CANADIAN SECURITIES ADMINISTRATORS NOTICE 53-302

REPORT OF THE CANADIAN SECURITIES ADMINISTRATORS

PROPOSAL FOR A STATUTORY CIVIL REMEDY FOR INVESTORS IN THE SECONDARY MARKET AND RESPONSE TO THE PROPOSED CHANGE TO THE DEFINITIONS OF "MATERIAL FACT" AND "MATERIAL CHANGE"

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EXECUTIVE SUMMARY

(1) Purpose

The Canadian Securities Administrators (the "CSA") have developed proposed amendments to securities legislation that would give investors in the secondary market the right to sue any public company and key related persons for making public misrepresentations about the company or for failing to make required timely disclosure. The amendments would provide a limit on the amount of money that can be claimed. The proposed amendments are being published for information purposes only. The CSA is not seeking further comment on the proposed amendments. Certain members of the CSA will recommend the amendments to their respective governments. **At this time, the respective governments of the CSA have made no decision to proceed with the amendments.**

(2) Key Features of the Proposed Remedies

(a) Scope of remedy

The proposed legislative remedy would provide secondary market investors with a limited right of action against an issuer of securities, its directors, responsible senior officers, "influential persons" (for example large shareholders with influence over the disclosure), auditors and other responsible experts. Secondary market investors would have the right to seek limited compensation for damages suffered at a time when the issuer had made, and not corrected, public disclosure (either written or oral) that contained an untrue statement of a material fact or failed to make required material disclosure.

(b) Reliance

Investors would have the right to sue whether or not they actually relied on the misrepresentation or failure to make timely disclosure. This provision is intended to remove the necessity to prove reliance and to reflect the fact that they may suffer damage indirectly because of the effect a misrepresentation has on the market price of a security.

(c) Standards of proof and potential defences

The issuer and other potential defendants would have varying defences based on their responsibility for the disclosure. For some types of disclosure, the person has a defence if that person conducted due diligence. For other types of disclosure, the person is not liable unless the plaintiff proves that the person knew about the misrepresentation in the document, deliberately avoided acquiring knowledge or was guilty of gross misconduct in making the statement containing the misrepresentation.

(d) Liability cap

The proposal is primarily directed to providing an effective deterrent to misrepresentations and failures to make timely disclosure. Providing compensation for investor damages is a secondary objective, which should be balanced against the interests of long term security holders of the issuer, who effectively pay the cost of any damage awards. In order to achieve this balance, the proposed legislation would limit the potential exposure of issuers and other potential defendants. The limits vary between different categories of defendants. For an issuer, the liability cap is set at the greater of $1 million or 5% of market capitalization. For potential defendants other than the issuer, the liability caps do not apply if the person "knowingly" made the misrepresentation or "knowingly" failed to make required timely disclosure.

(e) National application of liability cap

To ensure that the liability cap is not exceeded when there are multiple actions regarding the same misrepresentation or failure to make timely disclosure across Canada, the statutory limit on the total amount of damages received considers damage awards in other jurisdictions. Specifically, the amount of damages a defendant must pay are reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation or failure to make timely disclosure under a similar action in any Canadian jurisdiction.

(f) Screening mechanism

One of the risks of creating statutory liability for misrepresentations or failures to make timely disclosure is the potential for investors to bring actions lacking any real basis in the hope that the issuer will pay a settlement just to avoid the cost of litigation. To limit unmeritorious litigation or strike suits, plaintiffs would be required to obtain leave of the court to commence an action. In granting leave, the court would have to be satisfied that the action (i) is being brought in good faith, and (ii) has a reasonable possibility of success.

(g) Court approval of settlement agreements

A further discouragement to abusive litigation would be the requirement for court approval of any proposed settlement of an action under these provisions. The court would be expected to refuse approval where the terms or circumstances of the settlement indicate that the litigation was a "strike suit".

(h) Proportionate liability

Another concern about securities litigation is the prospect of defendants with "deep pockets" being forced to pay for damages caused primarily by others. The proposed legislation would make the liability of each defendant proportionate to that defendant's share of responsibility for the misrepresentation or the failure to make timely disclosure. However, in the case of a "knowing" misrepresentation or failure to make timely disclosure, the liability would be joint and several.

(3) Responses to 1998 Published Proposal

In May 1998, certain members of the CSA published its first civil remedies proposal, which was designed to implement the main recommendations of the Final Report of the Toronto Stock Exchange Committee on Corporate Disclosure. The comments received expressed two main concerns:

- the need for civil remedies for secondary market investors has not been demonstrated; and

- these remedies would produce costs that outweigh its benefits, primarily by forcing public companies and others to settle unmeritorious litigation commonly known as "strike suits".

The new proposal as described above attempts to address these concerns.

(4) The Rationale for Limited Secondary Market Civil Remedies

(a) Need for improved continuous disclosure

The quality of continuous disclosure in Canada can and should be improved. Institutional investors have characterized the quality of continuous disclosure in Canada as inadequate and inferior to that in the United States. As most trading now takes place in the secondary market in reliance upon continuous disclosure documents, it is important to proceed with civil remedies for investors in the secondary market. The CSA's proposal complements and supports other CSA initiatives aimed at improving the quality of continuous disclosure. These include the proposed integrated disclosure system and the CSA's increased focus on continuous disclosure review.

(b) Combined public and private enforcement

The CSA disagree with the comment that deficient continuous disclosure is not an appropriate subject for a civil remedy and should be dealt with only through regulatory enforcement measures.

Private enforcement and public regulation together provide effective and complementary incentives to public companies and others involved with their disclosure to ensure accurate and reliable primary and continuous disclosure.

A statutory right of action for secondary market investors, which is comparable to that already available to primary market prospectus investors, is desirable and appropriate.

(c) Limited compensation model

The CSA's new proposal is based on the belief that significant but limited liability would be an effective deterrent to misrepresentations and would significantly improve the quality of corporate disclosure. The new proposal keeps the limited compensation model, except in the case of a "knowing" misrepresentation or failure to make timely disclosure. In those cases, the liability caps do not apply.

Questions may be referred to any of:

Brenda Benham
Director, Policy & Legislation
British Columbia Securities Commission
(604) 899-6636
e-mail: bbenham@bcsc.bc.ca

Sheryl Thomson
Senior Policy Advisor
British Columbia Securities Commission
(604) 899-6778
e-mail: sthomson@bcsc.bc.ca

Stephen Murison
Legal Counsel
Alberta Securities Commission
(403) 297-4233
e-mail: stephen.murison@seccom.ab.ca

Barbara Shourounis
Director
Saskatchewan Securities Commission
(306) 787-5842
e-mail: bshourounis@ssc.gov.sk.ca

Susan Wolburgh Jenah
General Counsel
Ontario Securities Commission
(416) 593-8245
e-mail: swolburghjenah@osc.gov.on.ca

Rossana Di Lieto
Legal Counsel
Ontario Securities Commission
(416) 593-8106
e-mail: rdilieto@osc.gov.on.ca

Diane Joly
Directrice de la recherche et du développement des marchés
Commission des valeurs mobilières du Québec
(514) 940-2199, Ext. 2150
e-mail: Diane.Joly@cvmq.com

Sylvia Pateras
Special Advisor to the Chair for CSA Matters
Commission des valeurs mobilières du Québec
(514) 940-2199, Ext. 4412
e-mail: Sylvia.Pateras@cvmq.com

I. INTRODUCTION

In May 1998 certain members of the Canadian Securities Administrators (the "CSA") published for comment proposed amendments to securities legislation (the "1998 Draft Legislation") which would create a limited statutory civil liability regime for continuous disclosure. These amendments, if implemented, would enable investors who purchase securities in the secondary markets to bring a civil action against issuers and other responsible parties for misrepresentations in disclosure documents and other statements relating to the issuer or its securities or for failure to make timely disclosure when required.[1] The 1998 Draft Legislation arose out of the CSA's review and support of The Toronto Stock Exchange Committee on Corporate Disclosure's (the "Allen Committee") final report issued in March 1997 (the "Final Report"). The Allen Committee was established to review continuous disclosure by public companies in Canada and assess the adequacy of such disclosure. The Allen Committee was also asked to consider whether additional remedies ought to be available, either to regulators or to investors, if companies fail to observe the continuous disclosure rules.

The 1998 Draft Legislation also included proposed changes to the definitions of "material fact" and "material change". The amended definitions were first published for comment on November 7, 1997[2] (the "Request for Comment") and did not form part of the recommendations contained in the Final Report.[3] The CSA received several submissions in response to this Request for Comment. At the time the 1998 Draft Legislation was published, the CSA were still considering the comments received on the proposed amended definitions and no decision had been made to revise the definitions as proposed. In the meantime, a decision was made to reflect the proposed revised definitions in the 1998 Draft Legislation and publish the entire package for comment.

The CSA received 28 comment letters on the 1998 Draft Legislation. A summary, in tabular form, of the comments received and the CSA's response to those comments is contained in Appendix A. A summary of the comments received on the Request for Comment is contained in Appendix B.

As a result of these comments and further deliberation by the CSA, the CSA have made a number of changes to the 1998 Draft Legislation. This report (the "CSA Report") provides a background discussion on the proposal to introduce civil liability for continuous disclosure. In addition to those comments summarized in Appendix A, this CSA Report also summarizes the major concerns raised by the commenters, the CSA's responses and the substantive changes, if any, that have been made to the 1998 Draft Legislation in response to these concerns. Certain members of the CSA are also publishing

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1 The 1998 Draft Legislation was published for comment by the British Columbia, Alberta, Saskatchewan and Ontario Securities Commissions. In Alberta, at (1998) 7 ASCS 1761.

2 In Alberta, at (1997) 6 ASCS 3118 (the "Request for Comment").

3 With the exception of one aspect of the proposed change to the definition of "material fact" to remove the retroactive aspect of the current definition which was recommended by the Allen Committee.

as Appendix C to this CSA Report, for information only, the revised text of the amendments to securities legislation (the "2000 Draft Legislation") proposed to give effect to the CSA proposal in their jurisdiction. The CSA are not soliciting further comment on the proposal.

