British Columbia Supreme Court weighs in on test for leave to commence a secondary market action

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The first decision from a BC court to address the requirement for leave to commence an action for civil liability for secondary market disclosure under Part 16.1 of the British Columbia *Securities Act* was released on October 21, 2011. In *Round v. MacDonald, Dettwiler and Associates Ltd*. (*Round*) the Court denied leave on the basic threshold issues of whether the secondary market liability provisions applied retroactively and to shareholders who acquired their shares from treasury rather than in the secondary market. However, the Court's comments in *obiter* suggest that the BC courts may adopt a stricter approach to granting leave than the approach endorsed by the Ontario courts to date.

Background

The would-be plaintiff in the case, Ms. Round, "acquired" her shares from the treasury of MacDonald, Dettwiler and Associates Ltd. (MDA) pursuant to an Employee Share Purchase Plan (the ESPP). Pursuant to the ESPP, Ms. Round made monthly contributions to her ESPP account through regular deductions from her payroll. The ESPP administrator periodically purchased shares from the treasury of MDA and, throughout the relevant time period of October 2007 to May 2008, allocated an entitlement to shares to Ms. Round's ESPP account at the end of each month. Ms. Round did not, however, withdraw any shares from her ESPP account until December 2008, when she left her employment with MDA.

The principal allegations made by Ms. Round against MDA concern MDA's alleged failure to disclosure material facts relating to the proposed sale of one of its primary assets, including that it was in negotiations to sell the asset and the sale was subject to Ministerial approval under the *Investment Canada Act*. Ms. Round also alleged that MDA misrepresented the status of the agreement by repeatedly disclosing that it expected the sale to close in the second quarter of 2008, when it knew that there was a material risk that the sale might not be approved, and ultimately failed to disclose the Minister's conditional and final decisions not to approve the sale in a timely manner.

The Court concluded that there were three critical time periods in respect of the alleged misrepresentations, namely, January 1, 2008 to January 8, 2008, April 8, 2008 to April 10, 2008 and May 8, 2008 to May 12, 2008. The sale agreement was negotiated during the January time period and finally signed on January 8, 2008; the Minister released his conditional decision not to approve the sale on April 8, 2008, which decision was disclosed by MDA on April 10, 2008; and the Minister's final decision not to approve the sale was released on May 9, 2008 and disclosed by MDA in a press release issued that same day, as well as on May 12, 2008 in its interim Financial Statements. As argued by MDA, and

accepted by the BC Court, “these time periods are the only ones in which there is even a shadow of a claim that facts were not disclosed or were misrepresented.”

Based on forgoing, MDA took the position that the BC Court did not need to delve into the “finer points” of the leave test, but could dismiss the motion as a matter of course on the basis that (i) all of the material facts alleged by Ms. Round occurred before the secondary market liability provisions came into force on July 4, 2008, (ii) the secondary market liability provisions do not apply to Ms. Round’s alleged claim because she did not purchase her shares on the secondary market, but acquired them from treasury, and (iii) Ms. Round neither acquired nor disposed of her shares during the critical periods, but rather only acquired a right to acquire shares through the ESPP and did not, in fact, acquire any shares until December, 2008.

Leave Denied

The leave test under the BC *Securities Act* mirrors the test in the Ontario *Securities Act*; each require the applicant to show that the “claim is brought in good faith and that there is a reasonable possibility that the claim will be resolved at trial in favour of the plaintiff” before leave will be granted to commence an action. Only the second branch of the test was at issue in *Round*.

The Court ultimately accepted MDA’s preliminary arguments that the secondary market liability provisions were not in effect at any time material to Ms. Round’s alleged claim, and, even if the provisions were intended to have retroactive or retrospective application, Ms. Round did not acquire her shares in the secondary market. On this basis, the Court concluded that “there is no prospect that the intended action, as framed, could succeed at trial.”

Regarding the retroactive application of the secondary market liability provisions, the Court held that “the causes of action created by the Legislature do not apply to matters that were complete before the legislation came into effect,” and “there is nothing in the legislation that suggests that the Legislature intended the causes of action it created to apply either retroactively or retrospectively to completed matters.” As a matter of fact, the Court found that the material facts potentially giving rise to a cause of action were completed shortly after May 12, 2008, following the disclosure of the Minister’s final decision not to approve the sale in (i) a press release issued by MDA on May 9, 2008 and MDA’s interim Financial Statements released and filed on May 12, 2008. Alternatively, the Court concluded that the material facts were certainly completed by May 23, 2008, when MDA shares were trading at a higher price than they were immediately before the Minister announced his final decision to reject the sale; the legislation did not come into effect until July 4, 2008.

Interestingly, in determining that the proposed cause of action was completed by May 12, 2008, the Court gave no weight to Ms. Round’s argument that MDA’s failure to file a Material Change Report on SEDAR as required by National Instrument 51-102 *Continuous Disclosure Obligations* was a continuing failure to disclose that was not remedied until after July 4, 2008. Rather, the Court explained that, “disclosure and the filing of Material Change Reports are separate matters…. Disclosure is made by issuing a news release. The obligation to file a Material Change Report is simply a filing requirement. The Material Change Report is a record of disclosures that have been made, not the disclosure itself.” The Court was completely satisfied that the issuance of a news release constitutes “sufficient disclosure to the public to comply with [the] substantive disclosure obligations, as far as secondary market liability is concerned.”

As to Ms. Round’s “acquisition” of shares, the Court unequivocally concluded that, “[w]hatever interest Ms. Round may have had in the shares of MDA at the material times, that interest was not acquired in the secondary market.” “The legislative scheme is clear that the secondary market liability provisions do not apply to a person who acquired shares from treasury in the way [Ms. Round] did.” Having regarding to the express wording of the leave test requiring “a reasonable possibility that the action will be resolved at trial in favour of the plaintiff,” the Court held that “an action can only be brought by a person who has a cause of action and is, thereby, a proper plaintiff. If Ms. Round does not personally have a cause of action, leave cannot be granted to start the action.”

