

## Securities class action certified: First of its kind in Ontario

*Silver v. IMAX Corporation et al.* [2009] O.J. Nos. 5573 and 5585 (S.C.J.)

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On December 14, 2009, Justice van Rensburg of the Ontario Superior Court of Justice handed down two related rulings in the *Silver v. IMAX Corporation* litigation. The first (the “Leave Decision”) granted the plaintiffs leave to proceed with their class action against IMAX Corporation and certain individual respondents (collectively, the “IMAX Defendants”) under section 138.8 of Ontario’s *Securities Act* (“OSA”), while the second (the “Certification Decision”) certified the action, including both statutory and common law claims, as a class proceeding.

The Leave Decision is the first to consider the leave requirements for a statutory misrepresentation claim under the secondary market liability provisions in Part XXIII.1 of the OSA, while the Certification Decision appears to accept the “efficient market” (or “fraud on the market”) theory for common law misrepresentation claims. Justice van Rensburg permitted certification despite the defendant’s argument that the claim as pleaded is deficient for not alleging individual reliance by each member of the proposed class and accepted the plaintiffs’ argument that certification should extend to a global class of plaintiffs consisting of all persons who acquired securities of IMAX Corporation (“IMAX”) during the defined “Class Period” of February 17, 2006 to August 9, 2006 and who continued to hold some or all of those securities at the close of trading on August 9, 2006.

### Facts

The plaintiffs, shareholders of IMAX, are suing with respect to a decline in the price of their shares that they argue was caused by alleged misrepresentations in IMAX’s 2005 Form 10-K, in its 2005 Annual Report and in press releases issued in February and March of 2006. The plaintiffs allege that IMAX misrepresented the 2005 financial results reported in those documents as having been prepared in accordance with GAAP and further allege that, as a result, IMAX’s estimated earnings per share as reported in those documents was also misrepresented.

The plaintiffs assert common law causes of action for negligence, negligent misrepresentation, “reckless” misrepresentation and conspiracy in addition to a statutory cause of action for misrepresentations affecting the secondary market under Part XXIII.1 of the OSA.

This newsletter was prepared by members of the Class Action Group at Stikeman Elliott.

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## The Certification Decision

The plaintiffs sought certification of a global class for the common law claims of negligent misrepresentation, “reckless” misrepresentation, negligence *simpliciter* and conspiracy and with respect to their statutory claims for secondary market liability under the OSA. As discussed in the following section, the primary certification issues were whether the plaintiffs could establish a duty of care and whether the pleadings properly disclosed a cause of action for misrepresentation given that the plaintiffs had not pled individual reliance on the misrepresentation. The IMAX Defendants opposed the certification of the common law claims but did not oppose certification of the statutory cause of action under the OSA in the event that the Court decided to grant leave to proceed on the OSA claims.

### *The duty of care and reliance issues*

In addressing the plaintiffs’ common law misrepresentation claim, Justice van Rensburg considered whether the claim properly asserted the cause of action as is set out in *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87, namely whether (i) the defendants owed a duty of care to the plaintiffs based on a “special relationship”; (ii) the defendants made an untrue, inaccurate or misleading representation; (iii) the misrepresentation was made negligently; (iv) the plaintiff reasonably relied on the misrepresentation; and (v) the plaintiffs suffered damages as a result of the misrepresentation. As noted above, only elements (i) and (iv) – the existence of a special relationship and reasonable reliance – were the subject of dispute in this motion.

With respect to these two disputed issues, the plaintiffs argued (i) that IMAX and the individual defendants owed a duty of care to the investing public in releasing its disclosure documents and (ii) that the efficient market theory could be used to establish that by the act of purchasing or acquiring IMAX securities the plaintiffs relied on the misrepresentation.

