice. This may include permitting the action to be commenced even after the expiry of the limitation period in appropriate cases: see for example, *Degroote v. Canadian Imperial Bank of Commerce,* above. This will not be permitted, however, where granting the extension would defeat the very purpose of the limitation period: see *Joseph v. Paramount Canada's Wonderland* (2008), 90 O.R. (3d) 401, [2008] O.J. No. 2339 (C.A.) at para. 26. Similarly, in *Dugal v. Manulife Financial Corp.*, 2011 ONSC 1764, [2011] No. 1240 at para. 96, I observed as follows:

> To allow the claim to proceed based on "special circumstances" would defeat the very purpose of the 180 day limitation period in the *Securities Act* - it would promote uncertainty rather than certainty, and unrest in corporate affairs and securities markets, rather than repose.

[519] In *Dugal v. Manulife*, I considered whether the court has jurisdiction to extend the s. 183.14 limitation period in the context of an action under s. 130 of the *Securities Act* for misrepresentation in the primary market. I concluded, at para. 90, that it would probably not make sense to extend the special circumstances doctrine beyond the existing statutory or common law exceptions that had been engrafted onto specific statutory limitation periods. It was not necessary to decide the issue, however, because I concluded that, even if the jurisdiction existed, I would not have exercised it.

[520] I do not propose to review the authorities that were canvassed in *Dugal v. Manulife.* The issue of jurisdiction in this case boils down to whether it would be consistent with the purpose of the limitation period in s. 138.14 of the *Securities Act*, with section 28 of the *C.P.A.* and with the Court of Appeal's decision in *Timminco*, to make an order granting leave *nunc pro tunc* or extending the limitation period to the date of this decision.

[521] I have concluded that I have no jurisdiction to make such an order for the following three reasons:

[522] First, Part XXIII.1 of the *Securities Act* is a complete code governing the statutory remedy of civil liability for secondary market disclosure. It identifies the parties who will be liable, the circumstances giving rise to liability, the defences available, the quantification of damages and the limits of liability. It also establishes unique procedural requirements, including leave, and a special and rather unusual limitation period.

[523] The limitation period is unusual, because it is the only one of which I am aware that is tolled by a judicial act – the granting of leave – as opposed to simply the act of the plaintiff in issuing a statement of claim.

[524] The commencement of that limitation period is defined by the occurrence of specific, objective events. There is nothing in the statute to suggest that the limitation period can be extended as a result of common law principles such as discoverability or special circumstances. I note, in contrast, that in the case of prospectus claims under Part XXIII, s. 138 provides that an action for damages must be commenced within the earlier of 180 days after the plaintiff became aware of the facts giving rise to the cause of action, or three years.

[525] Second, there is nothing in the judicial interpretation of Part XXIII.1, or in the interpretation of Part XXIII, to suggest that the special circumstances doctrine applies. On the contrary, the interplay between s. 138.14 and s. 28 of the *C.P.A.* has been considered by the Court of Appeal in *Timminco* and that decision contains no suggestion at all that there may be scope for judge-made exceptions. The Court of Appeal has decided that three years is a sufficient time within which a leave motion can be brought and decided. The Court did not even consider the possibility that it might have jurisdiction to extend the limitation period before its expiry.

[526] Third, the general philosophy of the *Limitations Act, 2002*, S.O. 2002, c. 24, reflects the desirability that limitation periods be clearly defined and not subject to judicially-crafted exceptions that can lead to the uncertainty and unfairness they are designed to prevent. Engrafting a judge-made exception onto the clear language of s. 138.14 of the *Securities Act* would be unwarranted. Limitation periods are enacted for the purposes of certainty and finality. It would not promote either of those goals to make the limitation period dependent on the exercise of the court's discretion to grant relief *nunc pro tunc* or because of other "special circumstances".

[527] I turn, finally, to the plaintiffs' submissions concerning estoppel and waiver.

(iv) *Estoppel by Convention and Waiver*

[528] The plaintiffs assert the doctrines of waiver and estoppel by convention to say that the defendants are precluded from relying on the expiry of the limitation period.

[529] As I have noted, it is common ground that there were no discussions between plaintiffs' counsel and defendants' counsel concerning the limitation period. Nor, as I have found, is there any conduct on the part of counsel for CIBC or counsel for the individual defendants that could be regarded as a promise that a limitation defence would not be raised.

[530] This is not, therefore, a case of promissory estoppel, as there has been no clear and unequivocal promise by the defendants that they would not raise the limitations defence: see *Maracle v. Travellers Indemnity Co. of Canada.*, [1991] 2 S.C.R. 50 at 57-59. Nor is there evidence of specific action on the part of the plaintiffs in reliance on the alleged promise, such that it would be inequitable to allow the defendants to change their position.

[531] I agree with the submission of the defendants that their silence or inactivity counts for nothing. They owed no duty to the plaintiffs, who were responsible for protecting their own interests.

[532] Estoppel by convention "operates where the parties have agreed that certain facts are deemed to be true and to form the basis of a transaction into which they are about to enter ... If they have acted upon the agreed assumption, then, as regards that transaction, each is estopped

against the other from questioning the truth of the statement of facts so assumed if it would be unjust to allow one to go back on it ... [references omitted]": *Ryan v. Moore*, [2005] 2 S.C.R. 53 at para. 4.

[533] The most that can be said in this case is that all parties may have assumed that the limitation period had been interrupted by the commencement of the action seeking leave *nunc pro tunc*, an assumption that was confirmed by the decision of Perell J. at first instance in *Timminco.*

[534] There is, however, no evidence that the defendants actually shared the plaintiffs' assumption, and their silence on the point cannot be taken as evidence of such an assumption. They were perfectly entitled to say nothing on the point, keep their powder dry, and see how the case progressed and how the law developed. When the law improved their position, they were entitled to assert the defence.

[535] Moreover, a shared assumption does not give rise to estoppel by convention unless it is communicated by one party to the other: see *Ryan v. Moore* at pp. 82-83; *London Borough of Hillingdon v. ABC Limited*, 2000 WL 742044 (C.A.) at paras. 60, 62. In the latter case, the Court of Appeal observed, at para. 61:

> There has to be more to establish a convention than simply a request for details of ARC's claim. Where parties are acting on the basis of some generally assumed view of the law, which turns out to be wrong, more is needed than simply an assumption as to the legal position if a party is to be estopped from taking a defence which he then discovers is available to him.

[536] Turning to the plaintiffs' argument based on waiver, I conclude that the stringent requirements of unilateral waiver of rights have not been met. Those requirements are that: (a) the right must be susceptible to waiver, in the sense of being introduced solely for the benefit of the moving party; (b) full knowledge of the right by the party waiving; and (c) conduct or words on the part of the waiving party evidencing an unequivocal and conscious intention to abandon the right: see *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 S.C.R. 490 at 500; *Marchischuk v. Dominion Industrial Supplies Ltd.*, [1991] 2 S.C.R. 61 at 65-66.