In light of the foregoing conclusions, the BC Court declined to decide the third threshold issue put forward by MDA, namely, whether Ms. Round's right to acquire shares under the ESPP during the relevant time period qualified as an acquisition of shares under the BC securities legislation entitling Ms. Round to maintain an action.

Similarly, the Court declined to decide whether the evidence regarding the statements made by MDA or its alleged failures to disclose material facts in a timely way satisfied the "reasonable possibility of success at trial" branch of the leave test, preferring instead to adjourn "a definitive decision on the meaning of the test for granting leave [for] the case that calls for it."

The Court's Consideration of the Leave Test

Although the "finer points" of the leave test were not in issue on this motion, the Court took the opportunity to evaluate the test and provide some preliminary guidance to would-be plaintiffs and proposed defendants as to how future courts may approach the leave motion.

The Court began its analysis of the leave test with a consideration of the underlying legislative purpose of the statutory regime for secondary market liability. Like the Ontario courts in *Silver v. Imax Corp* (*Imax*), *Dobbie v. Arctic Glacier Income Fund* (*Arctic Glacier*) and *Ainsle v. CV Technologies Inc.* (*CV Technologies*), the Court in *Round* accepted that the secondary market liability provisions were enacted for dual purposes: (i) to deter companies from misrepresenting or failing to disclose material facts and changes, and (ii) to provide compensation for shareholders who incurred losses as a result of such misrepresentations and/or failures to make timely disclosure. (Detailed commentary on the Ontario decisions mentioned above can be found here and here)

However, unlike the Ontario courts, the BC Court seemed inclined to accord more weight to the deterrence aspect of the legislation than the remedial aspect, stating that "the reform appears to have been driven primarily by deterrence as a means of improving the efficiency and transparency of capital markets" and "it appears that a dominant purpose of creating these causes of action was to deter companies…"

As to the particular test for leave, the Court's general views were similar to those of the Ontario courts. The Court considered the removal of reliance as an essential element of the statutory cause of action to be a critical distinction from the common law claim for negligent misrepresentation, and readily accepted that this distinction could potentially give rise to abusive or unmeritorious actions, commonly referred to as "strike suits", by plaintiffs seeking to extort settlements whenever there were material changes in a company's share price.

The Court then went on to articulate a number of defining propositions regarding the test for leave to commence an action, based on the express wording of the provisions for leave requiring the parties to file affidavit evidence and the would-be plaintiff to establish a reasonable possibility that the action will be resolved at trial in his or her favour, as follows:

1. The leave application involves a review of evidence - each side is required to provide evidence of material facts upon which each intends to rely;
2. The analysis must involve a weighing and balancing of the evidence of each side – it is not sufficient for the court to simply rely on the material filed by the plaintiff;
3. The test involves an assessment of the merits of the proposed action on the evidence;
4. Weighing and testing the evidence to determine whether there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff is different from the test involved in certification of class actions, or the test for summary judgment.

Notwithstanding the propositions 1 and 2 above, the Court specifically rejected the argument that each of the proposed defendants is required to file its own affidavit. To the contrary, the Court held that section 140.8(3) "does no more than require each party to put before the court evidence in affidavit form of material facts it intends to rely on. It does not require each defendant to swear their own affidavit."

Here, the proposed defendants filed a single primary affidavit sworn by one of them, which all of the other proposed defendants purported to rely on. In light of that fact, it remains to be seen whether the BC courts will go as far as the Ontario courts in *CV Technologies* and *Arctic Glacier*, which determined that proposed defendants are not obligated to file any evidence or produce any affidavits in response to a leave motion, notwithstanding the "mandatory" language of section 138.8(2), which, like the BC legislation, provides that "each defendant shall serve and file one or more affidavits."

In attempting to delineate the boundaries of the leave test, the Court clearly distinguished the test for granting leave from any other threshold tests, including the tests for certification of a class action and summary judgment. The distinctions were principally premised on the basis that none of the other tests required the court to weigh and assess the evidence.

With respect to certification, the Court noted that the test is not merits based and does not involve the weighing of evidence or any assessment of the likelihood of success at trial. The Court accordingly concluded that "the test for granting leave is entirely distinct from and different to the test on certification. The one provides no guidance to the other." As to the test for summary judgment, the Court determined that "more is required to grant leave than to identify a triable issue. Whether there is a triable issue does not typically involve weighing and assessing, rather than identifying, evidence."

The Court further dismissed the notion that other threshold tests, such as the test for establishing a *prima facie* case, could provide any real assistant in applying the leave test. In this regard, the Court held that the leave test does not require a would-be plaintiff to establish that "it is more likely than not that he or she will succeed at trial." On the other hand, however, the Court held that leave test is "intended to do more than screen out clearly frivolous, scandalous or vexatious actions." In conclusion, the Court stated that "an action may have some merit, and not be frivolous, scandalous, or vexatious, without rising to the level of demonstrating that the plaintiff has a reasonable possibility of success."

In summary, the Court's emphasis on deterrence over compensation and the importance of detailed and careful assessment of the merits, combined with its clear rejection of a leave test that simply weeds out frivolous, scandalous or vexatious actions suggests that BC courts may take a stricter approach to granting leave than the Ontario courts have taken to date. However, the facts in *Round* did not require the Court to undertake a thorough and measured consideration of the test. In the result, the decision in *Round* does not differ markedly from the Ontario jurisprudence. The leave test remains elusive, falling somewhere between more than mere possibility and less than a probability.