While acknowledging that there is a “special relationship” between the defendants and the plaintiffs, the defendants relied on *Menegon v. Philip Services Corp.*, [1999] O.J. No. 4080 (S.C.), arguing that in the circumstances the duty of care should be limited or precluded for policy reasons, i.e. that the imposition of such a duty would lead to indeterminate liability and would conflict with the statutory remedy under the OSA. Justice van Rensburg rejected the defendants’ argument. Relying on *Mondor v. Fisherman*, [2001] O.J. No. 4620 (S.C.) and *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, she determined that it was not “plain and obvious” that the policy reasons asserted by the defendants precluded a claim of misrepresentation from proceeding at the certification stage. She found that a duty of care may have been owed in the circumstances, as the intended recipients of the documents containing the misrepresentation were the investing public, including the plaintiffs and proposed class members, and that IMAX issued the documents for the purpose of attracting and informing shareholders. Importantly, Justice van Rensburg refused to limit or restrict the alleged duty of care based on concerns of indeterminate liability and determined that the common law causes of action did not conflict with the statutory remedy contained in Part XXIII.1 of the OSA.

With respect to the second issue (reliance), the defendants argued that the plaintiffs’ assertion that reliance was established by the act of purchasing or acquiring IMAX securities was insufficient as there was no pleading that the proposed class members individually relied on the misrepresentations in making their investment decisions. The defendants maintained that the “efficient market” theory put forward by the plaintiffs was akin to the American “fraud on the market” theory, which is not recognized in Canada.

Although Justice van Rensburg acknowledged that no case asserting the “efficient market theory” has gone to trial, she held that, in this case, there was a conceivable claim based on the plaintiffs’ pleading of the “efficient market theory” to establish reliance, i.e. instead of alleging individual reliance by each class member, the plaintiffs alleged that the market for IMAX’s shares was efficient – that the market price of the shares reflected all public information – and that the plaintiffs relied on the misrepresentations by purchasing the shares. In so deciding, Justice van Rensburg relied on *Mondor v. Fisherman* and *Lawrence v. Atlas Cold Storage Holdings Inc.*, [2006] O.J. No. 3748 (S.C.J.), holding that the pleading disclosed a cause of action for misrepresentation notwithstanding the absence of an allegation of direct individual reliance by each class member. In so holding, Justice van Rensburg appears to have accepted that the “fraud on the market” or “efficient market” theory can be applied in Ontario, at least at the pleading or certification stage.

In respect of the plaintiff’s other common law claims, Justice van Rensburg found that the plaintiffs’ conspiracy and reckless (fraudulent) misrepresentation claims had been properly pled but that the negligence *simpliciter* claim was identical in substance to the negligent misrepresentation claim and therefore improper.

### ***Size of the class***

The plaintiffs sought to certify a global class consisting of all persons who acquired securities of IMAX during the proposed Class Period and who held some or all of those shares at the end of trading on August 9, 2006 when IMAX released its press release announcing the SEC investigation. The defendants opposed the certification of a global class on the grounds that it would be overinclusive inasmuch as it could include individuals (or entities) who did not know about or rely on the misrepresentation. The defendants also argued that the certification of a global class would create a conflict of laws issue, requiring an Ontario court to take jurisdiction over class members residing outside the province. In addition, they contended that the principles of order and fairness weighed against certification of a global class, particularly in light of a similar class proceeding that had been commenced in the United States.

In certifying a global class, Justice van Rensburg found that the issues raised by the pleading had a “real and substantial” connection to Ontario. She determined that the fact that a similar proceeding had been commenced (although not certified) in the United States was inconsequential to the Ontario action. Furthermore, she determined that any concern over conflict of laws issues was premature unless and until the defendants asserted reliance on laws of other jurisdictions in their statement of defence. In her view, it was appropriate to “wait and see” how the issues, if any, developed.

### **The Leave Decision**

The Leave Decision focused on whether the plaintiffs should be granted leave to proceed with their statutory misrepresentation claim. Section 138.8 of the OSA requires that the Court grant leave where it is satisfied that (i) the plaintiffs have brought the claim in good faith and (ii) there is a reasonable possibility that the plaintiffs will be successful at trial.

As this was the first case to consider the leave requirements of section 138.8, Justice van Rensburg’s main task was to interpret and apply the leave requirement and set the thresholds that would apply to both branches of the test. All parties agreed that the leave requirement involved a preliminary consideration of the merits of the action.

#### ***Good faith***

The IMAX Defendants took the position that the plaintiffs had a high onus to establish good faith, needing to establish (i) that the action has been brought for the benefit of the corporation and not for the plaintiffs’ benefit and (ii) that they have a reasonable belief in the merits of their claim. Justice van Rensburg rejected this characterization of “good faith” in favour of an alternative view according to which the plaintiffs were required only to establish that they brought the action in the honest belief that they have an arguable claim and for reasons that are consistent with the purpose of the statutory cause of action and not for an “oblique or collateral purpose.”