Certain members of the CSA will recommend the 2000 Draft Legislation to their respective governments and are hopeful that it will be tabled for legislative consideration at the first opportunity. **At this time, however, the respective governments of the CSA have made no decision to proceed with the amendments.**

II. BACKGROUND

(i) The Allen Committee

The Toronto Stock Exchange (the "TSE") established the Allen Committee to review continuous disclosure by public companies in Canada and to comment on the adequacy of such disclosure and determine whether additional remedies ought to be available, either to regulators or to investors, if companies fail to observe the rules. The TSE initiative to establish the Allen Committee was the result of a number of factors. These included several high profile and well publicized incidents of alleged misrepresentations and questionable disclosure by public companies in Canada which illustrated the anomalous gap between statutory civil liability for prospectus disclosure and the absence of such liability for continuous disclosure. This gap was underscored by the fact that primary issuances of securities under a prospectus accounted for only about 6% of all capital markets trading while secondary market trading constituted the remaining 94% of such activity. Also, there was a growing recognition that private rights of action were a necessary complement to the enforcement activities of securities regulators. In addition, the primary focus on the prospectus as the cornerstone of issuer communication was becoming an increasingly outmoded notion in today's electronic media-driven environment. Lastly, there were perceived differences between the Canadian and U.S. liability regimes as well as perceived gaps in the standard and quality of disclosure in the two countries.[4]

The Allen Committee began its deliberations based on the accepted premise that continuous disclosure is necessary to ensure that investors receive meaningful, timely, complete and accurate information concerning public companies.

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[4] The Allen Committee determined that empirical research was needed to establish whether those who receive, use and rely on disclosure in making investment decisions believe there is a problem with continuous disclosure. To assist the Allen Committee, the TSE commissioned two surveys of investor groups, entitled "Corporate Disclosure Survey Conducted for The Toronto Stock Exchange", February 1995 (the "Analysts Survey") and "Survey of Retail Investors", February 1995. The Analysts Survey results indicated that of those respondents that also analysed firms subject to U.S. reporting requirements, 88% found that disclosure was better in the U.S.

> "The entire capital market system in Canada is built on a foundation of information - full, true and plain disclosure of all material facts in a prospectus and continuous disclosure of material changes and information...Information is really the lifeblood of trading on securities markets".[5]

Following an extensive series of meetings with market participants and their advisers (including securities regulators) and research, analysis and discussion, the Allen Committee released its Interim Report (the "Interim Report") in December 1995. The Interim Report made several recommendations including that a limited statutory regime be created whereby issuers and others responsible for misleading continuous disclosure could be held liable in civil actions brought by injured investors to recover their damages.[6]

The reaction by market participants to the Interim Report was strong. With some exceptions, issuers tended to feel that a problem with disclosure did not exist, or that, if there was a problem, statutory civil liability was an excessive remedy. On the other hand, representatives of the investor community tended to feel, also with some exceptions, that there was a disclosure problem and that those who are responsible for misleading disclosure should be accountable.

In the summer of 1996, after the comment period, the Allen Committee resumed its meetings with, as stated in the Final Report, the objective of "testing the validity of the conclusions reached against the submissions, to obtain evidence that would either validate or refute the conclusions reached and to listen

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5 Interim Report, page iii.

6 A number of proposals to extend statutory civil liability to continuous disclosure preceded the recommendations of the Allen Committee. In 1979, a Task Force released a report entitled "Federal Proposals for a Securities Market Law of Canada" (P. Anisman, J. Howard, W. Grover & J.P. Williamson, "Proposals for a Securities Market Law for Canada", 1979). The authors of this report proposed, among other things, a statutory civil liability regime with respect to continuous disclosure (the "Federal Proposal"). These proposals were followed some years later by a proposal of the Ontario Securities Commission in 1984 which was published for comment (the "OSC Proposal") and which also suggested the adoption of a liability regime for continuous disclosure ("Civil Liability for Continuous Disclosure Documents Filed under the Securities Act - Request for Comments", 7 OSCB 4910 (1984)). While both the Federal Proposal and the OSC Proposal stimulated a considerable amount of public debate at the time and elicited significant public comment (most of which were opposed to the idea of civil liability for continuous disclosure) neither led to legislative change. Finally, in 1993, the Québec Government recommended a limited version of the proposed regime aimed at small investors (*Quinquennial Report on the Implementation of the Securities Act*, Minister of Finance, Louise Robic, Gouvernement du Québec, ministère des Finances, December 1993), whereas in 1994, the B.C. Government also developed a proposal to introduce a limited scheme of civil liability for certain disclosure in response to the Matkin Inquiry and recommendations reflected in the Matkin Report (J.G. Matkin & D.G. Cowper, *Restructuring for the Future; Towards a Fairer Venture Capital Market*, Report of the Vancouver Stock Exchange & Securities Regulation Commission (1994)). However, by this point in time, the Allen Committee had been established and so the Québec and B.C. Governments agreed to await the outcome of their report in the hopes that any eventual recommendations could be adopted nationally.

with care to the concerns expressed -- both the concern that the Committee had erred in going too far and the concern that it had erred in not going far enough".[7]

Having engaged in this process, the Allen Committee concluded in the Final Report that its original recommendations should remain, with certain changes to reflect some of the concerns expressed by market participants in their letters of comment. The Allen Committee found that there was evidence of a significant number of incidents of disclosure violations and a perception that problems existed with the adequacy of disclosure in Canada. The Allen Committee expressed concern that these circumstances could result in the capital markets falling into disrepute with attendant loss of investor confidence. The risk of this happening would have direct cost of capital implications for all companies that participate in our capital markets. Specifically, the Allen Committee concluded that:

"(i) There is a sufficient degree of non-compliance with the current continuous disclosure rules in Canada to cause concern.

(ii) The current sanctions available to regulators charged with the task of monitoring and enforcing compliance with Canada's continuous disclosure rules provide inadequate deterrent.

(iii) Similarly, the remedies available to investors in secondary trading markets who are injured by misleading disclosure are so difficult to pursue and to establish, that they are as a practical matter largely academic.

(iv) We believe that civil liability should attach to issuers and others for their continuous disclosure to investors in secondary markets, subject to reasonable limitations.

(v) Faced with the task of designing recommendations from the perspective of strengthening deterrence (conclusion (ii)) or creating a route to meaningful compensation of injured investors (conclusion (iii)), the Committee has adopted improved deterrence as its goal in the belief that effective deterrence will logically reduce the need for investor compensation.

(vi) The rules by which class actions are conducted in those provinces where class actions are permitted are sufficiently different from those in the United States that there is no practical risk that the establishment of statutory civil liability in Canada will facilitate extortionate class action in Canada.

(vii) Capital markets are moving to a fully integrated disclosure system in which companies will be able to issue new securities at any time based on the information in their continuous disclosure record rather than information in a

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[7] Final Report, page ii.

prospectus connected with a particular transaction."[8]

In sum, the majority of the Allen Committee members approached the task of designing a statutory civil liability regime for continuous disclosure from a "deterrence" perspective. Moreover, the Allen Committee felt that their recommendations, if implemented, would significantly deter misleading disclosure by providing a remedy for injured investors to obtain some measure of compensation for disclosure violations, without unduly penalizing remaining shareholders in the company or other innocent market participants and without adding unreasonably to the cost of good disclosure.

(ii) The CSA Civil Remedies Committee

Following the release of the Final Report, the CSA Chairs publicly indicated their support of the Allen Committee's recommendations and established a committee comprised of staff from the securities commissions of British Columbia, Alberta, Saskatchewan, Ontario and Québec (the "CSA Civil Remedies Committee") to consider the Allen Committee recommendations and draft legislation (which resulted in the 1998 Draft Legislation).[9]

The 1998 Draft Legislation differed from the existing prospectus remedy found in provincial securities legislation in its focus on deterring misrepresentations and encouraging good disclosure practices without necessarily providing full compensation to aggrieved investors. In this context, the 1998 Draft Legislation followed closely the model that had been adopted by the Allen Committee. The Allen Committee sought to create a system of statutory liability which would contain enough checks and balances (through the availability of due diligence defences and through limitations on liability by means of damage caps) so that issuers and their directors and officers would be deterred from inadequate or untimely disclosure without, at the same time, creating a regime that would favour short term over long term investor interests. This focus on deterrence rather than compensation of secondary market investors was, in part, a recognition of who ultimately bears the economic burden of providing compensation.[10]

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8 Final Report, page vii. The recommendations in the Final Report reflected the unanimous views of 11 of the 12 members of the Allen Committee. The dissenting member of the Committee did not disagree with the primary recommendation that civil liability for continuous should be introduced. The dissenting member would, however, have struck a different balance than the majority in the design of the civil liability regime; a balance generally more favourable to investor compensation.

9 Staff members of the Commission des valeurs mobilières du Québec are also taking steps to ensure that the resulting legislation will satisfy Québec civil law requirements.

10 Compensation of a prospectus investor would generally involve the culpable issuer returning subscription money that it received from the aggrieved investors, restoring both the issuer and the investor to their respective original positions. By contrast, compensation of aggrieved secondary market investors (who trade with other investors, not the issuer) would generally involve payment by a culpable issuer that did not in fact receive money from the secondary market investors; by

The CSA Civil Remedies Committee has been reconsidering the 1998 Draft Legislation, taking into account both formal and informal comments received since its publication.[11] While a number of significant changes have been made to the legislation, the 2000 Draft Legislation continues to be based on a deterrence model.

III. SUMMARY OF COMMENTS AND SUBSTANTIVE CHANGES TO THE 1998 DRAFT LEGISLATION

The CSA received submissions from 28 commenters on the 1998 Draft Legislation. This section describes the main issues that were raised by the commenters, the CSA's responses, and the substantive changes, if any, that have been made to the 1998 Draft Legislation in response to these comments.[12]

There were several recurring themes in the comments received by the CSA on the 1998 Draft Legislation:

- the need for a statutory civil liability regime with respect to continuous disclosure (the "Proposal") has not been demonstrated;
- the Proposal would produce costs disproportionate to its benefits, primarily by exposing issuers and others to coercion to settle unmeritorious litigation (often referred to as "strike suits");
- the 1998 Draft Legislation gives plaintiffs an incentive to unfairly target large issuers because the damage cap is tied to market capitalization;
- the application of the damage caps will be problematic where parallel actions are launched in more than one Canadian province or territory;
- the 1998 Draft Legislation goes beyond the U.S. implied right of action under Rule 10b-5.

