WHITHER COMMON LAW CLAIMS FOR SECONDARY MARKET MISREPRESENTATION?: AN ANALYSIS OF CERTIFICATION DECISIONS IN *MCCANN V CP SHIPS*, *SILVER V IMAX*, *MCKENNA V GAMMON GOLD*, AND *DOBBIE V ARCTIC GLACIER*

Andrea Laing and Robert Carson

Abstract: Part XXIII.1 of the Ontario *Securities Act* provides a statutory right of action for misrepresentations or omissions affecting the price of securities on the secondary market. Recent decisions have reached starkly contradictory conclusions to the question of whether common law misrepresentation claims — meaning claims that *do not* rely on the statutory right of action — may also be certified along with misrepresentation claims commenced pursuant to Part XXIII.1. These decisions provoke a reflection on the original reasons for the adoption of Part XXIII.1 and raise important questions about the past and future of the common law misrepresentation claims that Part XXIII.1 was intended to supplement, if not entirely supersede. The authors contend that Strathy J's reasons for declining certification of the common law misrepresentation claims in *McKenna v Gammon Gold* are consistent with Canadian jurisprudence before the enactment of Part XXIII.1 and should be preferred to the reasoning in *Silver v IMAX*, *McCann v CP Ships* and *Dobbie v Arctic Glacier*.

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A. INTRODUCTION

Part XXIII.1 of the Ontario *Securities Act*[1] (*OSA*) now provides a statutory right of action against "responsible issuers" and various related parties for misrepresentations or omissions affecting the price of securities on the secondary market. Recent decisions have reached starkly contradictory conclusions to the question of whether common law misrepresentation claims — meaning claims which *do not* rely on the statutory right of action — may also be certified along with misrepresentation claims commenced pursuant to Part XXIII.1. A review of the certification decisions of Rady J in *McCann v CP Ships*,[2] van Rensburg J in *Silver*

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1 *Securities Act*, RSO 1990, c S-5 [*OSA*].

2 *McCann v CP Ships Ltd*, [2009] OJ No 5182 (SCJ) [*CP Ships*].

v IMAX,[3] Strathy J in *McKenna v Gammon Gold*,[4] and Tausendfreund J in *Dobbie v Arctic Glacier*[5] — along with the subsequent decisions of Sachs and Corbett JJ denying leave to appeal the *McKenna* and *IMAX* decisions to the Divisional Court — provokes a reflection on the original reasons for the adoption of Part XXIII.1 and raises important questions about the past and future of the common law misrepresentation claims that the statute was intended to supplement, if not entirely supersede.[6]

The authors contend that Strathy J's reasons for declining certification of the common law misrepresentation claims in *McKenna* are consistent with Canadian jurisprudence before the enactment of Part XXIII.1 and should be preferred to the *IMAX* line of cases.[7] The introduction of statutory liability has not dismantled the barriers to the certification of common law misrepresentation claims, nor should it. The overriding impetus for the introduction of Part XXIII.1 was to overcome the impediment that the reliance component of the torts of fraudulent and negligent misrepresentation posed for the certification of such claims. The question of whether an individual plaintiff actually *relied* on the alleged misrepresentation or omission has generally been found by Ontario courts to raise complex individual issues that make such claims inappropriate for determination on a common basis.[8] By eliminating the hurdle posed

3 *Silver v IMAX Corp* (2009), 86 CPC (6th) 273 (Ont SCJ) [*IMAX*], leave to appeal to Div Ct refused, 2011 ONSC 1035 [*IMAX–Leave*].

4 *McKenna v Gammon Gold Inc*, 2010 ONSC 1591 [*McKenna*], leave to appeal to Div Ct allowed in part, 2010 ONSC 4068 [*McKenna–Leave*]. Justice Sachs granted leave to appeal Strathy J's decision with respect to the conspiracy claim, but denied leave to appeal all other aspects, including Strathy J's refusal to certify a common law misrepresentation claim.

5 *Dobbie v Arctic Glacier Income Fund*, 2011 ONSC 25 [*Arctic Glacier*].

6 Section 138.13 of the *OSA* provides: "The right of action for damages and the defences to an action under section 138.3 are in addition to and, and without derogation from, any other rights or defences the plaintiff may have in an action brought otherwise than under this Part." While this provision is often cited as a basis for the certification of common law misrepresentation claims, it begs the question of what the common law requires of plaintiffs to misrepresentation claims absent the availability of Part XXIIII.1.

7 For ease of reference, we refer to *IMAX*, *CP Ships*, and *Arctic Glacier* certification decisions as the "*IMAX* line of cases."

8 The US "fraud-on-the-market" doctrine — which posits that investors in an efficient market may reasonably rely on the integrity of the market price of securities — has been accepted by US courts. US plaintiffs may benefit from a presumption that they relied on the market price of a security as reflecting all public information, including material misrepresentations, rather than on any specific representation. Thus, the doctrine has been used to overcome the hurdle posed to certification by the reliance requirement. The fraud-on-the-

by the reliance component of the common law tort, Part XXIII.1 was intended to empower investors by facilitating certification.[9]

Notwithstanding the significant incentive that the new legislation presents for investors to pursue securities class actions, it also provides important safeguards to protect defendants against the potentially devastating liabilities that could result from such proceedings. Perhaps the most important measures adopted to counterbalance the elimination of the reliance requirement are the liability caps that limit the amount of damages plaintiffs may ultimately recover.[10]

There may be a number of explanations for the current tendency of class action plaintiffs to pursue common law claims in tandem with statutory claims under Part XXIII.1, but one of them is surely to maximize

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market doctrine has supported the certification of class actions brought under the statutory cause of action in Rule 10b-5, promulgated under the US *Securities Exchange Act of 1934*: *Basic v Levinson*, 485 US 224, 245-47 (1998) [*Basic*]; *Hevesi v Citigroups, Inc*, 366 F 3d 70, 77 (2d Cir 2004) [*Hevesi*]. However, this is considered to be a rebuttable presumption: *Basic* at 248, *In re Vivendi Universal SA Securities Litigation*, 2011 WL 590915 at *57–59 (SDNY) [*Vivendi*]. Plaintiffs' attempts to introduce the fraud-on-the-market doctrine into Canadian common law jurisdictions have been rejected by our courts. See *Carom v Bre-X Minerals Ltd* (1998), 41 OR (3d) 780 (SCJ) [*Bre-X–Pleadings*]; *Boulanger v Johnson & Johnson Corp*, [2002] OJ No 1075 at paras 12–13 (SCJ); *Menegon v Philip Services Corp* (2003), 167 OAC 277 at para 14 (CA); *Serhan v Johnson & Johnson* (2004), 72 OR (3d) 296 at para 57 [*Serhan*]; *Lawrence v Atlas Cold Storage Holdings Inc* (2006), 34 CPC (6th) 41 at para 92 (Ont SCJ) [*Lawrence*]; *Deep v MD Management*, [2007] OJ No 2392 at para 20 (SCJ); and *Wuttune v Merck Frosst Canada Ltd*, [2007] 4 WWR 309 at para 58 (Sask QB).

9 See Bradley Davis, "Bill 198 Will Bring a New Era in Class Action Litigation in 2006," *The Lawyers Weekly* 25:22 (14 October 2005); Patrick J O'Kelly, "Bill 198 Offers Remedy for Secondary Stock Purchasers," *The Lawyers Weekly* 24:35 (28 January 2005).

10 Section 138.7 limits the damages payable by a defendant when the actual damages assessed by the courts are greater than the liability caps listed under the section 138.1 definition of "liability limit." For example, a responsible issuer or a non-individual influential person is held to a liability limit that is the greater of $1 million or 5 percent of the issuer's market capitalization (as such term is defined in the regulations).

Subsection 138.7(2) provides that the liability caps do not apply to a

> person or company, other than the responsible issuer, if the plaintiff proves that the person or company authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure, or influenced the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure.

their potential damages. Although, to date, no action commenced under Part XXIII.1 has reached trial, when that day comes it will no doubt be argued that common law damages significantly exceed the damages caps imposed by the *OSA*. However, the willingness to certify common law misrepresentation claims that has been demonstrated by motions-level judges in a few recent decisions has the potential to subvert the careful balancing of the rights of plaintiffs and defendants that was intended to be provided by the drafters of Part XXIII.1. Ultimately, attempts to certify common law misrepresentation claims alongside statutory claims amount to a demand that plaintiff investors be allowed to "have their cake and eat it too." Section 138.13 of the *OSA* may be fairly interpreted as preserving common law rights of action and is relied upon by some class counsel in justification of the continued pursuit of the certification of common law misrepresentation claims.[11] However, if Ontario's common law did not provide investors with a cause of action for secondary market misrepresentation that was certifiable *before* the enactment of Part XXIII.1, section 138.13 cannot bolster their position.

In light of the divergent results in recent cases considering the question, and notwithstanding the denial of leave to appeal to the Divisional Court in the *IMAX* and *McKenna* cases (which appear to reach contradictory conclusions), it would be appropriate for the future of common law claims in the context of secondary market securities class actions in Ontario to ultimately be considered by our appellate courts. One of the benefits provided by Part XXIII.1 is the "bounding" nature of the liability limits, meaning that these limits allow plaintiffs and defendants alike to reach meaningful, objective estimates of potential liability at a preliminary stage of the proceedings and, where appropriate, enter into constructive early settlement discussions. There are no clear rules for estimating common law damages for misrepresentations affecting the price of securities in Canada,[12] and as long as common law remedies

11 See above note 6.

12 There has never been a damages award in a secondary market class action in Canada under Part XXIII.1 or at common law. The only securities class action award was in *Kerr v Danier Leather Inc* (2004), 46 BLR (3d) 167 (Ont SCJ). However, the damages in that case resulted from primary market claims which arguably should be calculated differently than damages arising from secondary market claims: see Section F(2) below. In any event, the trial decision was overturned on questions of liability by the Court of Appeal: (2005), 77 OR (3d) 321. The Court of Appeal decision was upheld by the Supreme Court of Canada: [2007] 3 SCR 331. Neither appellate court reviewed the damages methodology used by the trial judge.

remain "on the table" in association with potentially certifiable claims, they will add uncertainty to the valuation of securities class actions, impeding early settlement and increasing the cost, duration and complexity of litigation in this area.

B. THE ORIGINS OF STATUTORY CIVIL LIABILITY FOR SECONDARY MARKET MISREPRESENTATIONS

Before Part XXIII.1 came into force in 2005,[13] it was widely accepted that Canadian investors did not have a viable recourse for misrepresentations affecting the price of securities on the secondary market. For example, a TSX committee headed by Thomas Allen observed in 1997:

> The remedies available to investors in secondary trading markets who are injured by misleading disclosure are so difficult to pursue and establish that they are as a practical matter largely academic.[14]

In 2000, the Canadian Securities Administrators likewise concluded that secondary market investors "have no effective redress . . . through private rights of action."[15] The impediment is that the tort of negligent misrepresentation is generally unsuitable for certification in securities cases because it requires investors to prove that they relied on the misrepresentation. This is an inherently individual issue that requires complex inquiries into each investor's investment decision making.

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13 Part XXIII.1 was enacted in Bill 198, *Keeping the Promise for a Strong Economy Act (Budget Measures), 2002*, 3rd Sess, 37th Leg, Ontario, 2002 (assented to 9 December 2002) [Bill 198].