[537] In this case, as I have said above, there is no evidence of the third requirement – no evidence at all that CIBC or the individual defendants conducted themselves, by words or actions, so as to evidence an intention to abandon their rights to rely on the limitations defence. Their silence cannot be taken to be a waiver: *Allied Marine Transport Ltd. v. Vale Do Rio Doce Navegacao S.A.*, [1985] 1 W.L.R. 925 at 941 (C.A.). Moreover, until the decision of the Court of Appeal in *Timminco*, CIBC was not aware that it had a right to rely on the limitation period in the context of a pending action seeking leave.

[538] I conclude on this issue by observing that there is nothing improper in the defendants now relying on a defence that always was available and has now been authoritatively stated by the Court of Appeal in *Timminco*. Even if the defendants were aware of the possibility that the plaintiffs' claim might ultimately be time-barred if leave was not obtained within three years, they had no obligation to share their views with the plaintiffs. To paraphrase the House of Lords in *Republic of India v. India Steamship Co. Ltd.*, [1998] A.C. 878, parties to litigation are adversaries and, subject to compliance with the *Rules of Civil Procedure* and the *Rules of Professional Conduct*, one party has no obligation to point out mistakes or erroneous assumptions made by the other party, as long as he or she does not mislead the other party: see also *The Stolt Loyalty*, [1993] 2 Ll. Rep. 281 at 289.

(e) Conclusion on Limitations Issue

[539] As I have observed, until the release of *Timminco*, the *Securities Act* limitation period had not been raised as an issue in this proceeding, either between counsel or at a case conference. Had it been raised, the parties might have considered a tolling agreement. Had the parties not reached an agreement, I would have considered whether the hearing could be scheduled at an early date or whether some other order could be made to prevent potential injustice. The lack of prejudice to the defendants and the irreparable prejudice to Class Members as a result of the loss of their cause of action would have militated strongly in favour of some action.

[540] If I had found on this motion that I had jurisdiction to extend the limitation period, either through the special circumstances doctrine or by granting leave *nunc pro tunc*, I would have done so for several reasons.

[541] First, unlike the situation in *Timminco*, the plaintiffs have been diligently pursuing the motion for leave on their own behalf and on behalf of the Class. This is not a case in which the suspension of the limitation period would have left the parties, Class Members and the court without any guarantee that the action would be prosecuted.

[542] Second, *Timminco* was a case of first impression. It is fair to say that it came as a surprise to the bar. There are other decisions of this court, specifically those of Perell J. in *Timminco*, of Rady J. in *Nor-Dor Developments Ltd.* and of van Rensburg J. in *Silver v. Imax (Leave)*, that suggested that the course of action proposed by the plaintiffs was appropriate.

[543] Third, extending the limitation period in this particular case would not do violence to the purposes of limitation periods, including the need of parties to order their affairs after reasonable periods of repose and to avoid evidence becoming stale or lost. The defendants have known of the action from an early stage and have mounted a full evidentiary response. The limitation period could have been extended without unfairness to the defendant and without impairing public confidence in the administration of justice.

[544] Fourth, this is a proposed class action and the court has a duty to the unrepresented putative Class Members to ensure that their rights are protected. At least up until the decision in *Timminco*, it was reasonable for unrepresented Class Members to assume that their rights could shelter under the umbrella of this action. Their rights will now be lost as a result of the expiry of the limitation period.

[545] Finally, I have found that the plaintiffs' statutory claim has a reasonable possibility of success. In the next section of these reasons, I will set out my conclusion that the statutory claim would be suitable for certification under the *C.P.A.* As a result of the expiry of the limitation period, this class action, which has a reasonable possibility of success, will not be resolved on its merits, an unfortunate conclusion, under the circumstances.

VII. THE CERTIFICATION MOTION

1. General Principles

[546] The test for certification and the applicable principles are not in dispute. Section 5(1) of the *C.P.A.* stipulates that the court "shall" certify the proceeding as a class action if all the following criteria are met:

> (a) the pleadings or the notice of application discloses a cause of action;
>
> (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
>
> (c) the claims or defences of the class members raise common issues;
>
> (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
>
> (e) there is a representative plaintiff or defendant who,
>
> > (i) would fairly and adequately represent the interests of the class,
> >
> > (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
> >
> > (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members.

[547] It is well settled that the *C.P.A.* is remedial legislation and that it is to be given a broad, liberal and purposive interpretation, consistent with its objects. Those objects are: access to justice, judicial economy and behaviour modification: *Western Canadian Shopping Centres Inc. v. Dutton*, 2001 SCC 46, 201 D.L.R. (4th) 385 at paras. 19-29, *Hollick v. Toronto (City)*, 2001 SCC 68, 205 D.L.R. (4th) 19 at paras. 28-29; *Cloud v. Canada (Attorney General)* (2004), 73 O.R. (3d) 401, [2004] O.J. No. 4924 at paras. 36-38.

[548] The purpose of the certification motion is to determine whether the action is capable of proceeding as a class action. The Supreme Court observed in *Hollick* at para. 16 that the

certification stage focuses on the form – rather than the substance – of the action. The question is not whether the claim is likely to succeed, but whether it is appropriately prosecuted as a class action.

[549] The plaintiffs bear the burden of adducing evidence to show that there is "some basis in fact" to meet the requirements of sections 5(1)(b), (c), (d) and (e) of the *C.P.A.*: *Hollick*, at paras. 24-26; *McCracken v. Canadian National Railway Company*, 2010 ONSC 4520, [2010] O.J. No. 3466 at paras. 298-301, 345, 410.

2. Application of the Certification Test

(a) Cause of Action

[550] The test under s. 5(1)(a) of the *C.P.A.* is the same as that applied on a motion to strike a pleading under rule 21.01(1)(b) for disclosing no reasonable cause of action: "assuming that the facts as stated in the Statement of Claim can be proved, is it 'plain and obvious' that the plaintiff's Statement of Claim discloses no reasonable case of action?": *Hunt v. Carey Canada Inc.*, [1990] 2 S.C.R. 959, [1990] S.C.J. No. 93 at para. 33.

[551] No evidence is admissible for the purposes of the section 5(1)(a) analysis and the material facts pleaded must be accepted as true, unless patently ridiculous or incapable of proof.

[552] The plaintiffs plead three causes of action: (a) the statutory claim under s. 138.3 of the *Securities Act* for secondary market misrepresentation; (b) common law misrepresentation; and (c) fraudulent misrepresentation. The plaintiffs do not seek to certify the claim for fraudulent misrepresentation, so I will not consider it.

(i) The Securities Act Claim

[553] There is no dispute that the plaintiffs have properly pleaded a cause of action under s. 138.3 of the *Securities Act* and I so find.