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diminishing the issuer's assets, the compensation payment would in effect come at the expense of other innocent investors, in particular the issuer's continuing shareholders.

[11] In this context, the CSA Civil Remedies Committee has been reviewing and comparing existing Canadian provincial class action regimes and has met with outside counsel to discuss various aspects of civil procedure particularly in the context of class action litigation in Canada and the U.S. The CSA Civil Remedies Committee has also reviewed recent legislative changes in the United States which were intended to address perceived abuses in securities class action litigation against publicly held companies as well as the development of the case law under Rule 10b-5 of the *Securities Exchange Act of 1934*.

[12] For a detailed summary of the contents of the 1998 Draft Legislation, reference should be made to the Notice which was published in 1998. In Ontario, at (1998) 21 O.S.C.B. 3367.

1. IS THERE A PROBLEM?

The comment letters illustrate that the issuer community, in particular, remains unconvinced as to the need for the Proposal. In particular, the commenters question the basis upon which the Allen Committee concluded that there was a sufficient degree of non-compliance with continuous disclosure obligations to justify concern.

(i) Deficient Disclosure

The Allen Committee noted that institutional investors had characterized the quality of continuous disclosure in Canada as inadequate and inferior to that in the United States. Based on the CSA's collective experience, the CSA remain persuaded by the Final Report that the quality of continuous disclosure in Canada can and should be improved. Increased focus on continuous disclosure review will be helpful in improving the quality of this type of information provided it is accompanied by effective enforcement effort where disclosure violations are identified. In addition, improving standards of continuous disclosure will be an important component of an integrated disclosure regime.[13] However, the CSA remain committed to seeking implementation of the Proposal so that investors are empowered with the tools to seek redress when they suffer damages as a result of misrepresentative disclosure, resulting in improved continuous disclosure in Canada.

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[13] For example, the Ontario Securities Commission (the "OSC") recently approved two rules and companion policies designed to improve disclosure of financial information by public companies. The rules will increase significantly the extent and quality of information provided in quarterly reports. OSC Rule 52-501, Financial Statements, introduces a new requirement for all public companies to include in interim financial statements an income statement and a cash flow statement for each three-month period of its financial year, other than the last three-month period of the year. Companies will also be required for the first time to provide an interim balance sheet and explanatory notes to the interim financial statements. Under the rule, a company's board of directors will be required to review the interim financial statements before they are filed with the OSC and distributed to shareholders. The rule permits the board to satisfy this review obligation through delegation of the review to the audit committee of the board. The companion policy to Rule 52-501 urges boards, in discharging their responsibilities for ensuring the reliability of interim financial statements, to consider retaining external auditors to review the statements. Rule 52-501 is expected to come into effect on December 27, 2000 (unless approved earlier by the Minister).

OSC Rule 51-501 reformulates existing OSC Policy 5.10 and introduces a new requirement for management to provide a narrative discussion and analysis (MD&A) of interim financial results with the interim financial statements. This will facilitate investors gaining an understanding of past corporate performance and future prospects on a more timely basis. The Rule will replace OSC Policy 5.10 and give the OSC greater ability to enforce compliance with annual and interim MD&A content requirements. Rule 51-501 is expected to come into effect on January 1, 2001.

In addition to the Rules, the OSC intends to continue to consider other steps that might be taken to enhance the quality and reliability of public company financial reporting. Matters under consideration include; the role and responsibilities of audit committees generally, the qualifications of audit committee members, to what extent the audit committee should be mandated and to what extent external auditors should be involved in interim reports.

(ii) Asymmetry of Regulatory Scheme

The CSA also consider the Proposal to be justified, in principle, from a broader policy perspective. Primary market investors benefit from both:

- *public regulation* - regulatory review of the prospectus offering document, with discretion to withhold the necessary receipt, and potential enforcement action; and

- *private rights of action* - a statutory right to seek compensation from issuers and others, who bear direct personal liability for losses attributable to a misrepresentation in a prospectus without having to prove reliance which is required under existing common law rights of action.

In the view of the CSA, private rights of action and public regulation together provide important, effective and complementary incentives to issuers and others involved in the prospectus process to ensure sound disclosure (or disincentives to poor disclosure) and generally produce a high standard of prospectus disclosure.

Secondary market investors, by contrast, have:

- generally not benefited from regulatory review of continuous disclosure material and follow up enforcement action for breaches. This is because the limited regulatory resources have been focussed on prospectus disclosure and also because the volume and timeliness of continuous disclosure is incompatible with prior regulatory review; and

- no effective redress is available through private rights of action.

The CSA consider the disparity between the regulation of primary and secondary markets to be unjustifiable and continue to believe that a statutory right of action should be extended to secondary market investors.

The CSA are committed to recent steps to expand and intensify review of continuous disclosure (necessarily *ex post facto,* in most instances) and enforcement follow-up where appropriate. This move is being facilitated by the self-funding status of several members of the CSA.[14] At the same time, the CSA continue to recommend that secondary market investors be given an effective mechanism involving private rights of action based on a "deterrent model", as recommended by the Allen

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[14] For example, a number of commissions have created continuous disclosure teams which are responsible for monitoring and assessing the continuous disclosure record of reporting issuers. These teams will be reviewing the continuous disclosure record of all reporting issuers in their jurisdictions on a periodic basis through a combination of targeted and random reviews.

Committee, which would serve as an incentive to issuers to follow good disclosure practices.

2. STRIKE SUIT EXPOSURE

The CSA have carefully considered concerns raised in comments on the 1998 Draft Legislation and, before that, in the course of the deliberations of the Allen Committee, about the potential under the Proposal of exposing issuers and their long term shareholders to frivolous, coercive and costly litigation ("strike suits").[15] The concern, simply put, is that cost rules and other procedural protections included in the 1998 Draft Legislation would not deter plaintiffs from commencing meritless actions with a view to extracting an early settlement. This is the most prevalent concern raised by those who oppose the Proposal.

The concern about strike suits must be addressed regardless of whether, and to what extent, one believes this will be the result if the legislation is adopted. Strike suits could expose corporate defendants to proceedings that cause real harm to long-term shareholders and resulting damage to our capital markets.

The Allen Committee concluded that statutory civil liability for misleading continuous disclosure would have little effect without the mechanism of the class action suit. Throughout its deliberations, the Allen Committee focussed on the "strike suit" phenomenon in the U.S. in the securities litigation context. The Allen Committee compared the litigation environment in the U.S. to that in Canada and concluded that they are sufficiently different to make it unlikely that meritless class actions will be brought in Canada.

In response to comments received on the Interim Report, the Allen Committee again reviewed its recommendations and concluded that there was little practical risk that they would, if implemented, open the door to strike suits. Indeed, the Allen Committee was concerned that there are too many disincentives built into the litigation system in Canada that tend to discourage even actions with merit.

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15 "The term "strike action" or "strike suit" has emerged in the context of certain class proceedings litigation in the United States. The term connotes the commencement and pursuit of a class proceeding where the merits of the claim are not apparent but the nature of the claim and targeted transaction is such that a sizeable settlement can be achieved with some degree of probability. The term suggests a class proceedings that is properly regarded as an abuse of process. ... As the American experience suggests, "strike suits", which are lawyer rather than client driven, are disconcerting for two reasons. First, they often severely and unacceptably interfere with standard corporate governance practices, creating unnecessary inefficiencies and bypassing existing regulatory devices. Second, "strike suits" may effectively transform the class-action mechanism from a shield into a sword. When fashioned into a sword by profit-motivated lawyers and shareholder-plaintiffs posing as class representatives, the class proceedings becomes a means of harassing corporate defendants". (Justice Cumming in *Epstein v. First Marathon Inc.* 2000 CarswellOnt 346).

One example is the standard Canadian "loser pays" costs rules.[16]

The CSA Civil Remedies Committee in 1998 had been largely persuaded by the Allen Report's conclusion that the litigation environment in Canada differs sufficiently from that in the United States that strike suits are not likely to be a problem in Canada.[17] The depth of public concern on the part of the issuer community, however, coupled with some recent examples of entrepreneurial litigation in Canada, have led the CSA to recommend further measures to deter the potential for strike suits. These measures are discussed below.

(i) Court Approval of any Settlement

Much of the concern about strike suits stems from uncertainty about the likely response of Canadian courts to strike suit litigation and the coerced settlements that may be the real objective of strike suit litigation. The recent decision of the Ontario Superior Court of Justice in *Epstein* v. *First Marathon Inc.*[18] ("*Epstein*") provides a strong indication of judicial disapproval of any effort to import strike suit litigation on the American pattern. In *Epstein*, the Court had been asked to approve a settlement agreement between the parties pursuant to the *Class Proceedings Act, 1992* (Ontario) (the "CPAO"). The settlement agreement at issue involved the payment of fees and disbursements to plaintiff's counsel with no benefit conferred on any shareholders of the corporation. In declining to grant approval, the Court held that the plaintiff's class proceeding was in the nature of a "strike suit" in that it was brought to benefit "entrepreneurial lawyers" and nominal plaintiffs not shareholders in the class and thus constituted an abuse of process. The Court not only declined to approve the proposed settlement but went on to exercise its discretion under the CPAO to dismiss the action without costs and specifically prohibited any payment to the plaintiff's counsel under the settlement agreement or otherwise.

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16 Whereas in the U.S., each party to a lawsuit is responsible for its own costs, the Canadian "loser pays" costs rules act as a discipline on frivolous actions. Under Ontario's and Quebec's class proceeding legislation "loser pays" is the normal rule (subject to discretion in the trial judge to depart from the rule in specified circumstances). By contrast, the B.C. *Class Proceedings Act*, adopts the U.S. costs rule. In light of this discrepancy in costs rules under applicable class action legislation, the Allen Committee recommended that the "loser pays" costs rules be mandated for purposes of class actions predicated on statutory civil liability for a misrepresentation in continuous disclosure (Final Report, page 27). The 1998 Draft Legislation largely followed this recommendation.

