Ontario Superior Court of Justice grants leave and certification in securities class action

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On July 25, 2013, Justice Belobaba released his decision in *Dugal v. Manulife Financial* granting leave to commence a secondary market proceeding under Part XXIII.1 of Ontario's *Securities Act*(the "OSA")and certifying the proposed class action (subject to some modifications) under the *Class Proceedings Act, 1992*(the "CPA"). In doing so, Justice Belobaba grappled with a number of contentious issues including: (i) the leave standard under s.138.8 of the OSA; (ii) the limitation period under s.138.13 of the OSA; (iii) whether proof of reliance in a negligent misrepresentation claim can be the subject of a common issue based on the "efficient market" theory; and (iv) whether proof of individual reliance is required for a claim of negligent misrepresentation in a class proceeding. As will be seen from the below, most of these issues remain unresolved.

Background

In *Dugal,* the plaintiffs assert both statutory claims under the OSA and common law claims of negligence, negligent misrepresentation and unjust enrichment against Manulife Financial Corporation ("MFC") and a number of its directors and officers (collectively, the "defendants"). The plaintiffs sought to have the action certified on behalf of a proposed class consisting of persons and entities outside Quebec who purchased MFC common shares in either the primary or secondary markets between April 1, 2004 and February 12, 2009 (the "Class Period"). The plaintiffs allege that the defendants misrepresented the adequacy of MFC's risk management practices and failed to disclose the extent of the company's exposure to equity market risk (in particular, its decision not to hedge or reinsure its guaranteed investment product line) during the Class Period. The plaintiffs' sought damages to recover their losses incurred when the price of MFC's securities collapsed allegedly as a result of the "disclosure of the truth" on February 12, 2009.

The plaintiffs defined one key representation, namely, the "statement that MFC had in place enterprise-wide risk management systems, policies and practices that were comprehensive, effective, rigorous, disciplined and/or prudent, and the substantially similar statements that are particularized in the statement of claim" (the "Representation"). In addition, the plaintiffs identified five omissions, four of which were essentially the "flip side" of the Representation (the "Omission"). Justice Belobaba found that, for the purposes of the leave and certification motions, the Representation and the Omission, although both referencing various examples in the statement of claim, could stand as a single Representation and Omission and are judicially manageable.

The plaintiffs filed more than 5,000 pages of material, including three expert reports. The defendants filed no affidavit material or expert reports and relied instead on the cross-examinations of the plaintiffs' experts and on publicly available documents.

The Leave Motion

As is likely well known to many readers, s. 138.8(1) of the OSA provides that no action may be commenced under s. 138.3 without leave of the court that shall only be granted where the court is satisfied that: (a) the action is being brought in good faith; and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

Justice Belobaba found that the first requirement was easily cleared given the force of the plaintiffs' arguments and the content of their expert reports.

With respect to the second requirement that there is a reasonable possibility of success at trial, Justice Belobaba reviewed two different schools of thought. The first, which he found was that shared by most Ontario class action judges, is a "relatively low threshold" where the plaintiff has to show "something more than a *de minimis* possibility or chance that the plaintiff will succeed at trial." The second, and that preferred by defence counsel, is the "reasonable possibility of success" standard that originated in the Ontario Law Reform Commission's (the "OLRC") report on class actions. In that report, the OLRC recommended a merits-based hurdle as a pre-condition to certification that would require the plaintiff to prove something more than a mere possibility of success at trial and was not "intended to merely screen out impossible cases". Justice Belobaba preferred the latter approach and referred the reasoning of the British Columbia Supreme Court in *Round v. MacDonald* in which that court stated that "[e]stablishing a reasonable possibility of success at trial involves more than merely raising a triable issue or articulating a cause of action…it is it is clear, in my view, that the test is intended to do more than screen out clearly frivolous, scandalous or vexatious actions."