14 The Toronto Stock Exchange Committee on Corporate Disclosure, *Responsible Corporate Disclosure: A Search for Balance — Final Report* (Toronto: TSX, 1997) [Allen Committee *Report*].

15 CSA Notice 53-302 (2000), 23 OSCB 7383 at 7388 [CSA Notice 53-302]. The Canadian Securities Administrators (CSA) is a forum for Canada's thirteen securities regulators to coordinate and harmonize regulation of Canadian capital markets. In CSA Notice 53-302, the CSA placed significant emphasis on Winkler CJ's rejection of the fraud-on-the-market doctrine, which is discussed below in Section D(1)(b). The CSA explained (at 7392): "In general, claims which require proof of individual reliance are unlikely to be certified as class actions under Ontario class proceedings legislation . . . . The CSA view [Winkler CJ's decision rejecting deemed reliance] as being significant because it illustrates the limitations inherent in class actions in the context of securities litigation based on the common law."

In contrast, the Ontario legislature had already established a statutory civil liability regime for the primary market, which overcame the same hurdle by deeming investors to have relied on the representation at issue.[16] Further, since the 1980s, investors had been certifying secondary market misrepresentation cases in the United States on the basis of the fraud-on-the-market doctrine.[17]

Several groups had proposed statutory civil liability for secondary market misrepresentations in the decades before the enactment of Part XXIII.1, beginning with a federal task force in 1979[18] and the Ontario Securities Commission in 1984.[19] Significant progress toward legislative reform did not begin, however, until the Allen Committee released its report in 1997[20] and the CSA released draft legislation in 1998.[21]

C. POLICY OBJECTIVES OF THE SECONDARY MARKET STATUTORY CIVIL LIABILITY REGIME: THE BALANCING OF INTERESTS

In Part XXIII.1, the legislature enacted a statutory right of action intended to facilitate meritorious actions by eliminating the traditional requirement that individual plaintiffs demonstrate that they actually relied on the misrepresentation or omission at issue. But the legislature, the Allen Committee, and the CSA were not prepared to expose Canadian issuers without corresponding protections.[22] Thus, Part XXIII.1 was designed

16 The statutory civil liability provisions for the primary securities market were promulgated in *An Act to Revise The Securities Act*, SO 1978, c 47, s 126. Those provisions, as amended, are currently set out at s 130 of the *OSA*. The existence of statutory civil liability in the primary, but not secondary market, was seen as particularly striking in light of the fact that primary issuances only made up about 6 percent of capital market trading: CSA Notice 53-302, above note 15 at 7385.

17 The doctrine is discussed at note 8, above, and in more detail below in Section D(1).

18 Philip Anisman, J Howard, W Grover, & John Peter Williamson, *Proposals for a Securities Market Law of Canada* (Ottawa: Consumer and Corporate Affairs Canada, 1979).

19 *Civil Liability for Continuous Disclosure Documents Filed under the Securities Act — Request for Comments* (1984), 7 OSCB 4910.

20 Allen Committee *Report*, above note 14.

21 *Request for Comments* (1998), 21 OSCB 3367.

22 In particular, the Allen Committee was concerned that statutory civil liability could open the door to US-style "strike suits": meritless cases launched to pressure defendants into paying settlements to avoid threatening litigation. However, the Allen Committee believed that Canadian procedural rules could

to "achieve a reasonable balance between investors on the one hand and issuers on the other."[23] The legislature tempered the powerful new statutory right of action with several counterbalances, including:

a) a leave requirement that gives the court a "gate-keeping function" to screen clearly unmeritorious claims before they are commenced;[24]
b) a "loser pays" cost rule that is more onerous than the relatively plaintiff-friendly costs provisions in the *Class Proceedings Act, 1992*;[25]
c) a limitation period of three years from release of the misrepresentation (rather than the date of a corrective disclosure);[26] and
d) caps on the damages available under the statutory cause of action, which can severely restrict the potential recovery of the class in some circumstances.[27]

While all of these measures are important, the damages caps undoubtedly provide the most significant protection for Canadian issuers and their directors, officers, and shareholders against potentially unlimited liability. Even where a plaintiff establishes liability, the damages caps limit that liability to the *lesser* of the aggregate damages and the liability limits, which vary by defendant.[28] For example:

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prevent the flood of strike suits that the United States experienced: Allen Committee *Report*, above note 14 at 26 and 29.

23 *Ibid* at 40.

24 *OSA*, above note 1 at s 138.8. This screening mechanism imposes a threshold requirement that potential plaintiffs prove that there is merit to their claims and that they are bringing them in good faith; see *Silver v IMAX*, [2009] OJ No. 5573 (SCJ); *Arctic Glacier*, above note 5 at paras 105–79; Andrea Laing & Brian Donnelly, "*Silver v. IMAX* and *Ainslie v. CV Technologies*: What Has Been Left Out of the Leave Requirement" (2009) 5 Can Class Action Rev 180.

25 *OSA*, *ibid*, s 138.11. The loser pays rule applies despite section 31(1) of the *Class Proceedings Act, 1992*, SO 1992, c 6 (*CPA*), which may wholly or partially absolve an unsuccessful representative plaintiff from the obligation to pay costs if the proceeding "was a test case, raised a novel point of law, or involved a matter of public interest."

26 *OSA*, *ibid*, s 138.14. In some instances, this may result in a claim being statute-barred earlier than it would be if the limitation period were determined in accordance with the "discoverability" principles under the *Limitations Act, 2002*, SO 2002, c 24, Sch B.

27 *OSA*, *ibid*, s 138.7.

28 *Ibid*, s 138.7.

- the liability limits for a *responsible issuer* are the greater of $1 million and 5 percent of the issuer's market capitalization;
- for a *director or officer* of a responsible issuer, the liability limit is the greater of $25,000 and 50 percent of the director or officer's aggregate compensation from the issuer and its affiliates; and
- for an *expert*, the liability limit is the greater of $1 million and the revenue that the expert and the affiliates of the expert received from the issuer and its affiliates during the twelve months preceding the misrepresentation.[29]

Notably, if the plaintiff proves that a statement or omission was fraudulent — that is, a person knowingly authorized, permitted, or acquiesced in the making of the misrepresentation or in a failure to make timely disclosure — the liability limits will not apply.[30] This is circumscribed, however, by an exception for the responsible issuer, whose damages will always be capped at the greater of $1 million or 5 percent of the issuer's market capitalization. This exception for the issuer recognizes the detrimental effect that class actions can have on current shareholders of Canadian issuers, who may be unfairly and disproportionately penalized by large payouts to class claimants.

The damages caps play two important roles. First, and most obviously, they reduce the amount of potential damages. Both the CSA and Allen Committee stressed that the damages caps are necessary "to strike a fair balance between the interests of responsible issuers and plaintiffs":

> Whether the primary purpose of civil liability is deterrence or compensation, it is necessary to address the potential liability that would likely result from conferring a cause of action on public investors which is based on a negligence standard and in which reliance on the completeness and accuracy of an issuer's disclosure is presumed. *If proof of individual reliance is not required, the liability of issuers, their directors, officers and other participants might be unfairly excessive, as it would be limited only by the number of securities traded during the period of a disclosure violation. Such draconian consequences should be avoided, but only to the extent that any limits imposed are demonstrably justifiable.*[31]

The damages formula in section 138.5 of Part XXIII.1 calculates damages in relation to the decline in the market price of the securities at issue

29 *Ibid*, s 138.1 ("liability limit").

30 *Ibid*, s 138.7(2).

31 Allen Committee *Report*, above note 14 at 100–1 [emphasis added]. See also CSA Notice 53-302, above note 15 at 7391.

in the ten trading days following the correction of a misrepresentation or omission.[32] Although this decline may also be attributable to factors unrelated to the correction, defendants are deemed liable for the entire drop, subject to their ability to prove otherwise.[33] In response to the concern about "draconian consequences" raised by the Allen Committee, the damages caps mitigate against the potentially enormous damages awards that could be payable, even in respect of relatively minor misstatements, after the application of section 138.5 when there is a strong market reaction to a corrective disclosure.

A second function of the damages caps, the importance of which should not be underestimated, is that, in conjunction with section 138.5, they allow plaintiffs and defendants to develop realistic estimates of potential damages in claims that are exclusively pursued under Part XXIII.1. While this is not to say that plaintiffs and defendants will arrive at the same or even similar estimates,[34] the damages caps significantly narrow the gap between what a plaintiff might reasonably expect to recover and what a defendant might reasonably expect to pay. This facilitates constructive early settlement discussions.

However, as explained below, the *IMAX* decision detracts from this increased predictability by suggesting to plaintiffs that common law claims may also be pursued to trial. As is developed in Section F(2), there is no basis for concluding that damages for common law claims should be calculated in the same or even a remotely similar manner to that dictated by the damages formula in Part XXIII.1. Indeed, as questions of reliance are inextricably tied to elements of causation and damages when tort-based claims of misrepresentation are advanced, damages — like the question of reliance — may need to be resolved as an individual issue. This important consideration has not been addressed in recent decisions that have certified common law claims for secondary market misrepresentation, although it has the potential to derail the common issues trials of combined statutory and common law misrepresentation claims. In light of this and other complexities associated with the determination of individual issues arising from common law misrepresentation claims, it is unclear why plaintiffs who may benefit from the relatively straightforward resolution of issues of liability and damages as framed by the

32 *OSA*, above note 1 at s 138.5.

33 *Ibid*, s 138.5(3).

34 There is still considerable room for disagreement as to how to interpret and apply the damages formulas in s 138.5. Experts will likely play an important role in evaluating damages both in settlement contexts and at trial.

provisions of Part XXIII.1 would wish to participate in lengthy and complex individual determinations of questions of reliance, causation, and damages (presumably at their own expense) in the hopes of increasing their recoveries over what would be available to them under Part XXIII.1. While, on a superficial first look, adding common law claims to a statement of claim may appear to maximize the potential recovery for the proposed class, the realities associated with litigating such claims may actually make recovery for individual plaintiffs more costly, time consuming, and remote.

D. COMMON LAW MISREPRESENTATION CLAIMS BEFORE THE ENACTMENT OF PART XXIII.1 AND THE LEGACY OF *BRE-X*

Plaintiffs in Canada and the United States traditionally faced the same problem: the need to prove reliance made the certification of secondary market misrepresentation claims almost impossible. In the United States, however, courts came to accept the fraud-on-the-market doctrine to serve as a proxy for the requirement that actual reliance be demonstrated in the case of each individual plaintiff. To understand the conflict between *McKenna*, on one hand, and *IMAX* and *Arctic Glacier* on the other, it is necessary to understand the doctrine, and the reasons that Ontario courts have rejected it.