17 The Allen Committee reviewed the procedural provisions and other elements of the litigation environment that facilitate meritless class actions in the U.S. and concluded that many of these elements are not present in Canada. For example, the Allen Committee noted that pre-trial discovery rules have traditionally been more liberal in the U.S. than in Canada which in turn have allowed U.S. plaintiffs to engage in fishing expeditions. The Allen Committee also noted that jury trials for securities actions, while prevalent in the U.S., are rare in Canada. In this context, the Allen Committee concluded that defendants should be better able to assess their likelihood of success and should be less inclined to settle actions lacking merit and plaintiffs should be less inclined to commence lawsuits in the search for a "shakedown" settlement (see the Final Report pps. 30-33 for further examples).

18 February 16, 2000 (2000 CarswellOnt 346).

The *Epstein* decision represents a strong denunciation of strike suits and a clear indication that Canadian courts, if given statutory authority, will exercise that authority to discourage strike suits.

To ensure that courts have the opportunity, as did the Court in *Epstein*, to consider a proposed settlement of an action launched under the proposed civil right of action, the CSA have introduced in the 2000 Draft Legislation a provision requiring court approval before any action can be stayed, discontinued, settled or dismissed (section 175.9 of the 2000 Draft Legislation).[19]

(ii) Screening Mechanism

The CSA have also introduced in the 2000 Draft Legislation a new provision designed to screen out, as early as possible in the litigation process, unmeritorious actions (section 175.7 of the 2000 Draft Legislation). This screening mechanism is designed not only to minimize the prospects of an adverse court award in the absence of a meritorious claim but, more importantly, to try to ensure that unmeritorious litigation, and the time and expense it imposes on defendants, is avoided or brought to an end early in the litigation process. By offering defendants the reasonable expectation that an unmeritorious action will be denied the requisite leave to be commenced, the 2000 Draft Legislation should better enable defendants to fend off coercive efforts by plaintiffs to negotiate the cash settlement that is often the real objective behind a strike suit.

The new screening provision would require a plaintiff to obtain leave of the court in order to bring an action. Before granting leave, the court must be satisfied that the action (i) is being brought in good faith and (ii) has a reasonable prospect of success at trial.[20]

This screening mechanism, coupled with the new provision described earlier that would require court approval of a settlement agreement are procedural protections that supplement the “loser pays” cost and proportionate liability provisions retained from the 1998 Draft Legislation.[21]

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19 This provision mirrors the provision in the Ontario *Class Proceedings Act* but is somewhat different from the provision in the B.C. class proceeding statute and the Québec *Code of Civil Procedure*.

20 The screening provision is based on a test that was recommended by the Ontario Law Reform Commission (the "OLRC") in its 1982 *Report on Class Actions.* In its report, the OLRC paid particular attention to the certification of a class action. The OLRC identified the motion for certification as one of the most important parts of the proposed procedure. The OLRC recommended that a court should be able to certify an action as a class action only if it finds that five conditions are satisfied by the representative plaintiff including proof of the substantive adequacy of the action.

21 The 2000 Draft Legislation retains from the 1998 Draft Legislation the provision for the payment of costs by the unsuccessful party, further diminishing the burden on a successful defendant.

The CSA is recommending that the limited statutory civil remedy regime include a "loser-pays" cost provision in any jurisdiction where class proceedings legislation does not already include a

Taken together, these elements of the 2000 Draft Legislation should ensure that any exercise of the statutory right of action occurs in a litigation environment different from that in the United States and less conducive to coercive strike suits.

3. EFFECT ON LARGER ISSUERS

Some commenters suggested that the 1998 Draft Legislation went beyond "deterrence" in terms of the impact it will have on larger issuers because the damages cap is tied to market capitalization and thereby gives plaintiffs an incentive to unfairly target larger issuers.[22]

The CSA considered several alternative approaches to the damage caps proposed under the 1998 Draft Legislation but has ultimately decided to retain the original approach.[23] The CSA remain of the

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"loser-pays " cost rule. The inclusion of a "loser-pays" cost provision in the proposed legislation would serve as a deterrent to unmeritorious litigation, thereby reducing the risk of U.S. style strike suits against public issuers.

The *Class Proceedings Act* in British Columbia provides for a "no costs" rule. This provision generally prohibits the court from awarding costs to any party in a class proceeding except in special circumstances. Specifically, the *Class Proceedings Act* (British Columbia) permits a court to award costs only where the court considers that:

- there has been vexatious, frivolous or abusive conduct on the part of any party to the action;
- an improper or unnecessary application or other step has been made or taken for the purpose of delay or increasing costs or for any other improper purpose; or
- there are exceptional circumstances that make it unjust to deprive the successful party of costs.

Excluding the application of the "no costs" rule in the British Columbia *Class Proceedings Act* and including a "loser-pays" cost rule similar to that contained in the Ontario *Class Proceedings Act* in the proposed amendments would avoid a significant discrepancy between the proposed civil liability regime in British Columbia and that proposed in other provinces that provide for class actions. As with other aspects of the draft legislation, the government has not made any decision on the implementation of a "loser-pays" costs provision for securities class action lawsuits.

22 The liability caps proposed in the 1998 Draft Legislation tied maximum liability to an issuer's market capitalization, at the rate of 5% of market capitalization (or $1 million, whichever is greater). In this context, the 1998 Draft Legislation followed closely the recommendations of the Allen Committee.

23 One alternative approach fixed a single universal liability cap that would not vary with an issuer's market capitalization. The CSA were concerned, however, that any universal liability cap would either be so high as to shift the balance too far in favour of compensation or so low as to undermine the compensatory and deterrence objectives of the Proposal. Such an approach would also inevitably be perceived as inequitable by smaller issuers. The second approach applied a mathematical formula that smoothed out the differences in aggregate liability between issuers with different market caps (i.e., the damage caps increase but, at a decreasing rate). The CSA were concerned, however, that this approach would shift the balance so far away from compensation that it would undermine the deterrent impact of the Proposal. To the extent that liability caps

view that damage exposure must, if the system is to have deterrent value, be sufficient to make it worthwhile for a plaintiff to undertake an action but, on the other hand, reflect an issuer's ability to pay and recognize that it is the non-plaintiff shareholders who ultimately bear the economic burden of providing compensation. The CSA believe that the procedural safeguards described previously will reduce the risk of coercive application of the statutory right of action and render it unnecessary to alter the damage caps as originally proposed.

4. APPLICATION OF THE LIABILITY CAPS

It has been suggested that the application of the liability caps will be problematic where multiple actions are launched in respect of a single misrepresentation.[24] The CSA remain of the view that the dollar caps on liability are an essential factor in achieving the desired focus on deterring poor disclosure, rather than providing full compensation. The CSA believe that this practical difficulty can be addressed by courts and litigants who understand the legislative intent underlying the liability caps. In this context, the CSA have also revised the draft legislation to incorporate an express statement that the amount of damages that a defendant must pay is to be reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation under an action under similar legislation in any Canadian jurisdiction (section 175.6).

5. THE PROPOSAL CONTRASTED WITH RULE 10B-5

Some of the commenters submitted that the 1998 Draft Legislation went beyond Rule 10b-5 in the U.S. while others submitted that the CSA should simply adopt a Rule 10b-5 approach.

As a starting point, it is important to recognize that the 2000 Draft Legislation (and previously the 1998 Draft Legislation) is fundamentally different from Rule 10b-5. The 2000 Draft Legislation is a specific and comprehensive code whereas Rule 10b-5 is a general anti-fraud rule from which U.S. courts have implied a right of action and which has evolved and been variously interpreted by U.S. courts over the past several decades.[25] In fact, there has been considerable litigation in the U.S. over what could be

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increase less quickly than market capitalization, the amount recoverable by any single investor would diminish the larger the issuer (on the reasonable assumption that issuers with large market capitalization also have large numbers of shareholders), eventually reaching the point at which an individual investor would have no motivation to commence an action, however meritorious, simply because the amount recoverable by the investor would be too small to justify the effort. The CSA accept that deterrence should outweigh compensation but, at the same time, any deterrent effect requires a plausible element of compensation.

[24] In our federal system, in which 13 jurisdictions might have parallel legislation specifying identical liability caps, it is possible that at least that number of lawsuits may follow from a single misrepresentation, with unintended multiplication of possible damage awards and serious erosion of the intended caps on liability.

[25] Rule 10b-5 provides that "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:

considered strictly threshold issues such as who bears liability and what is the nature of such liability.

In a Rule 10b-5 action, a plaintiff must prove that the defendant acted with "*scienter*", defined by the U.S. Supreme Court as a "mental state embracing intent to deceive, manipulate or defraud", with most courts agreeing that recklessness constitutes *scienter* as well. Reliance, and to some extent causation, have been made easier to prove in the U.S. as a result of U.S. courts' decision to adopt a "fraud-on-the-market" theory. Essentially, this theory creates the presumption that because most publicly available information is reflected in the market price of an issuer's securities, an investor's reliance on any public material misrepresentations may be presumed.[26] In this context, Rule 10b-5 has developed into a fully compensatory model.[27]

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a. To employ any device, scheme or artifice to defraud,
b. To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading, or
c. To engage in any act, practice or cause 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."

[26] The seminal U.S. authority on the "fraud on the market" theory is the U.S. Supreme Court decision in *Basic Inc. v. Levinson* (485 U.S. 224 (U.S. Ohio 1988)). Mr. Justice Blackmun, writing for the majority, adopted the following description of the theory at 241-242:

> The "fraud-on-the-market" theory is based on the hypothesis that, in an open and liquid 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 purchaser does 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.

A defendant can rebut the presumption by proving that there was no causation in fact, that is: (i) that the statements in question did not affect the market price; (ii) other information was available that negated the statements such that the market price appropriately discounted the statements (the "truth in the market" defence); or (iii) the plaintiff did not rely on the market price (e.g. the plaintiff was aware of the misrepresentation but bought or sold the shares for other reasons). Prior to the availability of the (rebuttable) presumption, it was extremely difficult in the U.S. to prove that a plaintiff relied on given misrepresentations. This problem was particularly significant where multiple plaintiffs attempted to have a class certified for the purpose of a class action, because questions of reliance, damages, and causation were clearly not common question of fact or law as amongst the class members.