(ii) Negligent Misrepresentation

[554] The plaintiffs plead that, as a result of CIBC's status as a Canadian chartered bank, a public issuer of securities, and a member of the TSX and the NYSE, the defendants owed the

plaintiffs and class members a duty of care to accurately report CIBC's financial position. They plead that the plaintiffs and class members knew or ought to have known that:

> … the plaintiffs and Class Members would rely on the efficiency of the market to establish the fair market value of the common shares on the TSX, and the efficiency of the market, in turn, was dependent on the full, fair, accurate and timely disclosure of material information which could reasonably affect the price of CIBC common shares.

[555] They plead that the defendants' misrepresentations and omissions caused the price of CIBC's common shares to be traded on the TSX at an artificially inflated price during the Class Period and that, had the market been properly informed concerning the true state of CIBC's portfolio, the shares would have traded at lower prices during that time. They also plead that the defendants made negligent misrepresentations during the Class Period with respect to CIBC's investments in the USRMM, that they knew that the plaintiffs would rely on the accuracy of those representations and that the plaintiffs did in fact rely on these representations to their detriment.

[556] The elements of the cause of action for negligent misrepresentation are set out in *Queen v. Cognos Inc.,* [1993] 1 S.C.R. 87, [1993] S.C.J. No. 3 at para. 33:

> ... (1) there must be a duty of care based on a "special relationship" between the representor and the representee; (2) the representation in question must be untrue, inaccurate, or misleading; (3) the representor must have acted negligently in making said misrepresentation; (4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and (5) the reliance must have been detrimental to the representee in the sense that damages resulted.

[557] Causes of action for negligent misrepresentation were found to have been properly pleaded in both *Silver v. Imax (Certification)* and *Arctic Glacier.*

[558] I am satisfied that the plaintiffs have properly pleaded a cause of action for negligent misrepresentation against CIBC.

[559] That being said, I accept CIBC's submission that some of the disclosures pleaded in the statement of claim are not capable of supporting a cause of action for misrepresentation. These

alleged misrepresentations were not pursued in either the plaintiffs' factum or in oral argument, and they will not be certified.[13]

[560] The individual defendants say that the plaintiffs' claims against them for negligent misrepresentation should fail for two reasons. First, they say that they did not owe the plaintiffs a duty of care, and, in any event, a duty of care should be negated based on the existence of a statutory cause of action and other policy considerations. Second, they say that the facts as pleaded do not disclose a cause of action against them in their personal capacities. They rely on *Scotia McLeod Inc. v. Peoples Jewellers Ltd.* (1994), 26 O.R. (3d) 481, [1995] O.J. No. 3556 (C.A.), aff'g (1994), 15 B.L.R. (2d) 160 (Gen. Div.), leave to appeal refused, [1996] 3 S.C.R. vii. They also refer to: *Normart Management Ltd. v. West Hill Redevelopment Co.* (1998), 37 O.R. (3d) 97, [1998] O.J. No. 391 (C.A.); *Adga Systems International Ltd. v. Valcom Ltd.* (1999) 43 O.R. (3d) 101, [1999] O.J. No. 27 (C.A.); *NBD Bank, Canada v. Dofasco Inc.* (1999), 46 O.R. (3d) 514, [1999] O.J. No. 4749 (C.A.).

[561] The issue of whether there was a common law cause of action for negligent misrepresentation against the individual defendants in their personal capacity was not discussed in the certification motion in *Silver v. Imax (Certification)* or in *Arctic Glacier*. In *Silver v. Imax (Certification)*, van Rensberg J. considered whether the cause of action against the individual defendants would meet the second part of the *Anns* test, and concluded, at para. 55 that it was not plain and obvious that such a claim could not succeed. She held, "it is not plain and obvious that the policy reasons asserted by the defendants should preclude the common law claims of misrepresentation in the secondary market from being pursued at this stage in the litigation".

[562] The individual defendants contend, on the authority of *Montreal Trust v. Scotia McLeod*, that the plaintiffs have pleaded no cause of action against them in their personal capacity, because they have not alleged conduct of the defendants that took them outside their role as officers of the corporation. They say that their actions were in law the actions of the corporation, and they do not engage personal responsibility for the actions of the corporation in

[13] The pleadings are contained in paras. 174, 175, 176, 177, 179, 188, 189, 190-193 and 208 of the statement of claim.

the absence of independent tortious conduct or a separate identity of interest from the corporation.

[563] In *Montreal Trust*, the plaintiffs had purchased debentures of Peoples Jewellers. They sued the underwriters, and their own lawyers, alleging that certain crucial liabilities of Peoples had not been disclosed. As an inducement to purchasing the debentures, the plaintiffs had been given an information package, which included an earlier prospectus, pertaining to a share issuance by Peoples, as well as certain financial statements, a press release concerning Peoples' financial results and an annual information form. The plaintiffs claimed that these did not disclose certain liabilities. The underwriters and the lawyers made third party claims against the directors and officers of Peoples, claiming that they had misrepresented the financial condition of Peoples.

[564] The proposed third parties included all the directors of Peoples. In addition to being directors, the defendant Gill was the Vice-president, Finance and Administration, Gerstein was the President and CEO. It was alleged that at certain due diligence meetings, these individuals had misrepresented to the defendant underwriters and lawyers that the prospectus and the documents incorporated in them did not omit any material facts. The prospectus had been signed by both Gerstein and Gill and by two other directors on behalf of the Board.

[565] Allegations were made against Gerstein and Gill for negligent misrepresentation. The allegation against the other directors was essentially an allegation that they were jointly responsible with Peoples for any negligent misrepresentation made by Peoples.

[566] Farley J. struck the third party claim on motion by the officers and directors on the ground that it did not disclose a reasonable cause of action, but he gave leave to amend. Rather than making amendments, the defendants appealed to the Court of Appeal.

[567] The Court of Appeal noted that there was nothing in the third party claim against the directors to allege that they were negligent, that they knew or ought to have known that the liabilities were material, that the directors (other than Gerstein and Gill) were involved in the marketing of the debentures or that there was "conduct by the directors constituting fraud, bad faith or absence of authority such as would amount to an intentional tort on their part, or that

there was any other type of deliberate or reckless conduct that would render the directors' conduct their own as distinct from that of Peoples" (at para. 18).

[568] The Court of Appeal dismissed the third party claim against the directors of Peoples, other than Gerstein and Gill, without allowing leave to amend. Finlayson J.A. noted that in the absence of fraud, deceit, dishonesty or want of authority on the part of corporate officers, it would be rare to find officers personally liable for the actions carried out in the name of the corporation. He observed, at para. 25, that corporate officers and directors are generally protected from liability in the absence of dishonest conduct, or cases of piercing the corporate veil, inducing breach of contract or insolvency cases:

> ... officers or employees of limited companies are protected from personal liability unless it can be shown that their actions are themselves tortious or exhibit a separate identity or interest from that of the company so as to make the act or conduct complained of their own.