1) Unsuccessful Attempts to Import the Fraud-on-the-Market Doctrine and Efficient Market Hypothesis into Ontario Law

a) The US Experience

US plaintiffs generally bring securities class actions under Rule 10b-5, promulgated by the Securities and Exchange Commission under the Federal S*ecurities Exchange Act of 1934*, which seeks to curb fraudulent behaviour in securities markets:

> **Rule 10b-5: Employment of Manipulative and Deceptive Practices**
>
> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,

> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.[35]

To succeed on a Rule 10b-5 action, a plaintiff must establish materiality, *scienter*,[36] loss causation, and, most importantly for our analysis, reliance. Until the 1980s, plaintiffs were generally unable to certify Rule 10b-5 class actions because individual issues of reliance were typically found to "predominate" over the common issues, thus preventing satisfaction of a central element of the test for certification.[37] In response, US district and appellate courts developed the fraud-on-the-market doctrine, which the US Supreme Court ultimately endorsed in *Basic Inc v Levinson*:

> The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the company and its business . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements . . . the causal connection between the plaintiffs' purchase of stock in such a case is no less significant than in the case of direct reliance on misrepresentations.[38]

In essence, the doctrine, which posits that investors in an efficient securities market reasonably rely on the integrity of the market price of securities as reflecting all available public information — including material

35 Although neither s 10(b) of the *Securities Exchange Act of 1934* nor Rule 10b-5 expressly provides a civil cause of action, US courts have consistently inferred the existence of one. As the US Supreme Court has recognized, the cause of action is "simply beyond peradventure": *Herman & MacLean v Huddleston*, 459 US 375, 379 (1983).

36 *Scienter* is a mental state that includes an intent to deceive, manipulate, or defraud: *Ernst & Ernst v Hochfelder*, 425 US 185 (1976). Federal courts of appeal have ruled that recklessness may also constitute *scienter*: see discussion in *Greebel v FTP Software, Inc*, 194 F 3d 185 (1st Cir 1999).

37 See *Federal Rules of Civil Procedure*, Rule 23(b)(3): "[A class action may be maintained if Rule 23(a) is satisfied and if:] the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy."

38 *Basic*, above note 8 at 241–42.

misrepresentations or omissions — shifts the requirement that the plaintiffs demonstrate that they relied on the misrepresentation to a rebuttable presumption that the plaintiffs did in fact rely on the market price.[39]

Plaintiffs in US proceedings cannot simply invoke the doctrine; rather, they have the onus of proving that: (1) the defendant made public misrepresentations; (2) the misrepresentations were material; (3) the shares traded on an efficient market; (4) the misrepresentations would induce a reasonable investor to misjudge the value of the shares; and (5) the plaintiff traded the shares between the making of the misrepresentations and the correction.[40]

b) The Ontario Experience: Chief Justice Winkler's Rejection of the Fraud-On-The- Market Doctrine in *Bre-X*

Bre-X marks the first attempt by a plaintiff to import the fraud-on-the-market doctrine into Ontario.[41] The plaintiffs were shareholders and former shareholders of Bre-X, a company involved in exploring, acquiring, and developing gold mining properties. In the mid-1990s, the price of Bre-X shares rose dramatically on a series of announcements claiming the discovery of substantial gold deposits in the Busang area of Indonesia. The price plummeted, however, on independent reports that the gold samples had been "salted." The plaintiffs commenced a proposed class action claiming both negligent and fraudulent misrepresentation. Before certification, they moved to amend their pleadings to add claims premised on the fraud-on-the-market doctrine:

> A. The markets are efficient. The day-to-day price of Bre-X shares represented all of the information . . . disseminated by [the defendants].

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39 *Ibid* at 245–47; *Hevesi*, above note 8 at 77. It is well settled that this presumption is rebuttable, both on a class-wide basis and on an individual basis: *Basic*, *ibid* at 248–49; *Vivendi*, above note 8 at *57–59. In *Vivendi*, after a common issues trial in which the jury returned a verdict that the defendant issuer, Vivendi, had violated s 10(b), the plaintiffs moved for entry of a final judgment. The District Court for the Southern District of New York held, however, that the entry of judgment was premature because the defendants were still entitled to rebut the presumption of reliance of each class member on an individual basis.

40 *Basic*, *ibid* at 248, n 27.

41 *Bre-X–Pleadings*, above note 8.

> B. The purchase or holding of shares of Bre-X by the Class Members was, in effect, an act of reliance on each and every statement made by [the defendants].[42]

Justice Winkler (as he then was, now Winkler CJ) dismissed the motion to amend, applying the rule that the court should refuse an amendment that is not tenable in law and holding that the assertion of the fraud-on-the-market doctrine was certain to fail in Ontario.[43] Although he gave many reasons, the following are most relevant for understanding the important distinction between *McKenna* and the *IMAX* line of decisions. First, the Supreme Court of Canada has consistently held that actual reliance is an essential element of negligent misrepresentation.[44] Thus, to adopt a presumption of fraud-on-the-market would redefine the tort:

> The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. *In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance in either tort. In the context of the torts of fraudulent and negligent misrepresentation a presumption of the nature advocated for by the plaintiffs does not exist in Canadian common law. Indeed, to import such a presumption would amount to a redefinition of the torts themselves.*[45]

Second, US courts developed the doctrine in the unique statutory context of Rule 10b-5 and have generally rejected attempts to advance the doctrine in the context of common law misrepresentation claims.[46] Third, the doctrine applies to fraudulent — not merely negligent — behaviour:

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42 As discussed below, these are effectively the same issues that van Rensburg J later certified as common issues in *IMAX*.

43 *Bre-X–Pleadings*, above note 8 at 784–85, citing *Keneber Inc v Midland (Town)* (1994), 16 OR (3d) 753 (Gen Div); *Atlantic Steel Industries Inc v CIGNA Insurance Co Of Canada* (1997), 33 OR (3d) 12 (Gen Div); and *Hunt v Carey Canada Inc*, [1990] 2 SCR 959.

44 Chief Justice Winkler relied on *Parna v G & S Properties Ltd*, [1971] SCR 306; *Queen v Cognos Inc*, [1993] 1 SCR 87 [*Cognos*]; and *Hercules Management Ltd v Ernst & Young*, [1997] 2 SCR 165.

45 *Bre-X–Pleadings*, above note 8 at 794 [emphasis added].

46 *Ibid* at 793 and 795. Chief Justice Winkler relied on the US Supreme Court's statement in *Basic* that Rule 10b-5 actions are "distinct from common-law deceit and misrepresentation claims" and "Rule 10b-5's reliance requirement must encompass these differences," and on *Mirkin v Wasserman*, in which the

> Furthermore, the s. 10(b) and rule 10b-5 legislative objectives have been interpreted as providing a cause of action based on fraudulent behaviour . . . . The plaintiffs seek to obtain the benefit of an application of the theory and the resulting presumption to all of the pertinent causes of action as alleged, even though fraud is not an element of all such causes of action [i.e. negligent misrepresentation].
>
> . . .
>
> More so, the plaintiffs seek to apply the theory to common law causes of action, to which it would not be applicable in the United States, and in a wholesale fashion, without the restrictions which circumscribe it there. Simply put, the proposition advanced is ill-conceived.[47]

Bre-X therefore represents a wholesale rejection of the fraud-on-the-market doctrine in Ontario.

c) The Unique Basis for Certification of the Misrepresentation Claims in *Bre-X*

Although Winkler CJ refused the amendments associated with the fraud-on-the-market doctrine in *Bre-X*, he ultimately certified claims for fraudulent misrepresentation in the case.[48] Further, on appeal, the Ontario Court of Appeal certified the claim for negligent misrepresentation.[49] The certification decisions in *Bre-X* have controversial progeny in the form of subsequent cases dealing with the certification of reliance-based claims, including van Rensburg J's certification decision in *IMAX* and the decisions denying leave to appeal to the Divisional Court in both *IMAX* and *McKenna*. They therefore warrant a careful review.

California Supreme Court held that it could not apply the doctrine in common law actions for negligent misrepresentation: *Ibid* at 789.

47 *Ibid* at 793–94.

48 *Carom v Bre-X Minerals Ltd* (1999), 44 OR (3d) 173 (SCJ) [*Bre-X–Certification (SCJ)*].

49 *Carom v Bre-X Minerals Ltd* (2000), 51 OR (3d) 236 (CA) [*Bre-X–Certification (CA)*]. The action is currently progressing toward trial against several of the individual defendants. Examinations for discovery were held in 2009 and 2010; see online: www.brexclassaction.com. Given the recognition of Winkler CJ and the Court of Appeal that the case raises issues that will require individual determination, it will be interesting to see how the litigation ultimately unfolds.

i) Chief Justice Winkler Denies Certification of the Negligent Misrepresentation Claim

At first instance, Winkler CJ refused to certify the negligent misrepresentation claim because reliance could not be determined as a common issue and, accordingly, the individual trials that would be required to determine the issues of reliance, causation, and damages would be "complex and lengthy":

> The determination of reliance will require an inquiry into the investor–investment advisor relationship, the investor profile, the class member's awareness of any statements made by the defendants, any additional information concerning Bre-X of which the class member may have been apprised, the source of any such additional information, the specific trading activity of the class member and its correlation to the representations, the class member's knowledge of the business or reputation of the defendants and the class member's objectives in purchasing Bre-X stock. It is not reasonably foreseeable that these issues, and any others which may arise in the individual proceedings, will be decided in a brief inquiry.[50]

He did certify the fraudulent misrepresentation claim, however, on the basis that all of the alleged misrepresentations were "tainted" by a single fraudulent representation that Bre-X had the rights to gold in mineable quantities in the Busang.[51] Thus, he held, this allegation raised an important issue common to all claims, despite the fact that resolution of the fraudulent misrepresentation claim would necessarily require individual determinations, including "analysis and characterization of each individual representation, the plaintiff's perception of the representation and the circumstances in which it was made."[52] Finally, because the trial judge would ultimately be required to hear the common issues in respect of a claim that was advanced in conspiracy, it would promote judicial economy to marry the fraudulent misrepresentation claims in a common issues trial, "*even though the plaintiffs may still have to engage in lengthy individual trials.*"[53]

Given Winkler CJ's recognition that individual determinations could not be avoided, it is not clear why the need to conduct them would prevent certification of the negligent misrepresentation claims, but not the

50 *Bre-X–Certification (SCJ)*, above note 48 at paras 78, 97, 179, and 288.
51 *Ibid* at para 72.
52 *Ibid* at para 78.
53 *Ibid* at para 98.

fraudulent misrepresentation claims. Chief Justice Winkler appears to have been influenced by the complexity of the individual inquiries that would arise from determinations of the negligence claims in the case before him relative to the simplicity of determining whether all shareholders were commonly affected by a single, overriding fraudulent representation that there was a substantial gold deposit in the Busang. The negligent misrepresentation claim would raise a myriad of complex issues, including 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 and the transaction.[54] This, in turn, could require thousands of individual determinations necessitating, in many cases, significant documentary and oral discovery, examination and cross-examination of multiple witnesses, and even expert evidence. In contrast, Winkler CJ may have been persuaded that, notwithstanding the fact that the question would need to be individually resolved, it may not have been such a complex endeavour to determine whether shareholders all commonly relied on the fraudulent representation that Bre-X was what it claimed to be — a mining company with a stake in a substantial gold deposit. Indeed, it might be a credible conclusion that most, if not all, investors believed at least this much when they purchased their Bre-X shares, regardless of the source of their information.

ii) The Ontario Court of Appeal's Unique Basis for Certification of Bre-X

The Court of Appeal's decision in *Bre-X* turns on the specific issues that the parties brought forward on appeal and, accordingly, the decision has limited application to other secondary market misrepresentation cases. Although the plaintiffs appealed the refusal to certify the negligent misrepresentation claim, the defendants did not appeal certification of the fraudulent misrepresentation claim. Justice MacPherson, writing for the unanimous court, emphasized that reliance is a requisite element of misrepresentation claims regardless of whether it is alleged that the misrepresentation was fraudulent or negligent. Accordingly, individual trials would be necessary to determine issues of reliance arising from the fraud claims. Since the fraudulent misrepresentation claim had already been certified and this determination was not being appealed by the defendants, the need for individual inquiries should not prevent certification of