However, Justice Belobaba proceeded to state that although he "would very much prefer to treat the s. 138.8 hurdle as more than just a speed bump" he feared, given the Supreme Court of Canada's (the "SCC") decision in *R. v. Imperial Tobacco Canada* *("Imperial Tobacco*"), "that the battle may be lost." In *Imperial Tobacco,* the SCC held that on a motion to strike for not disclosing a reasonable cause of action, one only has to show a "reasonable prospect of success" at trial. Justice Belobaba stated that since, under s. 5(1)(a) of the CPA, a reasonable cause of action will be made out if the plaintiff can show a "reasonable possibility of success" at trial, it appears that "the OLRC's more demanding interpretation of the "reasonable possibility of success" standard cannot be resuscitated and the s. 138.8 leave hurdle is doomed to be nothing more than a speed bump."

In any event, Justice Belobaba found that the plaintiffs had established a reasonable possibility of success at trial on both the "more than a chance" standard and on the more demanding OLRC standard finding that the plaintiffs had established "a seriously arguable claim". Accordingly, Justice Belobaba granted leave under s. 138.8 of the OSA.

The Certification Motion

Justice Belobaba next turned to the certification requirements of s. 5(1) of the CPA and easily found that: (i) the identifiable class criterion in s. 5(1)(b); (ii) the preferable procedure criterion in s. 5(1)(d); and (iii) the suitable representative plaintiff criterion in s.5(1)(e), were satisfied. The issues that required more in-depth consideration were ss. 5(1)(a) and (c) of the CPA.

With respect to s. 5(1)(a) and whether the pleading discloses a cause of action, Justice Belobaba first considered the statutory cause of action under Part XXIII.1 of the OSA. MFC argued that the action was time-barred as it was not commenced within 3 years of the alleged misrepresentation as required by s. 138.14 of the OSA and the Court of Appeal's decision in *Sharma v. Timminco Ltd.*. Justice Belobaba referred to cases post-*Timminco* where the special circumstances doctrine was applied and found that it

was not plain and obvious that the limitation defence applies. He also noted that this issue is currently the subject of a reserve decision of a five-member panel of the Court of Appeal.

With respect to the claim of negligent misrepresentation (alleged on behalf of both primary and secondary market purchasers but only against MFC and only on the basis of the Representation and not the Omission), Justice Belobaba held that all of the essential elements had been pled and relied on *Silver v. Imax Corporation*in holding that it was not plain and obvious that there is no special relationship between issuers and secondary market purchasers.

Justice Belobaba also found that there were proper claims in negligence and unjust enrichment (although he questioned the utility of the unjust enrichment claim given the scope of recovery under the other causes of action).

Justice Belobaba spent considerable time examining s. 5(1)(c) of the CPA that requires that the class proceeding raise common issues of fact or law. He certified 7 of the 12 proposed common issues, finding that they do not require individual findings of fact or inquiries into the circumstances of individual claims and will help advance the litigation.

One of the proposed common issues certified was "[c]an each Class Member's reliance be inferred from the fact of the Class Member having acquired MFC's securities in an efficient market?" Referring to *NBD Bank, Canada v. Dofasco*, *Mondor v. Fisherman*and *McKenna v. Gammon Gold Inc.*, Justice Belobaba determined that individual reliance can be inferred from surrounding facts or circumstances and that given that this issue only asks whether buying securities in an efficient market can provide the surrounding circumstances for inferring individual reliance and does not require individual assessments, it is a legitimate query and one that will help advance the litigation.

One of the proposed common issues not certified asked: "Are the Class Members required to demonstrate individual reliance upon the Representation in order to have a right of action against the Defendants for common law negligence, or for negligent misrepresentation?" In refusing to certify this issue, Justice Belobaba held that the answer to this question had to be "yes" and stated that the SCC, in *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, has made it clear that proof of individual reliance remains an essential component of the claim for negligent misrepresentation. It may be inferred or even presumed, depending on the facts, but it is always necessary.

Given the above-noted findings, Justice Belobaba certified the class action.