[569] Finlayson J.A. continued, at para. 26, by noting that while a corporation acts through its "directing minds", the actions of its directing minds do not necessarily result in personal liability for the actions of the corporation:

> None of the conduct alleged against the respondent directors falls within the broad categories I have outlined above. Their exposure, if there is any, is narrowly focussed on their formal decision-making in the name of Peoples. A corporation may be liable for contracts that its directors or officers have caused it to sign, or for representations those officers or directors have made in its name, but this is because a corporation can only operate through human agency, that is, through its so- called "directing mind". Considering that a corporation is an inanimate piece of legal machinery incapable of thought or action, the court can only determine its legal liability by assessing the conduct of those who caused the company to act in the way that it did. This does not mean, however, that if the actions of the directing minds are found wanting, that personal liability will flow through the corporation to those who caused it to act as it did. To hold the directors of Peoples personally liable, there must be some activity on their part that takes them out of the role of directing minds of the corporation. In this case, there are no such allegations.

[570] Finlayson J.A. observed, however, that Gerstein and Gill were placed in a different position "by reason of being the two most senior executive officers of Peoples" (at para. 38). He also noted that there were allegations that they had been directly and personally involved in the marketing of the debentures and that they had been personally involved in making certain representations. He concluded that although the claims against them might "stretch the envelope", there was a low threshold applicable to sustaining the pleadings, and those claims should not be struck – at para. 39:

> While the authorities make clear that officers of corporations who are the directing minds of the corporation have the same identity of interest as the directors and thus the same immunity to suit, I am not prepared to dismiss the action against Gill and Irving Gerstein at this stage. The threshold of sustainability of pleadings is very low. Although I am of the view that the appellants are attempting to stretch the envelope of available jurisprudence to encompass the acts of Gill and Irving Gerstein, an action should not be dismissed at this stage simply because it is novel in law: see *R.D. Belanger & Associates Ltd. v. Stadium Corp. of Ontario Ltd.* (1991), 5 O.R. (3d) 778 at p. 782 (C.A.); *Hanson v. Bank of Nova Scotia* (1994), 19 O.R. (3d) 142 at p. 145 (C.A.); and *Hunt v. Carey Canada Inc.*, [1990] 2 S.C.R. 959 at p. 977, 74 D.L.R. (4th) 321.

[571] The individual defendants say that on the authority of *Montreal Trust*, the claim should be dismissed against them, without leave to amend. They point out that the claim has already been amended twice and the plaintiffs have had more than three years to get it right.

[572] The plaintiffs state that the requirements of *Montreal Trust* are met in this case, because the individual defendants were directly involved in CIBC's disclosures. McCaughey and Woods certified that the financial statements were accurately presented. All the individual defendants were aware of CIBC's exposure to the USRMM and were aware that the misrepresentation of that exposure would affect the price of CIBC's stock.

[573] *Montreal Trust* can be distinguished on the basis that the directors in that case were sought to be held liable simply because they were directors. In effect, it was said that they were jointly liable with Peoples for any misrepresentation it made. That is not the case here. It is alleged that the actions of the individual defendants were themselves negligent misrepresentations or omissions. I acknowledge that the pleadings are not as strong as they could

be and that this claim also "stretches the envelope", but given the low threshold, I would not strike the claim against the individual defendants for negligent misrepresentation.

(b) Identifiable Class

(i) Generally

[574] The plaintiffs propose the following class definition:

> All persons or entities, excluding U.S. residents, who purchased CIBC common shares between May 31, 2007 and February 28, 2008 on the TSX.

[575] The plaintiffs estimate that there could be more than 100,000 class members.

[576] It is common in securities cases to define the class by reference to persons who owned the shares: see *Hollick* at para. 20. Subject to the issues discussed below, the class definition is satisfactory – it indentifies those persons with a potential claim for relief, it identifies who will be bound by the result and it describes the persons entitled to notice: *Bywater v. Toronto Transit Commission* (1998), 27 C.P.C. (4th) 172, [1998] O.J. No. 4913 (Gen. Div.).

[577] In *Silver v. Imax (Certification)*, the class was limited to those persons who acquired securities during the Class Period and continued to hold some or all of those securities at the close of trading on the last day of the Class Period, presumably to avoid the issue of "early sellers", discussed below. In *Arctic Glacier*, the class was simply expressed to include all those who acquired units of the income fund during the Class Period.

[578] It is well-settled that a class need not include only those persons whose claims will ultimately be successful: see *Frohlinger v. Nortel Networks Corporation* (2007), 40 C.P.C. (6th) 62, [2007] O.J. No. 148 (S.C.J.); *Silver v. Imax (Certification)* at paras. 107-107.

[579] The defendants raise several issues with respect to the class definition. These issues are: the so-called "early sellers", the "short sellers" and the "global class".

(ii) Early Sellers

[580] CIBC notes that the class will include "early sellers", those who sold their shares before the end of the Class Period on February 28, 2008. During this time, there were more than

385,000,000 shares traded on the TSX in nearly 1,150,000 million separate transactions. Some of the early sellers will have no claim for damages, because they will have sold at a price that was inflated because the alleged misrepresentations had not been corrected. Others will have claims for damages that are different from other class members who bought and sold their shares at different dates. The defendants say that these "early sellers" may have conflicts with other Class Members, because they may argue that disclosures during the Class Period were corrective of the misrepresentations. Others, who purchased after these disclosures, will say that they were not corrective and that the misrepresentations were continued.

[581] *Pearson v. Boliden Ltd.*, 2002 BCCA 624, 222 D.L.R. (4^{th}) 453 was a prospectus case. In that case, the collapse of the tailings dam, the "triggering event" for the drop in the share price, occurred after the period of distribution under the prospectus. The Court of Appeal held that the early sellers should be excluded from the class, because if they paid "too much" for their shares, they also sold their shares for "too much" and presumably suffered no loss as the share price continued to reflect the misrepresentation.

[582] In *McKenna v. Gammon Gold Inc.*, 2010 ONSC 1591, [2010] O.J. No. 1057, I acknowledged that, as a general rule, it may be appropriate to exclude early sellers from the class, because no damages are suffered until the misrepresentation is disclosed. Shareholders who dispose of their securities before that date could not suffer a loss as a result of the misrepresentation. I referred to *Pearson v. Boliden Ltd.*, above, at paras. 92-93 and *Carom v. Bre-X Minerals Ltd.* (1999), 46 O.R. (3d) 315, [1999] O.J. No. 5114 (Div. Ct.) at paras. 21-23, var'd on other grounds (2000), 51 O.R. (3d) 236 (C.A.); see also *Kerr v. Danier Leather Ltd.* (2004), 46 B.L.R. (3d) 167, [2004] O.J. No. 1916 (S.C.J.) at para. 345, rev'd on other grounds (2007), 36 B.L.R. (4th) 95 (S.C.C.). I concluded, however, that in light of assertion that there had been ongoing misrepresentations during the Class Period, after the alleged partially corrective disclosure, it "would be arbitrary at this stage to conclude that "early sellers" could not have suffered a loss as a result of the alleged misrepresentations in the Prospectus and the onus of proving this should be on the defendants at trial" (at para. 122). Tausendfreund J. reached a similar conclusion in *Arctic Glacier* at para. 205.