Justice van Rensburg found that the plaintiffs had brought the action to permit shareholders to recover damages and to hold the IMAX defendants accountable for the company’s alleged misrepresentations (while deterring others from doing the same) – all of which, she determined, was consistent with the statutory scheme for secondary market liability. Accordingly, Justice van Rensburg found that the plaintiffs had met the first branch of the test for leave to assert their statutory claim.

#### ***Reasonable possibility***

With respect to the second branch of the leave test, i.e. whether there is a “reasonable possibility” that the action will be resolved in favour of the plaintiffs, all parties acknowledged that a preliminary consideration of the merits of the plaintiffs’ case was necessary. The plaintiffs contended that the threshold for a reasonable possibility of success at trial is met as long as there is some evidence which, if accepted by the court, is consistent with the allegation that a misrepresentation has been made. In contrast, the IMAX Defendants argued that the burden on the plaintiffs to meet this part of the leave test should be a heavy one given that the overall purpose of the leave requirement is to deter unmeritorious claims or “strike suits”. The defendants also argued that the plaintiffs must “overcome” the statutory defences asserted by the defendants – “reasonable investigation” and “expert reliance” (set out in subsections 138.4(6) and (11) of the OSA, respectively).

In interpreting this branch of the “leave” test, Justice van Rensburg held that the leave provision requires the plaintiffs to put forward evidence with respect both to the alleged misrepresentation and to the conduct of IMAX’s officers or directors in relation to it. However, Justice van Rensburg established a low threshold for a “reasonable possibility” – as requiring only “something more than a *de minimis* possibility or chance that the plaintiff will

succeed at trial” – finding that the leave requirement was only meant to prevent an abuse of process or purely speculative claims.

In reviewing the evidence, Justice van Rensburg found that the plaintiffs had satisfied this “low threshold” against the IMAX Defendants (except for two outside directors).

### ***Raising statutory defences at the leave stage***

Justice van Rensburg also addressed the statutory defences asserted by the IMAX Defendants, namely the “due diligence defence” and the “expert reliance” defence. In doing so, Justice van Rensburg determined that to establish these defences at the leave stage, a defendant must submit evidence that would foreclose the plaintiffs’ reasonable possibility of success at trial.

### ***The due diligence defence***

The statutory “due diligence” defence requires a defendant to establish (i) that an investigation, reasonable in the circumstances, was undertaken; and (ii) the defendant had no reasonable grounds to believe that there was a misrepresentation. Justice van Rensburg found that the first branch of this defence involved a consideration of the systems in place at IMAX concerning revenue recognition, the roles of responsibilities of those involved in revenue recognition, and the oversight and assurance measures including the performance of audit functions by IMAX’s auditors. The second branch involved a consideration of the specific knowledge of each respondent and the knowledge someone in his or her position ought to have had. Importantly, Justice van Rensburg determined that the “business judgment rule” should not be “read in” to the “due diligence defence” because, in her view, reading in a standard of deference to a director’s decision would be both unnecessary and inconsistent with the scheme and purpose of the statutory scheme for secondary market liability.

After a review of the evidence, Justice van Rensburg held that the defendants had not submitted evidence of “due diligence” that would foreclose the reasonable possibility that the plaintiffs’ would be successful at trial.

### ***Expert reliance defence***

The IMAX Defendants also asserted the expert reliance defence on the basis that it was reasonable for them to rely on the advice of IMAX’s auditors. Justice van Rensburg questioned whether this defence was applicable, as in her view, the defence applies to statements that originate with an expert. In this case the alleged misrepresentations originated with IMAX, having appeared in IMAX’s continuous disclosure documents.

As a result, Justice van Rensburg rejected this defence and granted leave for the plaintiffs to proceed with their statutory cause of action against all of the defendants, with the exception of two who were directors of IMAX but had not been involved in the audit committee or the making of the alleged misrepresentation.

### ***Going forward***

The IMAX Defendants have sought leave to appeal and this is likely not the last word on these issues.

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