54 *Ibid* at para 97.

the negligent misrepresentation claim either. Indeed, this would promote judicial efficiency, one of the objectives of the *CPA*:

> Third, I observe that the plaintiffs and defendants accept that detrimental reliance is an element of both the torts of fraudulent and negligent misrepresentation. *Moreover, they agree that the reliance component will have to be dealt with at individual trials on the issue of fraudulent misrepresentation. Yet the defendants do not use this two-track scenario as a basis for challenging, by way of appeal or cross-appeal, the certification of the claim in fraudulent misrepresentation*. In my view, this silence tells in favour of moving the negligent misrepresentation claim onto the same unchallenged track on which the fraudulent misrepresentation claim is already situated. [55]

The Court of Appeal's reasons suggest, however, that the outcome might well have been different had the defendants used the "two track" scenario that resulted from the distinction drawn between the fraud and negligence claims in the court below as a basis to appeal the certification of the fraud claims:

> Given the accepted definitions of the torts of fraudulent misrepresentation and negligent misrepresentation, I can see no logical or principled basis for treating them differently on the question of certification. I could understand the order certifying, or refusing to certify, both claims. I do not, however, understand why opposite orders were considered appropriate for the two claims.
>
> . . .
>
> Given this reality, I see no principled basis for treating the claim in negligent misrepresentation differently . . . . In short, the complexity that exists with respect to determining the defendants' states of mind and conduct is inherent in both torts. It follows that certification should either be granted or withheld for both claims. [56]

Thus, the basis for certification in *Bre-X* should be limited to its unique facts and particular procedural context, including the allegation that a common and fundamental fraud tainted each representation, the defendants' decision not to appeal certification of the fraud claims, and the Court of Appeal's implied suggestion that they should have.

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55 *Bre-X–Certification (CA)*, above note 49 at para 57 [emphasis added].
56 *Ibid* at paras 42 and 47.

iii) The Confusing Legacy of the Bre-X *Certification Decisions*

Reliance on the case as support for the proposition that common law claims premised on a single misrepresentation are amenable to certification has led to confusing determinations in subsequent cases, including *IMAX* and *Arctic Glacier*. It is somewhat ironic that Winkler CJ was the first judge in Ontario to rule that the "fraud-on-the-market" doctrine cannot be used to justify the certification of common law securities misrepresentation cases in the province, but that his subsequent certification decision in *Bre-X* has been used as a basis to do just that.

As is developed more extensively in Section D(1)(c), the distinction that Winkler CJ drew between the fraudulent and negligent misrepresentation claims on the basis of the facts and allegations in *Bre-X* has led to great uncertainty in the context of motions to certify common law claims for misrepresentations affecting the price of securities.[57] However, it does not and should not stand for a general rule that common law claims premised on a single alleged misrepresentation, or several alleged misrepresentations with a "common import," are amenable to certification, as some have suggested.[58]

Most importantly, it does not stand for the proposition that issues of reliance, causation, and damages do not need to be resolved through individual determinations when common law misrepresentation claims are advanced — indeed, Winkler CJ expressly found in *Bre-X*, and the Court of Appeal accepted,[59] that these were individual and not common issues which would necessarily be left to be resolved after a common

57 For example, in denying leave to appeal, Sachs J relied on this distinction to distinguish *IMAX* and *McKenna*: *McKenna–Leave*, above note 4 at para 37. In *IMAX*, above note 3 at para 177, van Rensburg J held that the claims were amenable to certification because the claims

> concern a single defined [r]epresentation that is alleged to have occurred in each of the February and March press releases and in the Company's Form 10-K. This is not a case where numerous different misrepresentations are alleged; rather, the plaintiffs allege a single misrepresentation, that was communicated to the public in different ways. The fact that class members may have received the misrepresentation in different ways, or may not have relied on the misrepresentation, is not relevant to whether [certain] issues . . . would be common to the class.

58 See *IMAX*, *ibid* at para 177; *IMAX–Leave*, above note 3 at para 54; *McKenna–Leave*, *ibid* at para 37; *Arctic Glacier*, above note 5 at para 227.

59 The parties agreed on appeal that "the reliance component will have to be dealt with at individual trials": *Bre-X–Certification (CA)*, above note 49 at para 57. Further, the Court of Appeal explicitly agreed with Winkler CJ's analysis that: "[T]he plaintiffs may still have to engage in lengthy individual trials to determine the actual liability of the defendants on the claims" (at para 56).

issues trial.[60] The significance of this for individual shareholders participating in a class action advancing common law misrepresentation claims should not be overlooked. Assuming that common issues were resolved in favour of the class, it would be left to individual plaintiffs to litigate these issues in individual hearings, presumably at their own expense, and they would have to win before they could recover any damages for the common law claims. Thus, simply making it easy to certify common law misrepresentation claims will not make it easy for investors to litigate such claims to conclusion. When the shares of the issuer are widely held and multitudinous claims are advanced for relatively small investment losses, it will be difficult for individual members of the plaintiff class to obtain any advantage by pursuing common law claims when, by comparison, proceedings under Part XXIII.1 will require next to nothing of them in terms of time, effort, or money.

2) *Mondor* and *Lawrence* Likewise Do Not Permit an Inference of Class-Wide Reliance

Notwithstanding that Winkler CJ unequivocally rejected the fraud-on-the-market doctrine in *Bre-X*, plaintiffs continue to advance arguments that courts can or should "infer" class-wide reliance from the facts of the case on the premise that plaintiffs relied on the integrity of the market price of the securities. It is difficult to understand how such arguments differ from an argument that the fraud-on-the-market doctrine should be adopted in Ontario.

Arguments that class-wide reliance should be inferred as a matter of fact were indirectly considered in two motions to strike: *Mondor v Fisherman*[61] and *Lawrence v Atlas Cold Storage Holdings Inc.*[62] These de-

60 Further, this presumption of reliance is rebuttable, both on a class-wide basis and on an individual basis. As the District Court for the Southern District of New York recently explained in *Vivendi*, above note 8: "[C]ertain means of rebutting the presumption of reliance require an individualized inquiry into the buying and selling decisions of particular class members . . . . Logically, any attempt to rebut the presumption of reliance on such grounds would call for separate inquiries into the individual circumstances of particular class members." Thus, even if reliance is presumed under the fraud-on-the-market doctrine, individual plaintiffs may be subjected to individual issues trials. In contrast, Part XXIII.1 benefits plaintiffs because it does not appear to leave any scope for defendants to rebut reliance in the context of individual hearings.

61 (2001), 18 BLR (3d) 260 (Ont SCJ) [*Mondor*].

62 *Lawrence*, above note 8.

cisions warrant consideration because they were interpreted and used very differently in *IMAX* and *McKenna*. While van Rensburg J relied on the cases as support for the certification of the common law claims in *IMAX*,[63] Strathy J relied on them as a basis for denying certification.[64] The authors contend that Strathy J's approach is correct; neither *Mondor* nor *Lawrence* support the certification of common law misrepresentation claims through the inference of class-wide reliance.

a) *Mondor*: Justice Cumming Was Not Prepared to Rule Out Inferred Reliance on a Motion to Strike

Justice Cumming's decision in *Mondor* did not consider whether reliance can be presumed on a class-wide basis. However, it is commonly cited as if it somehow opened the door to do so.[65] The plaintiffs in *Mondor* advanced claims of negligent and fraudulent misrepresentation and argued that a judge may conclude as a question of fact that *each* class member relied on a representation by the act of purchasing shares on the secondary market.[66] The defendants moved to strike the claim.

Justice Cumming stressed that he could not strike the claim unless the argument had been rejected by an Ontario case directly on point. As jurisprudence from the Ontario Court of Appeal held that a single plaintiff's reliance on an alleged misrepresentation could be inferred from the factual context, Cumming J could not foreclose consideration of the plaintiffs' argument on a Rule 21 motion:

> Had the plaintiffs simply pleaded the "fraud on the market theory" I would have foreclosed that consideration. Given, however, that the case law recognizes that a person's reliance upon a representation may be inferred from all the circumstances, in my view it would be premature to foreclose the consideration of this issue in the case at hand beyond the pleading stage.[67]

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63 *IMAX*, above note 3 at para 70: "[F]ollowing the decisions of Cumming J. in *Mondor* . . . and Hoy J. in *Lawrence*, I find that the Claim discloses a cause of action in negligent misrepresentation . . . , notwithstanding the absence of a pleading of direct individual reliance by each class member."

64 *McKenna*, above note 4 at para 154: "This does not mean, however, that reliance can be inferred on a class-wide basis. The need to examine the individual circumstances of each shareholder would, as Hoy J. suggested, make certification of the claim problematic."

65 *Serhan*, above note 8 at para 57; *OPSEU v Ontario*, [2005] OJ No 1841 at para 68 (SCJ) [*OPSEU*]; *IMAX–Leave*, above note 3 at para 53, n 21.

66 *Mondor*, above note 61 at para 64.

67 *Ibid* at para 69.

Justice Cumming made this observation on a pleadings motion and not in the context of a motion for certification. He did not suggest that a trial judge could infer class-wide reliance from the mere fact that a single plaintiff may be able to establish reliance in this manner; nor did he comment on the prospect of success of such an argument on certification. He simply recognized that, in certain circumstances, a plaintiff's reliance may be inferred from the circumstances. This is not an extraordinary observation, nor is it in any way inconsistent with Winkler CJ's determination that the fraud-on-the-market doctrine does not apply in Ontario.[68]

b) *Lawrence*: Justice Hoy Warns of the Impact of Reliance-Based Claims on Certification

Similarly, the plaintiffs in *Lawrence* argued that they relied on the representations at issue by their conduct in purchasing units of the issuer income trust. The defendants moved to strike the negligent misrepresentation claim. Again in the context of a pleadings motion, Hoy J essentially adopted Cumming J's approach and recognized that reliance could be inferred but specifically stated that "*Mondor* … is a pleadings decision in the action involving YBM Magnex . . . Notably, *Mondor* is not a certification decision."[69]

Although Hoy J did not strike the claim, she made two significant observations. First, she cautioned that the plaintiffs would need to determine reliance for each member of the class — *a matter of fact*, rather than rely on a class-wide presumption of reliance — *a matter of law*. Second, she explained that, although she would not strike the claim, the need to determine individual reliance "will of course significantly impact on certain issues in certification."[70]

In summary, the reasons in *Mondor* and *Lawrence* do not support arguments that issues of reliance may be determined on a class-wide basis without resorting to individual issues trials any more than the rea-

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68 Justice Cumming later certified *Mondor* in the context of a negotiated settlement: (2002), 26 BLR (3d) 281 (Ont SCJ), and noted with respect to the fairness of the settlement that: "There is uncertainty whether reliance could be established by the simple act of purchase of the shares or whether each shareholder would have to establish [reliance] individually" (at para 22). In other words, Cumming J recognized that individual reliance could have posed a hurdle to certification had a settlement not been reached.

69 *Lawrence*, above note 8 at para 91.