[583] In this case, I agree with the plaintiffs' submission that the early sellers should not be excluded at this stage and that the issue could be addressed, if necessary, as part of an ultimate claims process to weed out class members who have suffered no loss: see *Frohlinger v. Nortel Networks Corp.* at paras. 27-29.

(iii) Short Sellers

[584] CIBC objects to the inclusion of "short sellers" in the class. A short seller borrows shares, promises to redeliver the shares in the future and then sells the borrowed shares. If the price of the stock falls before the shares are required to be redelivered, the short seller makes a profit. A short seller is betting that the price of the stock will go down. In this case, short sellers who borrowed CIBC shares and sold them, later re-purchased CIBC shares at a lower price, and then returned the shares to the lender (usually their broker), will have earned a profit based on the decline of the price of CIBC shares between the time of the initial sale and the time of the purchase.

[585] CIBC says that from time to time during the Class Period, there were over 112 million CIBC shares subject to "short" positions. It alleges that the proposed class is overly broad, because the short sellers, having made a profit from their trades, will have no claim for damages. They say that individual inquiries will be necessary in order to identify and exclude short sellers.

[586] I am not satisfied that this is an insurmountable obstacle. A short seller on the TSX is required to disclose his or her position at the time of sale. If the plaintiffs are successful in this action, the claims process could identify and exclude short sellers, in the same manner as proposed for early sellers.

(iv) "Global Class" – Non-Residents

[587] The plaintiffs propose a "global class" of those, other than U.S. residents, who purchased CIBC shares on the TSX during the Class Period. A parallel class proceeding in the United States on behalf of a class of U.S. residents was dismissed: *Plumbers and Steamfitters Local 773 Pension Fund v. Canadian Imperial Bank of Commerce et al.*, No. 08 Civ. 8143 (WHP), 2010 WL 961596 (S.D.N.Y., March 17, 2010).

[588] I am satisfied that it is appropriate to certify such a "global class". Non-residents should be included in the Class. In acquiring their shares in Ontario, non-residents could reasonably expect that their rights would be determined by the courts of Canada: see *McKenna v. Gammon Gold Inc.* at para. 116; *Currie v. McDonald's Restaurants Canada Ltd.* (2005), 74 O.R. (3d) 321, [2005] O.J. No. 506 (C.A.) at para. 18.

[589] Global classes were approved in both *Silver v. Imax (Certification)* at paras. 108-130 and *Arctic Glacier* at para. 202. In *Silver v. Imax (Certification)*, after a thorough review of the authorities, van Rensburg J. found that there was a real and substantial connection between Ontario and the claims asserted on behalf of foreign class members. She stated, at para. 130:

> Such [real and substantial] connection exists in this case. IMAX is a CBCA corporation with its head office in Ontario. It is a reporting issuer under the OSA and its shares are traded on the TSX. The alleged Representation was made in Ontario through the issuance of the Company's Form 10-K and press releases from IMAX's Mississauga head office (although arguably it may have been made in IMAX's offices in New York as well). The alleged wrongful actions of the Individual Defendants in connection with the preparation and reporting of IMAX's financial statements are alleged to have taken place in Ontario as well as New York. The proposed common issues respecting liability that concern the conduct of the defendants accordingly have a substantial connection to this jurisdiction.

[590] In that case, as in this, the defendants argued that a global class should not be certified, because different laws might apply to the claims of class members depending on their place of residence or where they acquired their shares, thereby making the proceeding unduly complex and inefficient. Justice van Rensburg did not accept this submission. She concluded that it was appropriate to "wait and see" how the issue developed and that it could be dealt with by adjusting the common issues or by creating sub-classes – at paras. 164-165:

> Accordingly, I have concluded that it would be appropriate to certify the global class as proposed by the plaintiffs. The prospect that the claims of non-resident class members may be subject to different laws adds complexity to the litigation, but does not weigh against certification. The appropriate approach in this litigation is to "wait and see" how the conflict of law issues may develop, and as noted below in the discussion under "common issues", the court

> can deal with any differences in the law that might arise by adjusting the common issues or recognizing subclasses as appropriate.
>
> The court will also need to ensure that the interests of non-resident class members are protected by the form, content and distribution of the notice that is provided to them (this issue is addressed later in these reasons in considering the plaintiffs' proposed litigation plan.)

[591] I respectfully agree with this approach. The problem is less acute in this case. The class in *Silver v. Imax (Certification)* included purchasers on both the TSX and the NASDAQ, whereas the class in this case is limited to purchasers on the TSX, though CIBC also traded on the NYSE. It seems to me that there is a reasonable argument that the rights of a non-resident, who purchases shares of a Canadian company on the TSX, are governed by the laws of Ontario. In any case, it is not an issue that needs to be resolved at this stage.

[592] I therefore certify the proposed class.

(c) Common Issues

[593] The proposed common issues are listed in Schedule A to these reasons.

(i) <u>Common Law Misrepresentation</u>

[594] The first seven proposed common issues relate to the common law negligent misrepresentation claim. They are:

> 1. Did CIBC or the Individual Defendants, or any of them, owe a duty of care to Class Members?
>
> 2. Did CIBC or the Individual Defendants, or any of them, make representations, as set out in paragraphs 144 to 208 of the Second Amended Statement of Claim, concerning the overall extent of CIBC's CDO Exposure (as defined in the claim) and the extent of the impaired value of CIBC's CDO Portfolio and the hedges purchased to provide protection against the default of the RMBS and CDOs held directly and indirectly by CIBC during the Class Period, which were untrue, inaccurate or misleading? If so, what were the untrue, inaccurate or misleading representations, which Defendant(s) made the representations, when, where and how?

> 3. Did CIBC or the Individual Defendants, or any of them, make the representations described above negligently? If so, which Defendant(s) made the representations, when, where and how?
>
> 4. Were the representations described above publicly corrected? If so, when?
>
> 5. Did CIBC or the Individual Defendants, or any of them, make the representations intending that the Class Members rely upon them in acquiring CIBC shares?
>
> 6. Were the public markets on which CIBC securities traded during and immediately following the Class Period efficient markets? If so, did the trade prices of CIBC shares during the Class Period incorporate and reflect the misrepresentations?
>
> 7. If the answer to (6) is yes, did the purchase of CIBC shares by Class Members during the Class Period constitute reliance or inferred reliance upon the misrepresentations?