[27] In December 1995, U.S. Congress passed the *Private Securities Litigation Reform Act of 1995* (the "Reform Act") which amended both the *Securities Act of 1933* (the "Securities Act") and the *Securities Exchange Act of 1934* (the "Securities Exchange Act"). The Reform Act was intended to curb what Congress perceived as burgeoning abuse of the litigation process by securities plaintiff's lawyers by adopting procedural and substantive provisions that were intended to make it more difficult to bring claims under the Securities Act or the Securities Exchange Act. One such protection was the Reform Act's heightened pleading standard. The Reform Act provides that in any private action under the Securities Exchange Act for misrepresentations or omissions, the complaint must specify the allegedly false statements and explain why they are false. The

In a recent Ontario court decision the U.S. "fraud-on-the-market" theory was rejected.[28] The plaintiffs' claim for "deemed reliance" based on the "fraud on the market" theory was an attempt to establish a common issue in order to gain certification as a class proceeding in Ontario. In general, claims which require proof of individual reliance are unlikely to be certified as class actions under Ontario class proceedings legislation.[29] The Court rejected the notion of deemed reliance, and rejected the "fraud-on-the-market" theory in Canada. The Court held that in the U.S., deemed reliance is inextricably bound up with the statutory action under U.S. securities law. The Court confirmed that in Canada, where an investor is claiming loss based on negligent or fraudulent misrepresentation, proof of actual reliance by the individual investor is a key element. In the Court's view, "to import such a presumption would amount to a redefinition of the torts themselves". The CSA view the decision as being significant because it illustrates the limitations inherent in class actions in the context of securities litigation based on the common law.

Unlike Rule 10b-5, the 2000 Draft Legislation includes two liability standards, absence of due diligence and gross misconduct, based on a matrix of factors, including the importance and nature of the document (i.e., purpose and the time constraints applicable to the preparation of the document) and the person responsible for it. The legislation puts the onus on the defendant to establish due diligence unless knowledge or gross misconduct is required to establish liability. In those cases, the plaintiff will have to prove that the defendant was aware of the misrepresentation or the failure to make timely disclosure (or deliberately avoided acquiring knowledge) or was otherwise guilty of gross misconduct. Moreover under the 2000 Draft Legislation a plaintiff has a right of action without regard to whether the plaintiff relied on the misrepresentation or on the responsible issuer having complied with its disclosure

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complaint must also allege with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. Complaints that fail to meet these requirements are required to be dismissed.

Since the passage of the Reform Act there has been considerable debate as to whether the Reform Act's pleading provision changed the standard of liability under Rule 10b-5 and whether the Reform Act adopted the most stringent existing pleading standard, the Second Circuit's, or a higher standard. The Second Circuit standard requires a plaintiff to plead a "strong inference" of *scienter* either by alleging (i) facts showing that the defendant had both a motive and an opportunity to commit fraud; or (ii) strong circumstantial evidence of conscious misbehaviour or recklessness. U.S. courts still seem to be divided on this issue, with some courts holding that a plaintiff must plead, at a minimum, particular facts demonstrating deliberate or conscious recklessness.

28 See *Carom v. Bre-X Minerals Ltd.*, (1998) 41 O.R. (3d) 780 (Ontario Court of Justice).

29 See for example, *Carom v. Bre-X Minerals Ltd*., (1999) 46 B.L.R. (2d) 247 (Ontario Superior Court of Justice), where the Court refused to let a class action proceed against certain brokerage firms and analysts who had prepared research reports and provided recommendations. The Court held that class actions were not the preferable mode of litigating these issues, because of the significant individual issues of proof relating to, among other things, the reliance placed by an individual on the research and recommendations of a broker or analyst.

requirements[30].

The CSA recognize that a due diligence standard is a more rigorous liability standard than the fraud based standard under Rule 10b-5. The key element of intent or recklessness which a plaintiff must establish to succeed in a Rule 10b-5 action need not be proved to establish liability on the basis of an absence of due diligence. The rationale for the allocation of the burden is twofold. The first reason is to provide a deterrent to poor continuous disclosure. By requiring the defendant to prove due diligence, there is a much greater incentive to exercise due diligence. The second reason is access to evidence. The necessary information to establish that an officer or director, for example, was or was not duly diligent would be under the control of that officer or director. In this context, the 2000 Draft Legislation, unlike Rule 10b-5, is essentially a deterrent model.

The 2000 Draft Legislation attempts to strike a fair balance between the interests of responsible issuers and plaintiffs (for example, through the imposition of liability caps). The 2000 Draft Legislation effectively creates a presumption of causation if the market price following the correction of the misrepresentation is different from the market price at the time the misrepresentation was made (or the time at which the disclosure should have been made, in the case of an omission). The 2000 Draft Legislation does, however, exclude liability for any portion of the plaintiff's damages which does not represent a change in value of the security resulting from the misrepresentation or failure to make timely disclosure. The 2000 Draft Legislation also provides that no person or company is liable if that person or company proves that the plaintiff acquired or disposed of the security with knowledge of the misrepresentation or material change.

IV. DEFINITIONS OF "MATERIAL FACT" AND "MATERIAL CHANGE"

(i) Background

The 1998 Draft Legislation included proposed amended definitions of "material fact" and "material change" to be used for all purposes under securities legislation.[31] The Allen Committee's Final Report

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[30] It should be noted that the CSA will also consider recommending changes to the existing statutory rights of action for primary market investors to deal with the issue of reliance in a manner comparable to that set out in the 2000 Draft Legislation.

[31] In the 1998 Draft Legislation, "material change" was defined to mean

(a) if used in relation to an issuer other than an investment fund,

(i) a change in the business, operations, capital, assets or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or

(ii) a decision to implement a change referred to in subparagraph (a)(i) made by

A. senior management of the issuer who believe that confirmation of the decision by the directors is probable, or

B. the directors of the issuer, and

(b) if used in relation to an issuer that is an investment fund,

had recommended that the definition of "material fact" exclude the current *ex post facto* examination of the effects of the disclosure on the market price or the value of the security. In the course of considering the Allen Committee's recommendations, the CSA identified further concerns regarding the definition of "material fact" and "material change" in securities legislation:

- The terms do not have the same meaning throughout Canada. In this context, the *Securities Act* (Québec) does not define "material fact" and Québec courts have looked to United States jurisprudence to develop a different formulation of the materiality standard from that found in the legislation in other provinces of Canada. The standard articulated in the seminal U.S. case of *TSC Industries Inc., et al. V. Northway, Inc.*, 426 U.S. 438 (1976) has been used in Québec with approval. According to that standard, facts are material when they would be substantially likely to be considered important to a reasonable investor in making an investment decision.

- The current definitions are not easily applied in the context of mutual funds. National Instrument 81-102 concerning mutual funds[32] addressed this concern by incorporating a new defined term, "significant change", similar conceptually to the Québec interpretation of "material fact".

The CSA accordingly considered amending the definitions of "material fact" and "material change" to reflect the approach taken in Québec and the U.S. This would not only have removed the currently required ex post facto examination of market price or value of securities, as recommended in the Final Report, but also have produced a legal standard for disclosure that is uniform throughout Canada and consistent with that in the U.S.

(i) a change in the business, operations or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or
(ii) a decision to implement a change referred to in subparagraph (b)(i) made by
  A. senior management of the issuer or by senior management of the investment fund manager who believe that confirmation of the decision by the directors or trustees of the issuer or the directors of the investment fund manager is probable, or
  B. the directors or trustees of the issuer or the directors of the investment fund manager;

Similarly, "material fact" was defined to mean, "if used in relation to the affairs of an issuer or its securities, a fact or group of related facts which would be substantially likely be considered important to a reasonable investor in making an investment decision".

32 National Instrument 81-102 Mutual Funds has been adopted as a rule in each of British Columbia, Alberta, Manitoba, Ontario and Nova Scotia, a Commission regulation in Saskatchewan, and a policy in all other jurisdictions represented by the CSA and came into force on February 1, 2000.

(ii) Public Comment and CSA Responses

The CSA received 7 submissions in response to the original Request for Comment. A summary of all the comment letters that the CSA received is contained in Appendix B to this CSA Report.

In general, the majority of commenters expressed support for a consistent definition of materiality against which disclosure and other securities law obligations may be assessed. These commenters cautioned, however, that this cannot be accomplished merely by changing the definitions addressed in the Request for Comments, as securities laws contain requirements reflecting standards of materiality not based on the definitions of "material fact" and "material change". A change in the standard of materiality would need to address all of the materiality standards in securities laws to avoid creating unintended ambiguities. Conversely, some commenters expressed concern that the materiality standard in the 1998 Draft Legislation raised too many issues of interpretation and would introduce an unacceptable level of subjectivity and uncertainty into the determination. The commenters believed that this would be particularly troubling in a new statutory civil liability regime.[33]

In light of these comments, the CSA do not propose at this time to proceed with the amendments to the definitions of "material change" and "material fact" other than to:

a) tailor the definitions for application to mutual funds and non-redeemable investment funds by largely parallelling the terminology of the definition of "significant change" in National Instrument 81-102;[34] and

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33 Interestingly, one commenter noted that in the context of timely disclosure obligations U.S. courts have adopted a "market impact" test in applying the *TSC Industries* standard (i.e., whether or not the information in question would likely be price sensitive). The commenter cautioned against a change in Canada which would simply obfuscate the likely meaning to be given to such language in the courts. In this context, the commenter also questioned why Canadian regulators would move away from the "market impact" test (which is the current test in Canada, other than Québec under the current definitions) when U.S. courts appear to be moving towards it.

34 Under the 2000 Draft Legislation "material change" when used in relation to an issuer that is an investment fund, means,

(i) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or

(ii) a decision to implement a change referred to in subparagraph (i) made,

(A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity,

(B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or

b) follow the recommendation of the Allen Committee to remove the retroactive element from the definition of "material fact" as it applies outside Québec.[35]

V. CONFIDENTIAL DISCLOSURE FILINGS

The CSA have also introduced in the 2000 Draft Legislation changes to the provisions of securities legislation which permit an issuer to make disclosure of material changes to securities regulators on a confidential basis. Currently, the securities legislation of most jurisdictions permits reporting issuers to file a "confidential" material change report with the applicable securities regulatory authority in lieu of making public disclosure where an issuer believes that disclosure of a "material change" would be unduly detrimental to its interests. Confidentiality can be maintained so long as an issuer reaffirms the need for confidentiality every ten days. The 2000 Draft Legislation would amend this confidential filing mechanism to:

- require that the issuer's decision that it would be unduly detrimental to its interests to make public disclosure must be arrived at a reasonable manner; and
- make clear that the issuer may not maintain disclosure in confidence if there are reasonable grounds to believe that the market is trading on leaked information.