70 *Ibid* at para 93. Three years later, in *Charles Trust v Atlas Cold Storage Holdings*, [2009] OJ No 4271 (SCJ), Lax J certified the class proceeding, but for settlement purposes only.

sons in *Bre-X* support these arguments.[71] In light of this, it is difficult to understand how these decisions have been marshalled in support of the certification of common law misrepresentation claims. In *IMAX*, van Rensburg J determined that it may be open to a trial judge to infer class-wide reliance as a matter of fact and that this possibility justifies certifying common law secondary market misrepresentation claims.[72] Moreover the certification motion judges in *CP Ships*, *IMAX*, and *Arctic Glacier* each expressed some doubt as to whether reliance is even a requisite element of the tort of negligent misrepresentation.[73]

3) *CP Ships*: Deferral of Reliance Issues to the Trial Judge

In 2009, the question of whether reliance is a requirement of the tort of misrepresentation was raised in a certification motion before Rady J in *McCann v C.P. Ships* — a proposed class action on behalf of both prospectus purchasers and secondary market purchasers. Because the facts giving rise to the cause of action took place in 2003 and 2004, the plaintiff was unable to advance statutory claims pursuant to Part XXIII.1, which did not come into force until the end of 2005. Instead, the plaintiff advanced statutory primary market claims under section 130 (prospectus) and 130.1 (offering memorandum), and common law secondary market claims in negligent misrepresentation.

In respect of the latter, the plaintiffs argued that Ontario courts are moving away from the strict reliance requirement and, as such, it is no longer necessary for plaintiffs to address potential hurdles raised by the need to prove reliance at the certification stage. Justice Rady canvassed a variety of cases relating to negligence and "negligent mis-statement"[74]

71 *Lawrence*, above note 8 at para 93; *Bre-X–Pleadings*, above note 8. This is also confirmed by Strathy J in *McKenna* at para 154:

> In some cases examination of the surrounding circumstances may be a preferable means of determining reliance rather than the self-serving statement of the plaintiff saying "I relied on it." *This does not mean, however, that reliance can be inferred on a class-wide basis.* The need to examine the individual circumstances of each shareholder would, as Hoy J. suggested, make certification of the claim problematic [emphasis added].

72 *IMAX*, above note 3 at para 190. See also the discussion in Section E(1).

73 *Ibid* at para 75; *CP Ships*, above note 2 at paras 59–60; *Arctic Glacier*, above note 5 at paras 90–91. See also the discussion in Section E.

74 Subsequent cases, including both *IMAX* and *McKenna*, have distinguished the cases that underlie Rady J's decision in *CP Ships* on the basis that they were directed outside of the tort of negligent misrepresentation, primarily to the torts of negligence and "negligent misstatement." See *IMAX*, *ibid* at paras 73–75 and *McKenna*, above note 4 at paras 147–50 and 157–59. In particular, Rady

and concluded that, as other courts have been "prepared to relax the otherwise strict requirement to establish individual reliance," the claim should be certified:

> I think it would be an error to conclude, at this stage of the proceedings, that the plaintiff cannot possibly succeed in a claim for negligent misrepresentation. I would adopt the language of Justice Rooke in the Eaton case at para. 91 that "it is simply too early to determine whether, and to what extent, individual reliance will need to be examined in this case. A trial on the common issues will determine this need . . . First, the plaintiff should be permitted an opportunity to demonstrate at trial why individual reliance is not necessary . . . Second, if reliance is a necessary prerequisite to recovery, then the class members should have an opportunity to prove it as an individual issue.[75]

In spite of this acknowledgement that individual determinations of reliance might be required, Rady J did not consider the effect of the individual trials on the manageability of the proceedings in the context of the preferable procedure analysis. She simply certified the negligent misrepresentation claim and deferred to the trial judge the central questions associated with reliance, such as whether it was a common or individual issue, and what implications it might have for the manageability of the proceeding.

J relied on *Haskett v Equifax Canada Inc* (2003), 63 OR (3d) 577 (CA); *Spring v Guardian Assurance plc*, [1994] 3 All ER 129 (HL); and *Lowe v Guarantee Co of North America* (2005), 80 OR (3d) 222 (CA); cases that dealt with situations in which the plaintiffs were not the recipients of the erroneous statements and therefore reliance was not at issue. *Collette v Great Pacific Management Co*, 2004 BCCA 110, was fundamentally a claim in negligence rather than negligent misrepresentation, as was *Yorkshire Trust Co v Empire Acceptance Corp Ltd* (1986), 24 DLR (4th) 140 (BCSC), in which the plaintiffs themselves had not received or relied on the mortgage appraisal at issue. Finally, *Eaton v HMS Financial Inc*, 2008 ABQB 631 [*Eaton*] relates to inducement to invest in a fraudulent investment scheme as part of an action against a variety of parties who played incidental roles in the losses, rather than simply damages resulting from a misrepresentation.

75 *CP Ships*, above note 2 at paras 59–61.

E. COMMON LAW MISREPRESENTATION CLAIMS AFTER PART XXIII.1

1) *IMAX*: Departure from the Established Principles

In *Silver v. IMAX*, the plaintiffs alleged that the defendant IMAX and related parties were liable to the proposed class of investors for material misrepresentations in IMAX's audited financial statements and other public disclosures. The plaintiffs sought to certify common law negligent misrepresentation claims and statutory claims under Part XXIII.1.

For the purpose of this analysis, the most important feature of *IMAX* is van Rensburg J's handling of the reliance component of the common law misrepresentation claims in the context of the test for certification. The plaintiffs argued that the need to prove reliance by individual class members should not prevent certification because class-wide reliance could be inferred as a matter of fact. The plaintiffs claimed that the markets on which IMAX shares traded (the TSX and NASDAQ) are efficient and that each class member relied on the alleged misrepresentations "by the act of purchasing or [acquiring] IMAX securities."[76]

The plaintiffs' arguments were essentially the same as those rejected by Winkler CJ in *Bre-X* and cautioned against by Hoy J in *Lawrence*.[77] However, van Rensburg J certified the common law claims alongside the Part XXIII.1 claim, holding that it may be open to a trial judge to use the efficient market hypothesis to infer class-wide reliance as a matter of fact. Most notably, she certified the following common issues:

> 6. Did the traded price of IMAX shares during the Class Period incorporate and reflect the Representation?
>
> 7. If the answer to (6) is yes, did the acquisition of IMAX shares by the class members, on the TSX and NASDAQ, during the Class Period, constitute reliance upon the representation?[78]

It is difficult to see how, if these questions were answered in the affirmative, this could be anything other than the importation of the fraud-on-the-market-doctrine into Ontario law. Somewhat ironically, this development comes after the adoption of Part XXIII.1 — now that legislation has rendered such distortions of our common law unnecessary for

76 *IMAX*, above note 3 at paras 56–59.
77 See the discussion in Section D(1).
78 *IMAX*, above note 3 at paras 171 and 190.

the advancement of class actions for secondary market misrepresentations.

In the decision, van Rensburg J devotes considerable space to an analysis of the question of whether the common law misrepresentation claims were viable as a matter of pleading — in other words, whether they met the test under section 5(1)(a) of the *Class Proceedings Act*.[79] In so doing, she relied upon the decisions of Cumming J in *Mondor* and Hoy J in *Lawrence*.[80] The defendants argued that the common law claims should be struck because it was not pleaded that individual class members relied upon the alleged misrepresentations — only that they relied "by the act of purchasing [or acquiring] IMAX securities." However, even while affirming the statements of many prior courts, including the Supreme Court of Canada, that reliance is a requisite element of the tort of misrepresentation, van Rensburg J concluded that the claim met the requirements of section 5(1)(a). She held:

> While I do not find the cases relied upon by the plaintiffs persuasive as to the ability of a court to find liability for negligent misrepresentation without proof of reliance in light of the repeated statements by our courts (including the Supreme Court of Canada in *Queen* v. *Cognos Inc.*) that reliance is an essential element of negligent misrepresentation, it is unnecessary to specifically rule on this issue at this stage in the proceedings. For the purpose of certification, the question is whether the Claim discloses a cause of action in negligent misrepresentation. I have concluded that it does disclose a cause of action, notwithstanding the absence of a pleading of direct individual reliance by each class member. In the event that the plaintiffs are unable to prove reliance, it will remain open for them to argue at trial that reliance is not required.[81]

The question of reliance receives very little analysis where, for practical purposes, it may matter the most: in the context of the "preferable procedure" test under section 5(1)(d) of the *CPA*. Notably, van Rensburg J

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79 *Class Proceedings Act, 1992*, SO 1992, c 6 [*CPA*].

80 *IMAX*, above note 3 at paras 56–75. *Bre-X* and *CP Ships* are also cited by van Rensburg J as examples of cases in which reliance-based claims were certified. Justice van Rensburg also considered the cases that Rady J had found persuasive in *CP Ships* — as canvassed above in note 74 — and, although she distinguished most of these cases, van Rensburg J appears to have been persuaded by the approach in *Eaton*, above note 74, in which Rooke J of the Alberta Court of Queen's Bench held that the trial judge could determine whether proof of reliance was required.

81 *IMAX*, above note 3 at para 75.

did not resolve or even address the important question of whether questions of reliance will be common or individual issues in her determination of the "common issues" branch of the test for certification under section 5(1)(c) of the *CPA*. Perhaps as a result, there is no consideration whether individual issues trials to determine questions of reliance and related issues of causation and damages (as were clearly contemplated by Winkler CJ and the Court of Appeal in *Bre-X*) associated with the common law claims would render the proceeding unmanageable. Justice van Rensburg sets out her preferable procedure analysis in seven succinct paragraphs which address how the proposed proceeding in its totality would satisfy the objectives of the *CPA* — particularly judicial economy — without considering whether these objectives might be equally or better fulfilled if the common law misrepresentation claims were not certified.[82]

2) *McKenna*: A Reassertion of the Traditional Approach

Offering a stark contrast to the approach taken by van Rensburg J in *IMAX*, Strathy J refused to certify common law claims for negligent misrepresentation in *McKenna v Gammon Gold*.[83] In *McKenna*, the proposed representative plaintiff sought to represent a class of investors who acquired Gammon Gold securities under a short-form prospectus or in the secondary market. He alleged that the prospectus and other disclosure documents contained a variety of misrepresentations. As in *IMAX*, both common law and statutory causes of action for misrepresentation were advanced. However, the statutory claims were only brought under section 130 of the *OSA*, which provides a statutory cause of action for misrepresentations on the primary market. No statutory claims were advanced for misrepresentation on the secondary market. Justice Strathy's decision considers the question of whether the common law misrepresentation claims were appropriate for certification with distinct analyses conducted under branches 5(1)(a), 5(1)(c), and 5(1)(d) of the *CPA*. His reasons are equally applicable to common law misrepresentation claims in respect of misrepresentations on the primary and secondary markets.

82 *IMAX*, above note 3 at paras 210–16.
83 *McKenna*, above note 4 at para 43.

a) The 5(1)(a) Test: Do the Negligent Misrepresentation Claims Disclose a Cause of Action?

With respect to the question of whether the misrepresentation claims were adequately pleaded to meet the requirements of section 5(1)(a) of the *CPA*, Strathy J concluded that they were, since the plaintiff pleaded that he "relied directly or indirectly" upon the misrepresentations at issue.[84] Notwithstanding this determination, Strathy J rejected an alternate theory posited by the plaintiff that negligent misrepresentation could be established even without proof of reliance — a determination which becomes critical to Strathy J's conclusions in the "common issues analysis" under subsection 5(1)(c) of the *CPA* and his ultimate decision that the negligent misrepresentation claims could not be certified.