[595] As I have noted, the statutory remedy for a secondary market misrepresentation under s. 138.3 of the *Securities Act* was enacted, in part, due to the difficulty in proving reliance-based common law claims and the rejection in Ontario of the "fraud on the market" theory. The statutory provisions contain checks, such as the leave procedure, to ensure that the remedy is not abused and balances, such as the liability cap, to protect the corporation and its continuing shareholders from crippling exposures.

[596] Section 138.13 preserves rights of action the plaintiff may otherwise have. It is worth noting that the exercise of a common law cause of action for misrepresentation would allow a plaintiff to circumvent the elaborate procedural and liability structure of Part XXIII.1 of the *Securities Act*, which is designed for the protection of the public.

[597] If the common law cause of action is available, this entire system becomes redundant and the granting of leave is unnecessary – at least for that cause of action.

[598] The plaintiffs point to the evidence of Ms. Preston, who expressed the opinion that CIBC's shares traded in a semi-strong efficient market and noted that CIBC's expert, Dr. Bajaj, acknowledged that the market for CIBC shares was efficient. They note that in *Carom v. Bre-Ex Minerals Ltd.*, the Court of Appeal for Ontario held that it was appropriate to certify a negligent misrepresentation claim involving 160 alleged misrepresentations.

[599] In *McKenna v. Gammon Gold Inc.*, I declined to certify common issues of common law misrepresentation in the primary market. Referring to *McCann v. CP Ships* and *Silver v. Imax (Certification)*, I observed at paras. 159-161:

> With deference to my colleagues who have come to a different conclusion, I accept the submission of counsel for the defendants that there is authority, binding on me, that makes proof of reliance a necessary requirement of a negligent misrepresentation claim. This is why the legislature has seen fit to relieve the investing public of this onerous requirement in the primary market through s. 130(1) and s. 131.1(1), which contain "deemed reliance provisions," and in the secondary market by a similar provision in s. 138.3(1) of the *Securities Act.* The right to pursue the latter claim is subject to the plaintiff passing the initial hurdle in obtaining leave under s. 138.8 by showing that the action is brought in good faith and has a reasonable prospect of success.
>
> I conclude that the need to prove reliance as a necessary element of negligent misrepresentation, and the inability to establish reliance as a common issue, makes the common law misrepresentation claims, in both the secondary and primary markets, fundamentally unsuitable for certification. In this case, multiple misrepresentations are alleged throughout the ten month Class Period, in press releases, regulatory filings, conference calls, annual reports and a multitude of other written and oral forms. The alleged misrepresentations relate to a variety of complaints, not simply the level of gold production. The plaintiff complains of undisclosed equipment failures, contracts with insiders, stock option expenses, non-compliant financial statements and inadequate disclosure controls. Individual inquiries would have to be made into what alleged misrepresentations were made to each class member and whether he or she relied upon any of those representations. As was stated by Winkler J. in *Mouhteros v. DeVry Canada Inc.,* above, at para. 30:
>
>> Assuming that the misrepresentation issues identified above were capable of a common resolution, such resolution would be but the beginning, and not the end of the litigation. With respect to the claim for misrepresentation in tort, the plaintiff must prove reasonable reliance on a misrepresentation negligently made. Reliance is an essential element of the tort. The question of reliance must be determined based on the experience of each individual student, and will involve such evidentiary issues as to how the student heard about DeVry, whether the student saw

> any of the advertisements and if so, which ones, what written representations were made to the student prior to enrolment, whether the student met with an admissions officer, and whether the student relied on some or all of these in deciding to enrol in DeVry. The inquiry will not end there, however. If the class members are able to demonstrate reliance, they must show that they relied to their detriment. Damages will require individual assessment.

> There is no basis on which reliance could be resolved as a common issue. The need to determine the issue individually would give rise to a multitude of questions in each case concerning the representations communicated to a particular investor, the experience and sophistication of the investor, other information or recommendations made to the investor and whether there was a causal connection between the misrepresentation(s) and the acquisition of the security. The inability to determine the defendants' liability without individual inquiries as to reliance makes the proceeding unsuitable for certification in relation to the negligent misrepresentation claim.

[600] I remain of the same view in this case. The decision of the Supreme Court of Canada in *Sharbern Holdings Inc. v. Vancouver Airport Centre Ltd.*, above, has re-affirmed the need to establish reliance in a common law misrepresentation claim. This is not an issue that is capable of resolution on a common basis. In my view, there is no authority to support the proposition that "fraud on the market" or the "efficient market" theory can supplant the need to prove individual reliance.

[601] This issue is not capable of resolution on a common basis.

(ii) <u>Statutory Misrepresentation</u>

[602] The plaintiffs propose the following common issues with respect to the statutory misrepresentation claims:

> 8. Did some or all of the representations, as described above, made by CIBC and the Individual Defendants, or any of them, during the Class Period, constitute a misrepresentation within the meaning of section 138.3 of the *Securities Act*?

9. If the answer to (8) is yes, did the Individual Defendants, or any of them, authorize, permit, acquiesce in the release of any or all of the public oral statements or documents containing a misrepresentation within the meaning of section 138.3 of the *Securities Act*?

10. If the answer to (8) is yes, did CIBC or the Individual Defendants, or any of them, know that the non-core document as defined under the *Securities Act* or the public oral statement contained a misrepresentation, or deliberately fail to acquire knowledge that the non-core document or public oral statement contained the misrepresentation, or are guilty of gross misconduct in connection with the release of the non-core document or the making of the public oral statement that contained the misrepresentation?

11. Did CIBC or the Individual Defendants, or any of them, fail to make timely disclosure in relation to the material change(s) in CIBC's business, operations and capital relating to the extent of its CDO and CDS portfolio, and the extent of impairment to its CDO and CDS portfolio during the Class Period?

12. If the answer to (11) is yes, did the Individual Defendants or any of them, authorize, permit, or acquiesce in the failure to make timely disclosure?

13. If the answer to (11) is yes, did the Individual Defendants, or any of them, know, at the time that the failure to disclose first occurred, of the change and that the change was a material change, or deliberately failed to acquire knowledge of the change and that the change was a material change, or were, through action or failure to act, guilty of gross misconduct in connection with the failure to make timely disclosure?

14. If the answer to either (8) or (11) is yes, have the Defendants, or some of them, established a reasonable investigation or expert reliance defence under the *Securities Act*?

15. Can any or all of the Defendants rely on section 138.7 of the *Securities Act* in order to limit their liability in the prescribed statutory amounts? If CIBC can rely on section 138.7 of the *Securities Act*, what was CIBC's market capitalization for the purposes of determining the cap on its liability?

[603] I would only certify the common issues pertaining to the misrepresentations for which I have granted leave under the *Securities Act.* Proposed common issue 8 would have to be restricted accordingly, as would common issue 14.