These changes were recommended by the Allen Committee in both its Interim and Final Reports [36] and largely mirrors the safe harbour provision for confidential disclosure contained in subsection 175.3(8) of the 2000 Draft Legislation.[37]

(C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable;

35 Under the 2000 Draft Legislation "material fact", when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;

36 See Interim Report at page 93 and Final Report at page 80.

37 It should be noted that in order for a responsible issuer to avail itself of the safe harbour provision contained in subsection 175.3(8) of the 2000 Draft Legislation, the responsible issuer must have a reasonable basis for making the disclosure on a confidential basis.

APPENDIX A
TO
CSA NOTICE 53-302

Proposal for a Statutory Civil Remedy
for Investors in the Secondary Market
(the "Proposal")

Published in May 1998

Summary of Written Comments Received on the Proposal
and the Responses of the CSA

The following table provides a summary of the written comments received on the draft legislation published in May 1998 (the "1998 Draft Legislation") and the responses of the CSA. Defined terms are given alphabetically. Unless otherwise indicated, section references in this Appendix are references to the 1998 Draft Legislation. The CSA have included the names of the commenters for ease of reference. It should be noted, however, that the following information is a summary only. The CSA encourage readers to consult the comment letters, copies of which are maintained on the public file of the various Commissions.

1998 Draft Legislation	Public Comments	CSA Response
"control person" means, (a) a person or company who holds a sufficient number of the voting rights attached to all outstanding voting securities of an issuer, or (b) each person or company in a combination of persons or companies, acting in concert by virtue of an agreement, arrangement, commitment or understanding, which holds in total a sufficient number of the voting rights attached to all outstanding voting securities of an issuer, to affect materially the control of the issuer, and, where a person or company, or combination of persons or companies, holds more than twenty per cent of the voting rights attached to all outstanding voting securities of an issuer, the person or company, or combination of persons or companies, shall, in the absence of evidence to the contrary, be deemed to hold a sufficient number of the voting rights to affect materially the control of the issuer; **[included in Ontario version of the**	**The Toronto Stock Exchange** (28/08/98): Definition of "control person" unnecessary, can be folded into definition of "influential person".	The OSC incorporated the definition for the purpose of consistency, because "control person" is defined in Alberta and British Columbia. The OSC does not propose to revise this definition.

1998 Draft Legislation	Public Comments	CSA Response
Proposal]		
"correction of the failure to make timely disclosure" means, if there has been a failure to make timely disclosure, the disclosure of the material change in the manner required under the Act;	**The Toronto Stock Exchange** (28/08/98): The definitions of "correction of the failure to make timely disclosure" and "failure to make timely disclosure" unnecessarily confuse "timely disclosure" and failure to disclose a "material change". Eliminate the reference to "timeliness" (page 1).	The CSA consider "timeliness" an important element of the Proposal -- both in determining whether liability exists and, if so, in limiting liability through correction. Elimination of the concept could have two undesirable consequences. First, given that securities legislation requires prompt but not necessarily instantaneous disclosure of a material change, a failure to refer to the "timeliness" requirements of securities legislation could expose an issuer to liability, even if it made disclosure as and when required by securities legislation, for the period between the occurrence of the material change and the disclosure. This would be contrary to the objectives of the CSA. The CSA do not intend to impose civil liability unless there has been non-compliance with securities legislation. Second, without reference to "timeliness of disclosure", it might be argued that eventual late disclosure of a material change, however long after the disclosure was required to have been made under securities legislation, would cure the issuer's default. This would deprive investors of a remedy and eliminate a deterrent to non-compliance with timely disclosure obligations. The CSA believe, however, that the defined phrase ("correction of the failure to make timely disclosure") is unnecessary and propose to move the "timeliness" concept to the operative provisions of the legislation as set out in section 175.2(4) as follows: "175.2(4) If there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of an issuer's security between the time when the material change was required to be disclosed and the ***subsequent disclosure of the material change in the manner required under the Act*** has, without regard to whether

1998 Draft Legislation	Public Comments	CSA Response
		the person or company relied on the responsible issuer having complied with its disclosure requirements, a right of action for damages against...” (emphasis added).
"derivative security of a responsible issuer" means a derivative security, the value of which is derived primarily from or by reference to securities of the responsible issuer, and which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer;	**The Toronto Stock Exchange** (28/08/98): The definition is redundant -- see Ontario Securities Commission Rule 14-501. It is also confusing in that it incorporates guaranteed securities (page 2).	The CSA propose to modify the definition to incorporate concepts from an existing definition used in Ontario, and remove a redundancy by deleting the word "derivative" from the text, as follows: **"derivative security"** means, in respect of a responsible issuer, a security, (a) the market price or value of which, or payment obligations under which, are derived from or based on a security of the responsible issuer; and (b) which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer; The CSA do not consider the definition to be otherwise redundant, and consider the reference to guaranteed securities to be appropriate. The definition must be read in context: its purpose is not merely to describe what is meant by "derivative security", but more importantly to provide that the issuer of a security underlying a derivative security would not have liability under the Proposal except to the extent that the issuer itself participated in the creation of, or guaranteed, the derivative security.
"designated securities" means, for the purpose of the definition of "private issuer" (a) voting securities, or (b) securities other than debt securities carrying a residual right to participate in the earnings of the issuer	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	The CSA agree with the comment and propose to simplify the Proposal by eliminating the defined terms "private issuer" and "designated securities" and amending the definition of "responsible issuer" (see the discussion of that term).

1998 Draft Legislation	Public Comments	CSA Response
or, upon the liquidation or winding-up of the issuer, in its assets;		
"document" means any document, including a document that is transmitted in electronic form only, (a) that is filed or required to be filed with the Commission, or (b) that is, (i) filed or required to be filed with a government or an agency thereof under applicable securities or corporate law or any stock exchange under its by-laws, rules, or regulations, or (ii) a document the purpose of which makes it likely that it would contain information substantially likely to be considered important to a reasonable investor in making an investment decision in relation to a specified security, but does not include a document not reasonably likely to be released;	**The Toronto Stock Exchange** (28/08/98 (page 3): The commenter suggests a simpler definition. Subparagraphs (a) and (b)(i) overlap and can be combined. Subparagraph (b)(ii) loses track of the focus by looking to the purposes of the document, not its content.	The CSA propose to amend this definition: 1. to make clear the distinction between: (a) a document required to be filed with the Commission (for which, generally, public release can be presumed and civil liability under the Proposal is appropriate); and (b) a document filed with the Commission voluntarily, or filed or required to be filed with another agency under securities or corporate law, or any other communication the contents of which would be likely to affect the value of a security. In the case of documents described in (b), the CSA consider that civil liability under the Proposal would be inappropriate unless public release was or should reasonably have been expected. 2. to clarify the definition as it relates to documents neither filed nor required to be filed, for which the focus should be their likely effect on market price or value rather than the purpose of the document; and 3. to simplify the definition by removing the concluding phrase, the substance of which is reflected in a specific defence to civil liability as set out in subsection 175.3(13) of the Proposal.
"document" (continued)	**The Toronto Stock Exchange** (28/08/98): (continued) The commenter also suggests that a defence be available for leaked confidential documents.	The CSA agree with this comment and have provided for a specific defence in subsection 175.3(13) in respect of an unexpected public release or "leak" of a document: "**175.3(13)** No person or company is liable in an action under section 175.2 in respect of a misrepresentation in a document, other than a document required to be filed with the Commission, if the person or

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		company proves that, at the time of release of the document, the person or company did not know and had no reasonable grounds to believe that the document would be released."
"expert" means a person or company whose profession or practice gives authority to a statement made by the person in the person's professional capacity and includes an accountant, an actuary, an appraiser, an auditor, an engineer, a geologist and a solicitor;	**The Toronto Stock Exchange** (28/08/98): Do not define -- rely on Courts. If the qualification of acting in a "professional capacity" is meant to distinguish persons acting in multiple capacities, do so not in this definition but in the liability provisions (page 3).	The CSA believe that a definition is useful given the specific liability and defence provisions applicable to experts. The CSA propose to amend this definition to substitute the common term "lawyer" for "barrister and solicitor", a more formal term not used in all Canadian jurisdictions, and also to refer specifically to a "financial analyst". The definition has been amended as follows: **"expert"** means a person or company whose profession gives authority to a statement made in a professional capacity by the person or company including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer; The CSA also propose clarifications in the operative provisions of the Proposal (section 175.2(1)(e)(iii) and in the defences (section 175.3(12)) to ensure that an expert's liability is predicated on unrevoked consent: "**175.3(12)** No expert is liable in an action under section 175.2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert, if the expert proves that, the written consent previously provided was withdrawn in writing before the release of the document or making of the public oral statement."
"failure to make timely disclosure" means a failure to disclose a material change as and when required to do so by the Act;	**The Toronto Stock Exchange** (28/08/98): The definitions of "correction of the failure to make timely disclosure" and "failure to make timely disclosure" unnecessarily confuse "timely disclosure" and failure to disclose a material change. Eliminate the reference to "timeliness" (page 1).	The CSA consider "timeliness" an important element of the Proposal and propose to retain the concept. See the discussion above concerning the defined term "correction of the failure to make timely disclosure". The CSA have made, however, minor drafting changes to the definition, as follows:

