



Leave to commence meritless secondary market claim under the Ontario Securities Act refused

September 25, 2012

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A decision released on September 14, 2012 in the [Gould v. Western Coal Corporation](#) class action, on a motion for leave to commence a securities action under Part XXIII.1 of Ontario's [Securities Act](#) (the "OSA") provides guidance as to the plaintiff's burden of demonstrating that there is a "reasonable possibility" that the action will be resolved in his or her favour. Justice Strathy's decision denying leave is the first instance in which a plaintiff has been denied leave to proceed on the basis of the merits of the claim.

Background

Gould, a retired engineer living in Alberta, sought leave pursuant to section 138.8 of the OSA to pursue an action for statutory misrepresentation in the secondary securities market against Western Coal Corporation ("WCC" or the "Company"), a number of WCC's directors and officers, WCC's majority shareholder and an investment fund which had provided financing to WCC. Gould also made allegations that some of the defendants were liable for civil conspiracy and alleged oppression under British Columbia's [Business Corporations Act](#) (the "BCBCA"). The plaintiff sought to certify the entire proceeding pursuant to section 5 of the [Class Proceedings Act, 1992](#) (the "CPA").

Gould's claim was essentially that the defendants had fabricated a financial crisis in WCC in November, 2007 for the purpose of artificially depressing the Company's stock price and enabling the defendants to improve their respective shareholdings in WCC at a discounted price. Gould alleged that some of the defendants had falsified accounting information which, in turn, caused the Company's auditors to require that a note be included in the November, 2007 quarterly financial statements that there was "substantial doubt about the ability of the Company to meet its obligations as they come due" (the "Going Concern Note"). On receiving that news, Gould, and other investors, sold their WCC shares.

One week later, WCC announced that it had secured financing in the range of \$30-\$40 million from the defendant investment fund. Gould originally suggested that the financing had been pre-arranged and the release of this information was delayed as part of the larger conspiracy to temporarily deflate WCC's share price, to allow the defendants to buy shares and then benefit from the increase in stock price following announcement of the financing. This latter assertion was largely abandoned by the time of the leave motion, in the face essentially unchallenged evidence by the defendants to the contrary, and the focus of the motion was primarily the allegation that WCC had delayed efforts to obtain financing and deliberately painted an overly bleak picture of the Company's prospects for the insiders' own gain.

The Leave and Certification Motions

The motions for leave to proceed with the secondary market claim and certification of the claim as a class proceeding were heard together. Gould's evidence on the motion was largely based on the public record as well as the evidence of two experts, one a forensic investigative accounting firm, who deposed that WCC's public statements contained a misrepresentation and that its financial statements had not been prepared in accordance with general accepted accounting principles ("GAAP") and the other, a securities lawyer who deposed that the financing must have been known to WCC and management "a number of days" prior to announcement.

The defendants filed a significant body of evidence on the motion in response, including evidence from fifteen deponents, all of whom were personally involved in the events giving rise to the litigation and who provided what the Court described as "detailed and thoroughly documented evidence concerning their actions during the material time" only four of whom were cross-examined. In addition, the defendants also tendered evidence from two experts on the issue of the alleged accounting discrepancies.

In considering whether leave to proceed should be granted, Justice Strathy applied the test from [Silver v. IMAX Corporation](#) which recognizes that the plaintiff's evidentiary burden on the leave motion is not an onerous one and that the court on such a motion has a limited ability to weigh evidence. Notwithstanding the low threshold for leave and the conflicting expert evidence tendered, Justice Strathy concluded that the claim had no reasonable possibility of success at trial as the claim had been shown to be based on "speculation or suspicion rather than evidence"; as a result, leave to proceed was not granted. Justice Strathy was persuaded on the evidence before him that there was no intentional attempt to misrepresent WCC's financial circumstances and that the Going Concern Note was the product of active and informed discussions between WCC management, the auditor and the Company's Audit Committee.

In dismissing the leave motion, the Court was particularly critical of the Plaintiff's forensic accounting expert, finding that the expert had overstepped the bounds of appropriate expert evidence in numerous respects, including offering opinions outside the expert's area of expertise and effectively becoming an advocate for the plaintiff rather than providing impartial evidence for the Court's assistance.

Given that leave to proceed was not granted, the Court did not need to consider the "reasonable investigation" defence advanced by the defendants as set out in section 138.4 of the OSA but nevertheless concluded that the defence was available to the defendants in the circumstances. The defendants had engaged in a reasonable investigation and there were no reasonable grounds to believe the financial statements and the Going Concern Note contained a misrepresentation.

The motion for certification of the action as a class proceeding was also dismissed. The Court found that the civil conspiracy claim could not be certified as the core of that claim was the allegation of misrepresentation, which the Court had found to be groundless and having no reasonable prospect of success. In addition, the Court concluded that it had no jurisdiction over Gould's allegation of oppression under the BCBCA and such a claim could only be brought in the British Columbia courts as a matter of jurisdiction.

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