[604] I will therefore certify common issues 8, 9, 10, 14 and 15. Leave has not been pursued, or granted, with respect to the material changes referred to in common issues 11 to 13 inclusive, and those issues will not be certified.

(iii) Damages issues

[605] The proposed damages common issues are:

> 16. What was the impact on CIBC's share prices, on a total and per share basis, of the partial disclosures of previously known but undisclosed material information relating to CIBC's CDS and CDO exposure, both hedged and unhedged and write downs on its impaired CDO Portfolio between November 9, 2007 and February 28, 2008, as set out in paragraphs 178 to 208 of the Second Fresh as Amended Statement of Claim.
>
> 17. If CIBC or the Individual Defendants, or any of them, are liable to the Class for negligent misrepresentation, what is the procedure for assessing damages?
>
> 18. Can the court assess damages in the aggregate, in whole or in part, for the Class? If so, what is the amount of the aggregate damage assessment and who should pay it to the Class?
>
> 19. Was the conduct of any of the Defendants such that they ought to pay punitive damages to the Class? If so, who should pay what amount(s), to whom and why?

[606] In my view, question 16 is appropriate. Question 17 is not required in light of my decision not to certify the common law misrepresentation claim. Question 18 is not required in view of the statutory procedure in s. 138.5 for the assessment of damages. Question 19, dealing with punitive damages, is appropriate for the reasons set out in *McKenna v. Gammon Gold*; see also *Arctic Glacier* at paras. 229-230.

(iv) Ancillary Issues

[607] The proposed ancillary common issues raise questions concerning:

20. Responsibility for the costs of administering and distributing any monetary judgment and of determining individual issues or liability;

21. Directions for the determination of individual issues; and

22. Pre-judgment and post-judgment interest.

[608] The resolution of these issues could be left to the direction of the common issues judge, using the authority conferred by sections 24, 25 and 26 of the *C.P.A.*, the *Courts of Justice Act*, R.S.O. 1990, c. C.43 and the *Rules of Civil Procedure*.

(d) Preferable Procedure

[609] Section 5(1)(d) of the *C.P.A.* requires that a class proceeding be the preferable procedure for the resolution of the common issues. It necessitates an analysis of whether a class proceeding is a manageable way of resolving the claims of the class members and whether it is preferable to other means. It must be approached by considering the goals of class proceedings, namely access to justice, judicial economy and behaviour modification.

[610] I have stated that I am not prepared to certify common issues relating to the common law misrepresentation claim, which would require proof of reliance. For the same reason, a class proceeding would not be the preferable procedure for resolving a reliance-based claim, as it would give rise to individual issues of causation and reliance that would be unmanageable.

[611] There can be no doubt, however, that a class action is the preferable procedure for pursuing a claim under Part XXIII.1 of the *Securities Act.* The statutory remedy is tailor-made for a class action, as I found in *McKenna v. Gammon Gold Inc.* at para. 174 with respect to the primary market claim under s. 130.

[612] The defendants argue that the existence of multiple representations over a lengthy Class Period would make this case inappropriate for certification: see *Ramdath v. George Brown College of Applied Arts and Technology*, 2010 ONSC 2019, [2010] O.J. No. 1411 at para. 103; *Murphy v. BDO Dunwoody LLP* (2006), 32 C.P.C. (6^{th}) 358, [2006] O.J. No. 2729 (S.C.J.) at para. 44; *McKenna v. Gammon Gold* at para. 137. This concern is mitigated here because there is no need to prove reliance in the statutory claim. As well, the alleged misrepresentations and non-disclosures had a common message, that "CIBC's exposure to the USRMM is not material."

[613] There is no reasonable alternative procedure for advancing the claims. The statutory remedy would not be practical to assert on an individual basis. A class action will provide access to justice to an estimated 100,000 shareholders. It will promote judicial economy by avoiding duplication of fact-finding and legal analysis. It will potentially encourage public issuers to comply with their statutory disclosure obligations. Similar conclusions about the preferability of a class action to assert the statutory remedy were reached in *Arctic Glacier* at paras. 231-238 and in *Silver v. Imax (Certification)* at paras. 210-216. As van Rensburg J. observed in *Silver v. Imax (Certification)* at para. 16, a class action is the only viable method of advancing the s. 138.3 remedy.

[614] To conclude on the preferability analysis, I respectfully adopt the observations of Lax J. in *Marcantonio v. TVI Pacific Inc.* (2009), 82 C.P.C. (6th) 305, [2009] O.J. No. 3409 (S.C.J.) at para. 9:

> Individual litigation of securities cases can be difficult, time-consuming and expensive. Many claims would never be advanced because they are uneconomic for an individual investor to pursue. A class action is the optimal method of procuring a remedy for a group of investors who allege they have been harmed in similar ways as a single determination of the defendants' liability eliminates duplication of fact-finding and legal analysis. Further, a class action has the potential to act as an essential and useful supplement to the deterrent effects of regulatory oversight. It enhances the incentive for directors and officers to ensure that their disclosures to the investing public are materially accurate, thereby enhancing investor protection. Consequently, a class proceeding is the preferable procedure because it provides a fair, efficient and manageable method of determining the common issue, and advances the proceeding in accordance with the goals of access to justice, judicial economy and behaviour modification.

(e) Representative Plaintiffs

[615] The defendants say that the plaintiffs are unsuitable representatives of the class, primarily with respect to the common law negligent misrepresentation claim. They point out that neither one relied on any representation made by CIBC in connection with the acquisition of their shares.

[616] Mr. Green collected share certificates as a hobby. At the outset of the Class Period he owned 194.984 CIBC shares. As they were held in his "portfolio", he testified that he would have held onto those shares whatever information he might have received about CIBC. He acquired a total of less than six additional shares during the Class Period and retained those shares until the end of the period. CIBC says that because Mr. Green did not rely on any CIBC disclosure in connection with his acquisition of shares during the Class Period, he has no right to assert any reliance-based cause of action.

[617] The defendants make a similar complaint with respect to Mrs. Bell. Mrs. Bell did not make any investment decision during the Class Period, because all the transactions during the Class Period were made by her husband, to whom she delegated the management of her account. Neither she nor her husband relied on any disclosure made by CIBC.

[618] The defendants' objections to the representative plaintiffs relate primarily to their suitability to advance the common law claims for misrepresentation. As I have decided not to certify those claims, the objections are irrelevant. Proof of reliance is not required for the statutory claims.

[619] The defendants assert that the plaintiffs are mere "benchwarmers". I am satisfied that this is not the case. Mr. Green and Mrs. Bell are appropriate and engaged representatives of the class. In that regard, I note that Mr. and Mrs. Bell attended court for every day of the six-day certification and leave hearing. The court bench may have been warm, but it was surely not comfortable. The Bells have personally demonstrated a keen interest and engagement in the proceeding. They have retained experienced counsel who have the commitment and capacity to move this action forward.