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		"failure to make timely disclosure" means a failure to disclose a material change in the manner and when required under the Act; "
"influential person" means, in respect of a responsible issuer, (a) a control person of the responsible issuer, (b) a promoter of the responsible issuer, (c) an insider of the responsible issuer, or (d) an investment fund manager if the responsible issuer is an investment fund;	**Canadian Bankers Association** (21/09/98): A lender may become an "influential person" under this definition upon realizing on security for a loan; lender "will need to protect itself from potential liability...and ensure it does not 'knowingly influence' a violation...under the Proposal" (page 5).	While the circumstance described in the comment could indeed render a person an "influential person", liability would attach only to an influential person who actually made the misrepresentation or who "knowingly influenced" the making of a misrepresentation or failure to make timely disclosure. The concept of "knowingly influence" was chosen to ensure that the liability of influential persons is conditional on their deliberate involvement in the making of the misrepresentation. The CSA remain of the view that this is the correct standard.
"influential person" (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 1). Inclusion of "promoter", although not inappropriate, would pick up anyone who ever acted as a promoter. Limit this to those who acted as promoters within the preceding two years. Inclusion of insiders would pick up 10% voting securityholders whether or not in a control position -- too remote.	While the commenter is correct in noting that there is no time period to limit the inclusion of persons under the statutory definition of “promoter”, this will not cause a problem under the Proposal as liability will attach to “promoters” only to the extent that they knowingly influenced the misleading disclosure. The extension to insiders was deliberate, and tempered (as the commenter notes) by the requirement to have "knowingly influenced".
"MD&A" means the section of an annual information form, financial statement, annual report or other document that contains management's discussion and analysis of financial condition and results of operations of a responsible issuer as required under Ontario securities law;	**The Toronto Stock Exchange** (28/08/98): The term is better defined in Rule 14-501 (page 4).	The commenter refers to a definition in Ontario Securities Commission Rule 14-501*Definitions*. The CSA prefer, for the purpose of the Proposal, the published definition, which limits the scope of the term to identifiable documents.
"market capitalization" in respect of an issuer means the aggregate of	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98):	

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(i) in relation to its securities traded on a published market, an amount that is the sum of the products of multiplying the total number of outstanding securities of each such class by the market price at which a security of the class traded, on the principal market on which the securities trade, during the ten trading days before the day on which the misrepresentation was made or there was a failure to make timely disclosure, and (ii) in relation to its securities not traded on a published market, an amount equal to the fair market value thereof, as determined by a court, as at the time of the making of the misrepresentation or the failure to make timely disclosure.	Change the 10 trading day test to 30 days, to conform with the reformulation of the short form prospectus distribution system.	The commenter notes that NI 44-101 *Short Form Prospectus Distributions* applies a market value test at any time during a 60 day period prior to the filing of a preliminary prospectus. That test, however, is used for a very different purpose than under the Proposal, namely as the basis for determining eligibility to file a short form prospectus. Under the Proposal, market capitalization must be a more precise figure determined much closer to the relevant time, because it forms the basis of quantifying potential liability of the measured entity. The CSA propose to retain the substance of the published definition but have made some drafting changes to clarify the mechanics of the calculation and to specify that market capitalization is calculated on the basis of an issuer's equity securities. In this context, a definition of "equity securities" has been added to the Proposal.
"market price" means for the securities of a class for which there is a published market (a) except as provided in paragraphs (b) or (c), (i) if the published market provides a closing price, an amount equal to the weighted average of the closing price of securities of that class on the published market for each trading day on which there was a closing price for the period during which the market price is being determined, and (ii) if the published market does not provide a closing price, but provides only the highest and lowest prices of securities traded, an amount equal to the average of the weighted averages of the highest and lowest prices of the securities of that class for each of the trading days on which there were highest and lowest prices for the period during which the market price is being determined, (b) if there has been trading of the securities of the class in the published market on fewer than half of the trading	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The weighting of closing prices to determine "market price" is inappropriate. Suggested alternatives: follow Allen Committee approach or section 183 of the Regulations to the *Securities Act* (Ontario).	The CSA's approach was chosen deliberately, in recognition of the relevance of trading volume in assessing the importance of a particular price. Use of a weighted average is compatible with the approach suggested by the Allen Committee for determining market capitalization.

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days for the period during which the market price is being determined, the average, weighted by number of trading days, of the following amounts established for each trading day of the period during which the market price is being determined (i) the simple average of the bid and ask price for each trading day on which there was no trading, and (ii) either (A) the weighted average of the closing price of the securities of that class for each trading day on which there has been trading, if the published market provides a closing price, or (B) the weighted average of the highest and lowest prices of the securities of that class for each trading day on which there has been trading, if the published market provides only the highest and lowest prices of securities traded on a trading day, or (c) if there has been no trading of the securities of the class in the published market on any of the trading days during which the market price is being determined, the fair market value thereof as determined by a court;		
"market price" (continued)	**The Toronto Stock Exchange** (28/08/98): A weighted average of all trading prices rather than of closing prices is superior (page 4).	While the CSA agree with this comment in principle, they are concerned that it would be difficult to apply in practice. The CSA propose no change to the definition other than minor drafting changes.

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"material change" means, (a) if used in relation to an issuer other than an investment fund, (i) a change in the business, operations, capital, assets or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or (ii) a decision to implement a change referred to in subparagraph (a)(i) made by A. senior management of the issuer who believe that confirmation of the decision by the directors is probable, or B. the directors of the issuer, and (b) if used in relation to an issuer that is an investment fund, (i) a change in the business, operations or affairs of the issuer which would be substantially likely to be considered important to a reasonable investor in making an investment decision, or (ii) a decision to implement a change referred to in subparagraph (b)(i) made by A. senior management of the issuer or by senior management of the investment fund manager who believe that confirmation of the decision by the directors or trustees of the issuer or the directors of the investment fund manager is probable, or B. the directors or trustees of the issuer or the directors of the investment fund manager;	**Canadian Investor Relations Institute** (28/09/98): Recommends that the definitions "capture more fully the standard proposed in *TSC Industries Inc.*". Displeased with incomplete move toward Québec/US standard.	The CSA do not propose at this time to proceed with the amendment to this definition as published in November 1997 and in the Proposal in May 1998. The CSA at that time were proposing to amend the definition to move from the current "market impact" standard of materiality (outside of Québec) to an investment decision approach (i.e., a change would be a "material change" only if the disclosure would be substantially likely to be considered important to a reasonable investor in making an investment decision). Please see the Notice for a more complete discussion of this issue.
"material fact" means, if used in relation to the affairs of an issuer or its securities, a fact or a group of related facts which would be substantially likely to be considered important to be reasonable investor in making an investment decision.		The CSA do not propose at this time to proceed with the amendment to this definition as published in November 1997 and in the Proposal in May 1998. Please see the discussion noted immediately above as well as the Notice for a more

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		complete discussion of this issue.
"material change" & "material fact" (continued)	**Canadian Bankers Association** (21/09/98) (page 4): Use the concept of "significant change" for mutual funds, using the definition under proposed NI 81-102.	In response to this comment, the CSA propose, as in the proposed amendments published in November 1997, to tailor the definition for application to investment funds by parallelling the terminology of the definition of "significant change" in National Instrument 81-102 *Mutual Funds*. The CSA also propose to follow the recommendation of the Allen Committee to remove the retroactive element from the definition of "material fact" as it applies outside Québec. The proposed definitions, which would apply for all purposes of securities legislation, follow: **"material change"** , (a) when used in relation to an issuer other than an investment fund, means, (i) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or (ii) a decision to implement a change referred to in subparagraph (i) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and (b) when used in relation to an issuer that is an investment fund, means, (i) a change in the business, operations or affairs of the issuer that would be considered important

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		by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or (ii) a decision to implement a change referred to in subparagraph (i) made, (A) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity, (B) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or (C) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable; **"material fact",** when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;
"material change" & "material fact" (continued)	**Canadian Investor Relations Institute** (28/09/98): Pleased with removal of retroactive aspect of the current definitions.	See the discussion immediately above.
"material change" & "material fact" (continued)	**KPMG** (28/08/98): The commenter expressed concern about the application of these terms to misstatements in audited financial statements. The commenter recommends that, in that context, the terms refer specifically to a "material departure from GAAP" or, in the alternative, that they move toward the definition of "material	See the discussion above. The CSA do not propose to adopt different definitions applicable specifically to the accounting presentation.

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	misstatement" in the CICA Handbook section 5130.05. (page 5) The commenter believes that the proposed definition of material fact would shift the burden of proof in respect of an alleged misrepresentation away from the plaintiff onto the defendant. (page 6)	As previously noted, the CSA do not propose to amend the defined terms in question and, in any event, do not agree with the comment. The defined terms describe concepts; burdens of proof are contained in operative provisions of securities legislation and this Proposal.
"person or company who acquires or disposes of a specified security" means a person or company who acquires or disposes of a specified security, other than (a) a person or company who acquires a specified security under a prospectus, (b) a person or company who acquires a specified security in a distribution pursuant to an exemption from the prospectus requirement under the Act except as may be prescribed by regulation for the purposes of this definition, (c) a person or company who acquires or disposes of a specified security in connection with or pursuant to a take-over bid or issuer bid except as may be prescribed by regulation for purposes of this definition, or (d) such other person or company or class of persons or companies as may be prescribed by regulation for the purposes of this definition;	**The Toronto Stock Exchange** (28/08/98): The definition is cumbersome. All that is needed are definitions of "acquires" and "disposes". The Proposal's list of exclusions is more limited than the Allen Committee's. (pages 4-5).	The CSA remain of the view that the concepts embodied in the definition are necessary. The CSA have moved the concepts, however, to subsection 175.1(2) of the legislation which section specifies the transactions that are not subject to the Proposal. Acquisitions and dispositions of securities under a prospectus, pursuant to exemptions from the prospectus requirements or pursuant to a take-over bid or issuer bid are generally excluded from the operation of the civil remedy on the basis that investors in such transactions are not viewed as secondary market investors and already afforded a comparable remedy under securities legislation. Subsection 175.1(2) (formerly in the definition section) contemplates in paragraphs (b) and (c) the authority to include by Rule investors who acquire or dispose of securities in transactions which are otherwise excluded from the operation of the civil liability regime. The accompanying proposed Rules currently identify investors purchasing from a control person or from a creditor selling securities held as collateral for a debt, and those acquiring or disposing of securities under take-over bids and issuer bids that are made (i) through the facilities of a recognized exchange, (ii) for not more than 5% of a class of securities or, (iii) in reliance on a de minimus exemption. In these cases, the transactions are in substance more analogous to a secondary market transaction rather than a private transaction.
"principal market" means, for a class of securities of an issuer in respect of which there has been a misrepresentation or a failure to make timely disclosure,	**The Toronto Stock Exchange** (28/08/98): The definition is redundant and unnecessary; item (a) is completely	The CSA consider the defined term useful but have moved the definition to the regulations and amended the proposed