Justice Strathy's analysis reinforces the principle that "while reliance can be established by inference, it remains a necessary ingredient of negligent misrepresentation."[85] It also emphasizes the importance of reliance as a requisite component of the tort and its inherent relationship to questions of proximity, causation and damages when negligent misrepresentation is alleged:

> *Words are at the root of the action for misrepresentation. Like the tree that falls in the forest and is heard by no one, unless the words reach someone's eyes or ears, they result in no action and they cause no damage.* Reasonable reliance plays a role in the proximity analysis by defining the scope of what the defendant can reasonably foresee. It also plays a role in the damages analysis by establishing causation. The role of reliance as an essential ingredient of a claim for negligent misrepresentation has been repeatedly affirmed by the highest authority. [86]

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84 *McKenna*, above note 4 at para 41.

85 *Ibid* at para 44.

86 *Ibid* at paras 132–33 [emphasis added]. Justice Strathy refers to Allen Linden & Bruce Feldthusen, *Canadian Tort Law*, 8th ed (Toronto: LexisNexis, 2006) at 446:

> [M]isrepresentations do not injure anyone directly. The plaintiff must take some action in reliance on the statement before any harm occurs. This gives the plaintiff opportunities for self-protection not available in most physical injury situations. The reasonableness of the plaintiff's reliance is central to the duty-of-care analysis; critical to the issue of causation in fact; and also relevant to the question of contributory negligence.

Justice Strathy also states that "the role of reliance as an essential ingredient of a claim for negligent misrepresentation has been repeatedly affirmed by the highest authority," and cites *BG Checo International Ltd v British Columbia*

Justice Strathy also noted that the Ontario Court of Appeal recently augmented the list of requisite elements developed by the Supreme Court of Canada in *Cognos* by explaining that there is an onus on the plaintiff to prove that the misrepresentation was material in the sense that it would be likely to influence his conduct or judgment.[87] In other words, the onus on a plaintiff seeking to establish negligent misrepresentation is not being relaxed, but is being stringently applied by our appellate courts.

b) The 5(1)(c) Test: Do the Negligent Misrepresentation Claims Raise Common Issues?

After concluding that the pleadings disclosed a cause of action in negligent misrepresentation, Strathy J went on to consider the question of whether the claims would raise common issues. While Strathy J agreed with the conclusion drawn by Cumming J in *Mondor*, and Hoy J in *Lawrence* that there may be situations in which proof of reliance can be established by inference,[88] he made it clear that this does not support the conclusion that reliance can be inferred on a class-wide basis so as to remove the hurdle that reliance presents to certification:

> In some cases examination of the surrounding circumstances may be a preferable means of determining reliance rather than the self-serving statement of the plaintiff saying "I relied on it." *This does not mean, however, that reliance can be inferred on a class-wide basis.* The need to examine the individual circumstances of each shareholder would, as Hoy J. suggested, make certification of the claim problematic.[89]

Justice Strathy reiterated that the need to prove individual reliance — and the fact that it is a nearly insurmountable hurdle — is the reason that the "legislature has seen fit to relieve the investing public of this onerous

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Hydro and Power Authority, [1993] 1 SCR 12 and *Hercules Managements Ltd v Ernst & Young*, [1997] 2 SCR 165.

87 *McKenna*, *ibid* at para 134, citing *White v Colliers Macaulay Nicholls Inc* (2009), 95 OR (3d) 680 (CA). This is, of course, a prerequisite to invoke the fraud on the market doctrine: *Basic*, above note 8 at 248, n 27.

88 *McKenna*, *ibid* at para 151, citing *Mondor*, above note 61.

89 *McKenna*, *ibid* at para 154 [emphasis added]. This is supported by *Bre-X*, in which Winkler CJ stated: "the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance." See *McKenna* at para 138, citing *Bre-X–Pleadings*, above note 8 at 794.

requirement [through] 'deemed reliance provisions.'"[90] In refusing to certify the negligent misrepresentation claims he observed:

> 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. [91]

Justice Strathy also rejected the plaintiffs' attempt to "finesse the thorny issue of reliance" by making the very question of whether reliance needed to be demonstrated by individual class members a common issue to be determined by the trial judge.

Notably, Strathy J addressed the cases cited by the plaintiff's counsel in support of their position that the need to prove reliance did not render the common law misrepresentation claims uncertifiable. In each instance, he explained why the case was distinguishable or did not support the plaintiff's position. For example, a line of cases in which "negligent mis-statements" were alleged were concluded to be inapplicable because they dealt with situations in which the plaintiff was not the recipient of the erroneous statement and therefore reliance was not at issue.[92] With respect to *CP Ships* and *IMAX*, Strathy J explained that he respectfully disagreed with the determinations of Rady and van Rensburg JJ in those cases:

> 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.
>
> . . .

90 *McKenna*, *ibid* at paras 159–160.

91 *Ibid* at para 161.

92 *Ibid* at para 143, citing *Haskett v Equifax Canada Inc* (2003), 63 OR (3d) 577 (CA); *Spring v Guardian Assurance plc*, [1994] 3 All ER 129 (HL); and *Lowe v Guarantee Co of North America* (2005), 80 OR (3d) 222 (CA).

> *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.*[93]

c) The 5(1)(d) Test: The Argument that Part XXIII.1 is the Preferable Procedure Because Individual Reliance is a Necessary Element of a Negligent Misrepresentation Claim

As reflected in the reasons, the defendants in McKenna advanced the argument that certification was not the preferable procedure for resolving the secondary market claims:

> [Section] 138 is the preferable procedure because the "deemed reliance" provision overcomes the intractable problem of proving reliance in a class action alleging common law misrepresentation. [The defendants] say that the procedure is fair to both parties since it contains a reasonable threshold for leave that simply requires the plaintiff to show that the action has been brought in good faith and that there is a reasonable possibility that the action will be resolved in the plaintiff's favour. Moreover, while there are certain liability caps available to the defendants in the s. 138.1 action, there are certain benefits to plaintiffs. *The availability of a fair efficient and manageable remedy under that Part, which has definite advantages over a common law action (albeit subject to some limitations), give some reassurance that access to justice and behaviour modification can be achieved, notwithstanding that the common law claims have not been certified.*[94]

As Strathy J had already concluded that the secondary market claims advanced by the plaintiff could not be certified, he determined that it was unnecessary for him to consider this argument. Nonetheless, it seems likely that the argument will be advanced by other defendants in subsequent cases in which both statutory and common law claims for secondary market misrepresentation are advanced. It is unclear why it was not considered by van Rensburg J in *IMAX*.

3) *Arctic Glacier*: *IMAX* Becomes a Precedent

In *Arctic Glacier*, the plaintiffs purchased units of the Arctic Glacier income fund on the secondary market, but brought a class action on be-

93 *Ibid* at paras 159–60 [emphasis added].
94 *Ibid* at para 177 [emphasis added].

half of secondary market purchasers and other investors who purchased units under a prospectus. They advanced common law claims in negligent misrepresentation and statutory misrepresentation claims under section 130 and Part XXIII.1 of the *OSA*.

Justice Tausendfreund followed the reasoning in *CP Ships* and *IMAX* and certified the common law misrepresentation claims (in respect of both primary and secondary market purchases) alongside the statutory claims. He deferred to the trial judge the issue of whether reliance is required and certified as a common issue the following question: "What is the procedure whereby class members must demonstrate their individual reliance upon the defendants' misrepresentations?"[95]

Justice Tausendfreund accepted, based on the reasoning of Rady J in *CP Ships* and van Rensburg J in *IMAX* that the state of the caselaw on the question of whether "reliance may be inferred" was "in a state of evolution."[96] He then went on to distinguish Strathy J's decision in *McKenna* on the facts:

> I recognize that depending on the type and number of alleged misrepresentations in a particular case, these could in certain circumstances overwhelm the common issues and would, as such, not be suitable to be resolved in a class proceeding. I find that the alleged misrepresentations made in this case in core documents are consistent and repetitive and can easily be treated as one. As such, I distinguish these misrepresentations factually from those detailed in para. 160 in *Gammon Gold*.[97]

There is no further consideration of the question of whether the individual determination of questions of reliance would render the proceeding unmanageable or whether an action under Part XXIII.1 would be the preferable procedure in light of the deemed reliance provisions.

The focus on the question of whether reliance may be inferred in *CP Ships*, *IMAX*, and *Arctic Glacier* appears to be misplaced. The central issue, when it comes to determinations as to whether common law misrepresentation claims should be certified, is not whether it might be possible to infer the reliance of an individual plaintiff on the facts of a particular case (which may be the substance of the inquiry under section 5(1)(a) of the *CPA* or a preliminary motion to strike as in *Mondor* and *Lawrence*), but whether it could be concluded that all members of the class relied to their detriment on the misrepresentations alleged (the sub-

95 *Arctic Glacier*, above note 5 at para 228.
96 *Ibid* at para 227.
97 *Ibid*.

stance of the inquiry under sections 5(1)(c) and/or (d) of the *CPA*). This distinction was not lost on Cumming J in *Mondor* or Hoy J in *Lawrence*, but it has been missing in more recent decisions.

Further, the finding that there was effectively a "common" misrepresentation — which Tausendfreund J used to distinguish *McKenna* on its facts — does not resolve the "thorny issues" of individual reliance; a point that is developed in more detail in Section F. These issues do not arise from a consideration of the representation at issue, but rather from the myriad of complex questions relating to the receipt of the representation by each individual investor and the effect, if any, that this representation had on the investment decisions of each class member. As Strathy J explained in *McKenna*, "Words are at the root of the action for misrepresentation. Like the tree that falls in the forest and is heard by no one, unless the words reach someone's eyes or ears, they result in no action and they cause no damage."[98]

Whether there was one misrepresentation or hundreds, the problem remains that each individual class member bears the onus of proving that she received the misrepresentation and acted upon it to her detriment. If the class is large, as it often is in a shareholder class action, consideration must be given to whether conducting these individual determinations of reliance for each individual class member will render the proceeding completely unmanageable. Notably, in arriving at the conclusion that certification of the common law claims should be refused in *McKenna*, Strathy J focussed on legal principles rather than factual determinations relating to the number of misrepresentations.

4) Leave to Appeal is Refused in both *McKenna* and *IMAX*

While it may not be surprising that the defendants in *IMAX* and the plaintiff in *McKenna* sought leave to appeal the certification decisions of van Rensburg and Strathy JJ to the Divisional Court, what is surprising is that, despite the divergence in the decisions, leave was denied in both instances. Neither decision will receive further consideration by an appellate court. The test for leave requires the applicant to satisfy the requirements in rule 62.02(4):

> (4) Leave to appeal shall not be granted unless,
>
> (a) there is a conflicting decision by another judge or court in Ontario or elsewhere on the matter involved in the proposed appeal and

98 *McKenna*, above note 4 at para 133.

> it is, in the opinion of the judge hearing the motion, desirable that leave to appeal be granted; or
>
> (b) there appears to the judge hearing the motion good reason to doubt the correctness of the order in question and the proposed appeal involves matters of such importance that, in his or her opinion, leave to appeal should be granted.