[620] The defendants also assert that the plaintiffs' litigation plan does not set out a workable method of advancing the proceeding. Again, the elimination of the common law misrepresentation claim makes this objection less significant. The plaintiffs' counsel acknowledges that the litigation plan is a work in progress and would require amendment.

3. Conclusions on the Certification Motion

[621] For the foregoing reasons, I would have certified this action as a class proceeding on behalf of the class described above, to assert the cause of action for misrepresentation under Part XXIII.1 of the *Securities Act*. I would have approved common issues 8 to 10, inclusive, 14, 15 and 16. I would have approved the appointment of the plaintiffs as representatives of the class, subject to delivery of a satisfactory litigation plan.

[622] While I find that the plaintiffs have properly pleaded a cause of action for common law misrepresentation, I find that the claim is not suitable for certification because the issue of reliance cannot be addressed on a class-wide basis.

VIII. CONCLUSION

[623] I am obliged to dismiss the action as time-barred. Had I not been required to do so, I would have granted leave to pursue the statutory cause of action, and would have certified this action as a class proceeding for that purpose.

I would suggest that the parties attempt to resolve the issue of costs. If this cannot be done within 30 days, costs may be addressed by written submissions to me, care of Judges' Administration. The parties should agree on a timetable for the exchange of submissions, with submissions to be completed no more than 60 days from this date.

GR Strathy J

Strathy J.

Released: July 3, 2012

APPENDIX A: PROPOSED COMMON ISSUES

Common Law and Negligent Misrepresentation Issues

1. Did CIBC or the Individual Defendants, or any of them, owe a duty of care to Class Members?

2. Did CIBC or the Individual Defendants, or any of them, make representations, as set out in paragraphs 144 to 208 of the Second Amended Statement of Claim, concerning the overall extent of CIBC's CDO Exposure (as defined in the claim) and the extent of the impaired value of CIBC's CDO Portfolio and the hedges purchased to provide protection against the default of the RMBS and CDOs held directly and indirectly by CIBC during the Class Period, which were untrue, inaccurate or misleading? If so, what were the untrue, inaccurate or misleading representations, which Defendant(s) made the representations, when, where and how?

3. Did CIBC or the Individual Defendants, or any of them, make the representations described above negligently? If so, which Defendant(s) made the representations, when, where and how?

4. Were the representations described above publicly corrected? If so, when?

5. Did CIBC or the Individual Defendants, or any of them, make the representations intending that the Class Members rely upon them in acquiring CIBC shares?

6. Were the public markets on which CIBC securities traded during and immediately following the Class Period efficient markets? If so, did the trade prices of CIBC shares during the Class Period incorporate and reflect the misrepresentations?

7. If the answer to (6) is yes, did the purchase of CIBC shares by Class Members during the Class Period constitute reliance or inferred reliance upon the misrepresentations?

Statutory Claim Issues

8. Did some or all of the representations, as described above, made by CIBC and the Individual Defendants, or any of them, during the Class Period, constitute a misrepresentation within the meaning of section 138.3 of the *Securities Act*?

9. If the answer to (8) is yes, did the Individual Defendants, or any of them, authorize, permit, acquiesce in the release of any or all of the public oral statements or documents containing a misrepresentation within the meaning of section 138.3 of the *Securities Act*?

10. If the answer to (8) is yes, did CIBC or the Individual Defendants, or any of them, know that the non-core document as defined under the *Securities Act* or the public oral statement contained a misrepresentation, or deliberately fail to acquire knowledge that the non-core document or public oral statement contained the misrepresentation, or are guilty of gross misconduct in connection with the release of the non-core document or the making of the public oral statement that contained the misrepresentation?

11. Did CIBC or the Individual Defendants, or any of them, fail to make timely disclosure in relation to the material change(s) in CIBC's business, operations and capital relating to the extent of its CDO and CDS portfolio, and the extent of impairment to its CDO and CDS portfolio during the Class Period?

12. If the answer to (11) is yes, did the Individual Defendants or any of them, authorize, permit, or acquiesce in the failure to make timely disclosure?

13. If the answer to (11) is yes, did the Individual Defendants, or any of them, know, at the time that the failure to disclose first occurred, of the change and that the change was a material change, or deliberately failed to acquire knowledge of the change and that the change was a material change, or were, through action or failure to act, guilty of gross misconduct in connection with the failure to make timely disclosure?

14. If the answer to either (8) or (11) is yes, have the Defendants, or some of them, established a reasonable investigation or expert reliance defence under the *Securities Act*?

15. Can any or all of the Defendants rely on section 138.7 of the *Securities Act* in order to limit their liability in the prescribed statutory amounts? If CIBC can rely on section 138.7 of the *Securities Act*, what was CIBC's market capitalization for the purposes of determining the cap on its liability?

Damages Issues

16. What was the impact on CIBC's share prices, on a total and per share basis, of the partial disclosures of previously known but undisclosed material information relating to CIBC's CDS and CDO exposure, both hedged and unhedged and write downs on its impaired CDO Portfolio between November 9, 2007 and February 28, 2008, as set out in paragraphs 178 to 208 of the Second Fresh as Amended Statement of Claim.

17. If CIBC or the Individual Defendants, or any of them, are liable to the Class for negligent misrepresentation, what is the procedure for assessing damages?

18. Can the court assess damages in the aggregate, in whole or in part, for the Class? If so, what is the amount of the aggregate damage assessment and who should pay it to the Class?

19. Was the conduct of any of the Defendants such that they ought to pay punitive damages to the Class? If so, who should pay what amount(s), to whom and why?

Ancillary Issues

20. Should the Defendants, or any of them, pay the costs of administering and distributing any monetary judgment and/or the cost of determining eligibility and/or the individual issues? If so, who should pay what costs, why, in what amount and to what extent?

21. If the court determines that the Defendants are liable to the Class, and if the court considers that participation of individual Class Members is required to determine individual issues:

    (f) are any directions necessary?
    (g) should any special procedural steps be authorized?
    (h) should any special rules relating to admission of evidence and means of proof be made?
    (i) what directions, procedural steps or evidentiary rules ought to be given or authorized?

22. Should the Defendants, or any of them, pay prejudgment and post-judgment interest, at what annual interest rate, and should the interest be compounded interest?

CITATION: *Green v. Canadian Imperial Bank of Commerce*, 2012 ONSC 3637
COURT FILE NO.: CV-08-00359335-0000
DATE: 20120703

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

HOWARD GREEN and ANNE BELL

Plaintiffs/Applicants

- and -

CANADIAN IMPERIAL BANK OF COMMERCE, GERALD McCAUGHEY, TOM WOODS, BRIAN G. SHAW, KEN KILGOUR

Defendants/Respondents

REASONS: CERTIFICATION AND LEAVE UNDER S. 138.3 OF THE *SECURITIES ACT*

G.R. Strathy J.

Released: July 3, 2012