Although Strathy J expressly disagreed with determinations made by van Rensburg J on the governing principles of the tort of negligent misrepresentation and the suitability of such claims for certification; in both instances the leave judge justified the denial of leave on the basis that the decisions in *IMAX* and *McKenna* do not, in fact, conflict. It is helpful to review these leave decisions as they highlight a confusing and arbitrary distinction which is often reverted to when clearly contradictory strains of caselaw in this area cannot otherwise be reconciled: the distinction between "single" and "multiple" misrepresentation cases.

a) Leave is Denied in *McKenna*

Justice Sachs denied leave in *McKenna*.[99] She generally concluded that there was no basis to doubt the correctness of Strathy J's reasons, noting that courts usually conclude that negligent misrepresentation claims are unsuitable for certification because of the necessity of establishing reliance.[100] As she explained, "it is because of this that the legislature came up with a statutory remedy for secondary market shareholders."[101]

Justice Sachs also held, however, that the *IMAX* and *McKenna* decisions do not conflict because *McKenna* involved multiple misrepresentations, whereas *IMAX* involved a single defined representation.

While other courts have distinguished class actions premised on misrepresentation claims on this basis — as argued above — in most proposed securities class actions, this will be a distinction without a meaningful difference. More importantly, focusing on this arbitrary distinction obscures the unavoidable fact that *IMAX* and *McKenna* do in fact conflict — and they conflict on fundamental issues which will be of ongoing significance to litigants in securities class actions. First, the cases conflict on the issue of whether proof of individual reliance is a necessary requirement of a negligent misrepresentation claim. In fact, Strathy J

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99 *McKenna–Leave*, above note 4. Justice Sachs did, however, grant leave to appeal issues related to the conspiracy claim.

100 *Ibid* at para 33, citing *McKenna*, above note 4 at para 135.

101 *McKenna–Leave*, *ibid* at para 34.

clearly understood his decision to conflict with that of van Rensburg J in *IMAX*, as he expressly disagreed with the conclusion in that case:

> *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.[102]

Second, *IMAX* and *McKenna* clearly diverge on the question of whether issues of investor reliance can be resolved as a common issue. Justice Strathy held that the inability to determine the defendants' liability without individual inquiries for each class member makes the claim in negligent misrepresentation unsuitable for certification. Justice van Rensberg appeared to be prepared to accept that class-wide reliance could be inferred through resort to the efficient market hypothesis or, in any event, was prepared to defer the issue to the trial judge.

b) Leave is Denied in *IMAX*

Several months later, in February 2011, Corbett J denied leave in *IMAX* for similar reasons. In particular, Corbett J relied on the single/multiple misrepresentation distinction to distinguish *McKenna* from *IMAX* and stated: "I agree with Sachs J. and with her reasons on this point."[103]

However, the leave analysis in *IMAX* should arguably have been different from the analysis of Sachs J in *McKenna* because *IMAX* represents a significant departure from the established caselaw. Although Corbett J referred to authorities which he stated to support the decision to certify the common law misrepresentation claims, his decision does not analyse these authorities to confirm whether they truly supported van Rensburg J's conclusion that reliance could be inferred. For example, Corbett J stated:

> van Rensburg J. found that there is authority for the proposition that class reliance may be proved as a matter of fact, even where it will not be deemed as a matter of Canadian law. There is coordinate authority to support this analysis.[104]

The "coordinate authorit[ies]" Corbett J cited for this proposition were *Mondor* and *Lawrence*. However, as explained previously in Section D(1)

102 *McKenna*, above note 4 at para 159 [emphasis added].
103 *IMAX–Leave*, above note 3 at para 54.
104 *Ibid* at para 53.

above, neither *Mondor* nor *Lawrence* supports the proposition that class-wide reliance can be proved as a matter of fact. Indeed, *Lawrence* explicitly conflicts with van Rensburg J's decision on this point, as Hoy J stated that the plaintiffs "need to determine reliance, as a matter of fact, with respect to each member of the class" — and could not rely on a class wide presumption. In other words, an inference of class-wide reliance would represent novel law in Ontario and conflicts with the existing jurisprudence, including Winkler CJ's determination that the fraud-on-the-market doctrine is not available to plaintiffs in Ontario.

Although he denied leave to appeal in *IMAX*, Corbett J nonetheless observed that: "The relationship between common law and statutory claims of misrepresentation is important, and merits appellate consideration."[105] Indeed, further debate of this critical issue should be encouraged in all forums, including, most importantly, our appellate courts.

F. ANALYSIS: WHAT ROLE SHOULD COMMON LAW MISREPRESENTATION CLAIMS PLAY IN THE WAKE OF PART XXIII.1?

There may have been pragmatic motivations for courts to relax the strict onus imposed by the common law on individual plaintiffs in order to facilitate the certification of investor class actions prior to the enactment of Part XXIII.1. However, Ontario courts have declined to do this, with the exception of *Bre-X* — which, as explained above, is something of a special case which should be confined to its unique facts and procedural history. Whatever policy rationales or other incentives might have existed for certifying common law secondary market misrepresentation claims, they have now been addressed by a statutory cause of action that has been crafted for the express purpose of permitting such claims to be litigated as class actions, with little or no need to resort to costly and inefficient individual reliance trials. As argued by the defendants in *McKenna*, surely proceedings under Part XXIII.1 should be the "preferable procedure" for litigating such claims going forward.

The common law of Ontario still treats reliance as an individual issue in securities actions, and the availability of proceedings under Part XXIII.1 was never intended to change this — nor should it. Individual investors will continue to diverge widely in their level of sophistication and in the extent and manner in which they use public information to make

105 *Ibid* at para 55.

investment decisions. In *Bre-X*, Winkler CJ underscored the heterogeneity of investor behaviours and explained why it impedes certification (in the absence of a statutory cause of action that absolves investors of the need to prove reliance):

> The determination of reliance will require an inquiry into the investor–investment advisor relationship, the investor profile, the class member's awareness of any statements made by the defendants, any additional information concerning Bre-X of which the class member may have been apprised, the source of any such additional information, the specific trading activity of the class member and its correlation to the representations, the class member's knowledge of the business or reputation of the defendants and the class member's objectives in purchasing Bre-X stock. It is not reasonably foreseeable that these issues, and any others which may arise in the individual proceedings, will be decided in a brief inquiry.[106]

In *McKenna*, Strathy J likewise explained that the need for complex individual inquiries makes common law claims unsuitable for certification because of the multitude of questions that would arise for each investor.[107]

1) Even if Reliance is Presumed, the Presumption Should be Rebuttable

Even if, for the sake of argument, one accepts van Rensburg J's conclusion in *IMAX* that it is possible that the common issues judge will accept that the entire class relied on the market price of the security as a reflection of all public information relevant to its value, this would not obviate the need for individual trials because it would be open to the defendant to rebut this inference of reliance. That is, the defendant would have the opportunity to individually examine each class member to determine the representation's role in the investment decision. Justice Cullity pointed this out in *Serhan*:

> In *Mondor*, Cumming J. did not suggest that an inference of reliance drawn from the conduct of class members in purchasing shares after the representations were made could not be rebutted by evidence that there was, in fact, no causal connection between the representation and the decision to purchase. The possibility of such a rebuttal was recognized

106 *Bre-X–Certification (SCJ)*, above note 48 at para 179.
107 *McKenna*, above note 4 at para 161.

> explicitly in a passage he quoted . . . In determining whether any inference of reliance arising simply from the conduct of class members in purchasing, or using, the devices was rebutted, the defendants would be entitled to inquire into the motivation of, and examine, every member of the class. As Winkler J. stated in *Carom*:
>
> > Reliance is not established by a mere showing that a plaintiff was a recipient of a representation, rather the representation must have caused the recipient to act in a certain manner.
> >
> > *Whether reliance should be inferred is a question of fact and the answer may differ from individual to individual . . . . The defendants may, or may not, have difficulty in rebutting any inference, or presumption, of reliance that is found to arise but the possibility should not be foreclosed on this motion.*[108]

Justice van Rensburg determined that Cullity J's reasoning did not apply because *Serhan* was a product liability claim and not "an efficient market claim."[109] However, it is difficult to understand why this would make a difference, unless one accepts that the fraud-on-the-market doctrine is available in Ontario as a special exemption from the requirement to prove reliance that is applicable only in securities cases. Leaving aside Winkler CJ's determination that the doctrine does not apply in Ontario, van Rensburg J has not explained why, even if it does, a defendant should be deprived of the right to rebut an inference of reliance on a case-by-case basis, as they would in any misrepresentation case.[110]

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108 *Serhan*, above note 8 at paras 58–59 [emphasis added].

109 *IMAX*, above note 3 at para 188. Justice van Rensburg's reliance on *OPSEU*, above note 65 also seems misplaced. In *OPSEU*, Cullity J held that group reliance might be inferred because a union acted as bargaining agent for all class members and the detrimental reliance could only have occurred through the agency of the union. It was therefore properly a common issue.

110 Notably, the right to rebut the presumption that plaintiffs relied, *en masse*, on the market price of a security as reflecting all relevant public information about it is recognized even in US jurisdictions in which the fraud-on-the-market doctrine is applied. See *Vivendi*, above note 8 at *57–59. While the plaintiffs moved for judgment at the end of the common issues trial, Holwell J found that individual issues trials could be conducted to determine whether the inference of reliance could be rebutted in individual cases.

2) Other Complex Individual Issues Raised by Common Law Misrepresentation Claims

Further, as pointed out by Strathy J, the complexities associated with common law misrepresentation claims do not end with reliance. Individual questions of reliance will be inextricably bound up with issues of foreseeability, causation, and damages — other elements that must be proven in order to substantiate a claim in negligent misrepresentation.[111] As motions to certify common law misrepresentation claims have generally failed at the first hurdle — the mass of individual trials that would be required to determine reliance — our courts have not scratched the surface when it comes to the host of other determinations that would need to be made in individual issues trials if common law securities misrepresentation claims began to be routinely certified.

Just to provide one example, a good argument can be made that the damages analysis for common law misrepresentation claims should not simply follow the formula set out in Part XXIII.1 and that, like reliance, it also needs to be assessed individually.[112] At common law, notions of reliance are inextricably bound up with the element of causation. Damages should be limited to losses suffered by individual plaintiffs that were caused by the misrepresentation.[113] Arguably, concepts of detrimental reliance should limit a plaintiff's recovery to those losses that would not have been encountered "but for" the misrepresentation, and a plaintiff would be required to show that if they had not relied on the alleged misrepresentation, they would have made a different, more profitable investment. The damages analysis at common law should calculate the difference in the performance of the shares purchased in reliance on the misrepresentation relative to the performance of the alternate investment that would have been made.[114] Unlike damages analyses under Part XXIII.1 which will, in most cases, require little of individual investors beyond proof of how many securities they purchased and when, this analysis may need to be considered on a case-by-case basis as the choice

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111 *McKenna*, above note 4 at para 133.

112 As damages are directly tied to issues of reliance and causation which will require proof in individual cases, it seems unlikely that aggregate damages could be awarded under section 24(1) of the *CPA*.

113 For example, see *McKenna*, above note 4 at para 133, in which Strathy J explains: "Reasonable reliance plays a role in the proximity analysis by defining the scope of what the defendant can reasonably foresee. It also plays a role in the damages analysis by establishing causation."

114 *VK Mason v Bank of Nova Scotia*, [1985] 1 SCR 271 at 284–85.

that individual investors would have made "but for" the misrepresentation would surely vary widely depending on individual choices and circumstances.

Damages should not simply be measured with reference to the decline in the value of the shares purchased as they would be under Part XXIII.1. As the Supreme Court of Canada explained in *Rainbow Industrial Caterers Ltd v Canadian National Railway Co*, the plaintiff must prove the position that he would have been in on a balance of probabilities.[115]

3) A Loss of Certainty for All Interested Parties

In short, individual issues of reliance, causation, and damages associated with common law claims may be complex and could require discoveries, examinations, and cross-examinations of multiple witnesses and even expert witnesses. When weighing the potential benefits of such proceedings to individual investors and the relative access to justice that they would provide over and above what is now available under Part XXIII.1, one must ask: who would be responsible for litigating such individual issues and for bearing the associated costs before they would have any chance of recovery? Presumably, it would be the individual plaintiffs.

While the potential benefits to plaintiffs associated with the certification of common law securities misrepresentation claims may seem illusory, the downside for potential defendants is striking. Allowing such claims to proceed beyond the certification stage will deny issuers and their directors and officers of the initial promise of Part XXIII.1, which was designed to balance fairness for both plaintiffs and defendants.[116] While plaintiffs are provided with a certifiable cause of action, defendants are supposed to be protected by damages caps and other procedural safeguards, such as the leave requirement, which will not apply if common law claims are to be certified. As set out above, even leaving aside issues of liability, damages associated with common law claims raise complex issues, many of which may require individual determination, and will prove much more difficult to quantify than damages under Part XXIII.1. Issuers and their shareholders confronted with such claims will face considerable uncertainty as to what their potential exposure might be — uncertainty which Part XXIII.1 was, in part, designed to prevent.

Indeed, if the certification of "two track" securities class actions, pursued under both the *OSA* and the common law, are to become the norm

115 [1991] 3 SCR 3 at 14–15.

116 See CSA Notice 53-302, above note 15 at 9.

in Ontario, we can expect more costly and protracted litigation in this area. This would be disadvantageous to plaintiffs and defendants alike who will have difficulty evaluating every aspect of their cases, from their prospects of success to what potential damages may be, to the length and cost of resolution. Unlike Part XXIII.1, which narrows the potential bases for dispute over such issues, the certification of common law claims will expand them exponentially.

Further, if the approaches adopted in *CP Ships* and *IMAX* are generally accepted, these uncertainties will be further compounded as parties will be required to proceed to trial uncertain as to whether reliance will be a common or an individual issue. Notably, Winkler CJ decided this very question on a preliminary motion to amend the pleadings. As Winkler CJ has written, "Problems that are apparent at the time of certification should be dealt with squarely at that time and not postponed."[117] Notably, US courts have held that it is the certification judge's duty to scrutinize plaintiffs' claims of market efficiency:

> If it were appropriate for a court simply to accept the allegations of a complaint at face value in making class action findings, every complaint asserting the [relevant statutory] requirements would automatically lead to a certification order, frustrating the district court's responsibilities for taking a "close look" at relevant matters.[118]

Thus, it is not only the parties to securities class actions who deserve to proceed to trial with more clearly defined parameters, but also trial judges, who are entitled to know at the outset of the trial what common issues need to be determined, and who should not be confronted with manifestly unmanageable actions.

4) The Single/Multiple Misrepresentation Distinction

a) The Role of the Distinction in Misrepresentation Claims that Have Been Certified in Non-Securities Contexts

No discussion of the certification of common law misrepresentation claims would be complete without a consideration of the distinction that Ontario courts have drawn between "single" and "multiple" misrepresentation cases. This is the distinction that was used by the leave judges in *IMAX* and *McKenna* as a basis for concluding that the cases do not

117 Warren Winkler, "Advocacy in Class Proceedings Litigation" (2005) 19 Advocates' Soc J 6 at 7.

118 *Gariety et al v Grant Thornton, LLP et al*, 368 F 3d 356, 365 (4th Cir 2004).

conflict, which, in turn, supported the conclusion that leave was not warranted in either case.

Despite the general unsuitability of secondary market common law misrepresentation claims for certification, this is not to suggest that *no* misrepresentation case will ever be appropriate for certification. Indeed, several class actions based on misrepresentation claims have been certified outside of the securities context.

As Strathy J recently explained in *Ramdath v George Brown College*, misrepresentation claims lie on a spectrum.[119] Cases may be more appropriate for certification where they involve a relatively small class, a single misrepresentation, and it is reasonable to expect that the class members would have received and relied on that misrepresentation. In other words, the critical issue is the manageability of the proceeding. If the class is relatively small and it is apparent to the certification judge that individual issues of reliance are unlikely to be so complex or numerous that they will render the proceeding unworkable, certification of misrepresentation claims may be warranted.

The most obvious example of such cases involves students who rely on the representations of colleges or universities when choosing to enrol; for example, *Hickey-Button v Loyalist College of Applied Arts & Technology* or *Ramdath*.[120] In *Ramdath*, Strathy J certified the claims of three classes of students who alleged that the George Brown course calendar misrepresented the benefits of the international business management program, including the alleged misrepresentation that graduates were eligible to obtain three industry designations. Justice Strathy accepted that most students would have read the alleged misrepresentation because it appeared in their course calendar — a contractual document — and would likely have had some impact on their decision making. He held that a class proceeding was the preferable procedure, even though each class member would still be required to prove reliance as an individual issue.

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119 2010 ONSC 2019 at para 103 [*Ramdath*].

120 In *Hickey-Button v Loyalist College of Applied Arts & Technology* (2006), 211 OAC 301 (CA), the plaintiff sought certification of the 1997 and 1998 entering classes of nursing students at Loyalist College (a total of approximately ninety students). The action claimed negligent misrepresentation on the basis that the material that Loyalist had provided to these potential students the "Queen's Option," which would allow them to earn a nursing degree from Queen's University in four years. The students then alleged that this program was not available to them. The Ontario Court of Appeal certified the claim, including the claim for negligent misrepresentation.

In other negligent misrepresentation cases involving colleges, however, certification has been refused where multiple misrepresentations are alleged.[121] For example, in *Matoni*, Hoy J declined to certify a claim for negligent misrepresentation involving a class of approximately 200 students who had received different representations in different ways. Justice Hoy found that the individual issues associated with determining whether the students relied upon a false representation, and which representations they relied upon, would overwhelm the common issues and a class proceeding would not be the preferable procedure, notwithstanding that the class was relatively small.

Thus, the distinction between single and multiple misrepresentations may be meaningful in some contexts, particularly where the class is small and the court is persuaded that issues of reliance will not be too complex to resolve.[122] Whereas individual determinations relating to a single misrepresentation may be resolvable in a small class proceeding, the existence of multiple misrepresentations may "tip the scale" towards the conclusion that certification is not warranted.

b) The Size of the Class in Securities Class Actions Will Generally Render the Distinction Meaningless

Securities class actions will almost invariably fall at the opposite end of the spectrum from a "course calendar" case like *Ramdath*. The class of plaintiffs will generally consist of a difficult to quantify, but extremely large group of investors, and issues of reliance will be complex. As explained above, whether there is one representation or hundreds, the size of the class alone will generally make any individual issues determinations difficult, if not impossible, to accommodate in a securities class action.

Ultimately, however, if the number of misrepresentations alleged is relevant at all to the question of whether a securities class action should

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121 See *Mouhteros v DeVry Canada Inc* (1998), 41 OR (3d) 63 (Gen Div), Winkler J; *Matoni v CBS Interactive Multimedia Inc*, [2008] OJ No 197 (SCJ), Hoy J [*Matoni*].

122 For example, in *Lewis v Cantertrot Investments Ltd* (2005), 24 CPC (6th) 40 (Ont SCJ), Cullity J certified an action brought on behalf of 120 condominium unit owners who alleged that they relied on a representation in the condominium declaration, budget, and a sales flyer provided before the purchase about the monthly assessment and maintenance fees. Although reliance remained an individual issue, Cullity J held that it would not overwhelm the common issues for such a small class. See also *Murphy v BDO Dunwoody LLP* (2006), 32 CPC (6th) 358 (Ont SCJ), Cullity J.

be certified, it is simply one factor to be weighed with other arguably more important considerations, such as the size of the class and the number of individual issues to be determined, in the context of the preferable procedure test. There is no general rule that "single misrepresentation" cases can be certified while "multiple misrepresentation" cases cannot — and this distinction cannot absolve the certification judge of her duty to carefully weigh all factors relevant to the preferable procedure analysis. As mentioned above, Strathy J's reasoning focused primarily on the complexities associated with the issues of reliance, rather than a factual finding that *McKenna* was a "multiple misrepresentation" case. Further, the preferable procedure analysis in *IMAX* does not include a consideration of any factors that would be relevant in assessing the manageability of the proceeding, such as the size of the class or the number of individual issues. If the conclusion that there was really only one misrepresentation at issue was relevant to the preferable procedure analysis, one would expect it to have been weighed in the proper context.

Thus, while it is conceivable that a fact situation could arise in which a court could reasonably determine that certifying a common law secondary market misrepresentation claim would promote the objectives of the *CPA*, such as a closely held security in which the class of plaintiff investors is remarkably small, the single/multiple misrepresentation distinction will be meaningless in all but the most unusual of cases.

G. CONCLUSIONS

Common law claims for negligent misrepresentation in securities class actions have arrived at a crossroads. Ontario's courts must decide whether the established common law and certification principles and the policies underlying Part XXIII.1 are to prevail over the approach recently taken in *CP Ships*, *IMAX*, and *Arctic Glacier*.

There is simply no reason to distort principles of the common law or to relax the test for certification through recourse to the single/multiple misrepresentation distinction, the fraud-on-the-market doctrine, or any other legal fiction in order to rationalize the certification of common law securities misrepresentation claims. While the Part XXIII.1 regime remains in its infancy, and future litigants will no doubt find many reasons to find fault with its provisions and the interpretations that courts may come to place on them, it is hard to argue that certifying unwieldy common law misrepresentation claims will better serve the interests of

issuers, shareholders or our judicial system, or promote the stability of our capital markets.

US courts, experienced with statutory liability for secondary market misrepresentations, have firmly shut the door on attempts to impose concepts of presumed reliance from their statutory regime into the common law. As the District Court for the Northern District of Georgia observed in *Wells v HBO & Company*, the elimination of the reliance component of misrepresentation claims is best reserved for the legislature, which has the ability to provide a remedy in certain, limited contexts, but not others:

> With any consumer commodity, the price serves to some extent as a proxy for its value. Would this suggest that a buyer of an automobile may sue for misrepresentations about its characteristics even if he never heard or read them? In the [US statutory] context, the fraud on the market theory can be confined to securities transactions, but common law fraud is an all-purpose remedy without natural divisions.[123]

Similarly, in *Bre-X*, Winkler CJ quoted from the California Supreme Court in *Mirkin* that "Courts should be hesitant to impose new tort duties involving complex policy decisions which are more appropriately the subject of legislative deliberation and resolution."[124]

The approach taken in *IMAX* is not easily confined to securities class actions and has the potential to distort misrepresentation cases in a broad spectrum of scenarios, potentially even the used car deal contemplated in *Wells*. More importantly, the governing principles of the tort of negligent misrepresentation need not be distorted in order to facilitate securities class actions. Instead, investors have a tailor-made statutory cause of action that was designed to balance the rights of all interested parties. Thus, the *McKenna* approach, which affirms the purpose of Part XXIII.1 and upholds established principles of law, should be preferred going forward.

123 *Wells v HBO & Company*, 813 F Supp 1561, 1569 (Georgia Dist Ct, 1992).
124 *Bre-X–Pleadings*, above note 8 at 789.