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(a) if there is only one published market in Canada, that market, (b) if there is more than one published market in Canada, the published market in Canada on which the greatest volume of trading in the particular class of securities occurred during the ten trading days immediately before the day on which the misrepresentation was made or there was a failure to make timely disclosure, or (c) if there is no published market in Canada, the market on which the greatest volume of trading in the particular class of securities occurred during the ten trading days immediately before the day on which the misrepresentation was made or there was a failure to make timely disclosure;	redundant (page 5).	definition to read: '"**principal market'** means, for a class of securities of a responsible issuer (i) the published market in Canada on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred, or (ii) if there is no published market in Canada, the market on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred;
"private issuer" means a person or company, other than a reporting issuer, that is (a) an issuer in whose constating documents, or in one or more agreements between the issuer and the holders of its designated securities (i) the right to transfer the designated securities of the issuer is restricted, (ii) the number of beneficial holders of the designated securities of the issuer, exclusive of persons who are in its employment and exclusive of persons who, having been formerly in the employment of the issuer, were, while in that employment, and have continued after termination of that employment to be, holders of designated securities of the issuer, is limited to not more than fifty, two or more persons who are the joint registered owners of one or more designated securities being counted as one beneficial security holder, and (iii) any invitation to the public to subscribe for securities of the issuer or any securities convertible into or exchangeable for securities	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The Proposal extends liability to issuers whether or not they are reporting issuers and whether or not their securities are publicly traded, as soon as they cease to be a "private issuer", seriously affecting the ability of issuers in the pre-IPO transitional stage to raise capital.	The CSA agree with the comment. In light of proposed change to the definition of "responsible issuer" this definition is unnecessary. See the discussion of comments on the defined term “responsible issuer”.

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of the issuer is prohibited, or (b) a private mutual fund.		
"private issuer" (continued)	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	See the comment immediately above.
"public oral statement" [new - No definition in the 1998 Draft Legislation]	**Canadian Investor Relations Institute** (28/09/98): Oral misrepresentations: "Oral communications are more easily capable of misinterpretation and, without recording each encounter..., defending...will be difficult at best". Scope of oral disclosure [should] be clearly defined, limited to "conference calls with financial analysts and/or the media" (page 5).	The CSA propose to introduce a definition of "public oral statement" to clarify that liability will only arise where a reasonable person would expect that the statement will become generally disclosed. The proposed definition will read as follows: **"public oral statement"** means an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed.
"public oral statement" (continued)	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): Amend the definitions to ensure that only public oral statements containing information substantially likely to be important should attract potential liability.	Under the Proposal, liability only arises for a misrepresentation in any statement, including an oral statement, if it was reasonable to expect that the misrepresentation would have an impact on the market price or value of a security of the responsible issuer.
"published market" means, for a class of securities, a market on which the securities of the class are traded that is (a) a stock exchange, or (b) an over-the-counter market if the prices at which securities of the class have been traded on that market are regularly published in a publication of general and regular paid circulation;	**The Toronto Stock Exchange** (28/08/98): The definition is unnecessary (page 4).	The CSA propose to eliminate the definition because the term as used in the Proposal is not meant to connote an exhaustive list of published markets but only to make clear that market capitalization, for example, should be determined where possible by reference to published trading prices.

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"release", if used in relation to a document, means to publish, make available or disseminate to the public;	[No public comment]	The term "release" is used to clarify that liability will only arise where it is reasonable to expect that a document will be made available to the public. See also the new related defence in subsection 175.3(13). However, the CSA consider the term "publish" to be unnecessary in this definition and have amended it accordingly.
"responsible issuer" means an issuer that is not a private issuer;	**Canadian Bankers Association** (21/09/98): Include a specific exemption for NP 39 mutual funds, for which there is no secondary market and which are typically issued under a prospectus, "to ensure there is no confusion" (page 4)	The CSA intended no automatic exemption for mutual funds or any other type of issuer. The CSA recognize that few circumstances would likely arise in which a mutual fund could have liability under the Proposal, but if such circumstances do arise the CSA perceive no justification for special treatment for investment fund issuers.
"responsible issuer" (continued)	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): The Proposal should apply only to issuers with shares that are actually publicly traded, rather than focussing on whether the private company restrictions are in their articles.	The CSA agree with this comment and have amended the definition as noted below.
"responsible issuer" (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 2). The Proposal extends liability to issuers whether or not they are reporting issuers and whether or not their securities are publicly traded, as soon as they cease to be a "private issuer", seriously affecting the ability of issuers in the pre-IPO transitional stage.	The CSA agree with this comment.

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"responsible issuer" (continued)	**The Toronto Stock Exchange** (28/08/98): Replace the definitions of "private issuer", "responsible issuer" and "designated securities" with a simpler definition of responsible issuer. (page 2)	The CSA propose to simplify the Proposal by eliminating the defined terms "private issuer" and "designated securities" and amending the definition of "responsible issuer" to reflect the general approach in the original Allen Committee recommendation. The revised definition of "responsible issuer" will state: **" "responsible issuer"** means, (i) a reporting issuer, or (ii) any other issuer with a substantial connection to Alberta any securities of which are publicly traded ".
176(2) For the purposes of this Part, (a) multiple misrepresentations that have sufficient common features, including the persons or companies responsible for releasing the documents or making the public oral statements in which misrepresentations are contained and the content of the misrepresentations may in the discretion of the court be treated as a single misrepresentation, and (b) multiple instances of a failure to make timely disclosure that have sufficient common features, including the persons or companies responsible for failures to make timely disclosure and the subject matter of the information that was required to be disclosed, may in the discretion of the court be treated as a single failure to make timely disclosure.	**Canadian Bankers Association** (21/09/98): (page 6): "Further refinement of these provisions is necessary."	The CSA have revised and moved the proposed provision to read: **"175.2(6)** In an action under [this section], (a) multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation; and (b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common subject matter may, in the discretion of the court, be treated as a single failure to make timely disclosure."
Operative provisions creating "right of action": **177(1)** Where a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of a specified security during the period between the time when the		

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document was released and the time when the misrepresentation contained in the document was publicly corrected, is deemed to have relied on the misrepresentation and has a right of action for damages against (a) the responsible issuer, (b) each director of the responsible issuer, (c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document, (d) each influential person or director or officer of an influential person, who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the responsible issuer or any person or company on behalf of the responsible issuer to release the document, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document, and (e) each expert if (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the document includes, refers to or quotes from the report, statement or opinion of the expert, and (iii) the written consent of the expert to the use of the expert's report, statement or opinion in the document has been obtained.		
177(2) Where a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates directly or indirectly to the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of a specified security during the period between the		

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time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected is deemed to have relied on the misrepresentation and has a right of action for damages against (a) the responsible issuer, (b) the person who made the public oral statement, (c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement, (d) each influential person, or director or officer of the influential person who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the person who made the public oral statement to make the public oral statement, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement; and (e) each expert if (i) the misrepresentation is also contained in a report, statement or opinion made by the expert, (ii) the person making the public oral statement includes, refers to or quotes from the report, statement or opinion of the expert, and (iii) the written consent of the expert to the use of the expert's report, statement or opinion in the public oral statement has been obtained. **(3),(4)** [Similar liability for other misrepresentations.]		

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177 (Operative "right of action" section, generally; see text above)	**Canadian Bankers Association** (21/09/98): "...we are concerned [that] the vagueness of the term 'knowingly influence' will make it difficult for financial institutions to manage potential risk under the Proposal." "...consider excluding financial institutions that acquire a position in a corporate borrower's holdings in connection with a financing from the definition of 'influential person'." "...the term 'knowingly influence' should be re-examined."	The CSA do not agree that the term "knowingly influence" presents unmanageable uncertainty, nor that any "influential person" who does "knowingly influence" another person or company to make a misrepresentation or a failure to make timely disclosure should be automatically exempt from liability. The concept of "knowingly influence" was deliberately chosen by the CSA to denote a high degree of awareness. The CSA remain of the view that it is the correct standard and do not consider that exemption would be necessary or appropriate for particular categories of issuers or institutions.
177 (Operative "right of action" section, generally; see text above)	**Canadian Investor Relations Institute** (28/09/98): Excessively broad net of liability, far exceeding that applicable to prospectus liability. "Officer" is an expansive term. "Permitting" and "acquiescing in" are broad and uncertain terms. "Little attention...paid to ...legitimate concerns of corporate officers of all levels of management". (page 4) Oral misrepresentations: "Oral communications are more easily capable of misinterpretation and, without recording each encounter..., defending...will be difficult at best". Scope of oral disclosure [should] be clearly defined, limited to "conference calls with financial analysts and/or the media" (page 5).	The issues raised in this comment were considered in detail both by the Allen Committee and by the CSA. The CSA are of the view that the proposed right of action must be comprehensive in scope, but should balance legitimate needs and expectations of investors, issuers and issuers' management. The CSA remain of the view that the Proposal does properly address legitimate concerns of diligent management. Renumbered section 175.2 must be read (i) together with definitions that incorporate elements of reasonable expectation ("document", "public oral statement"), (ii) in light of the element of awareness inherent in each of the words "authorized, permitted or acquiesced", (iii) in light of the positive action implied by the words "authorized" and "permitted", (iv) recognizing that a plaintiff would bear the burden of demonstrating, to the satisfaction of a court, all the elements of the right of action under section 175.2, and (v) having regard to the available defences, which include "due diligence" that, under section 175.3(7), would take into account the circumstances surrounding the impugned disclosure, the existence, if any, and the nature of any system to ensure that the responsible issuer meets its continuous disclosure

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		obligations and; the reasonableness of reliance by the person or company on the disclosure compliance systems in place at the time. The cumulative effect of these provisions should restrict liability to instances in which an individual has failed to act reasonably.
177 (Operative "right of action" section, generally; continued)	**Davies, Ward & Beck** (28/08/98): "...[I]ssuers will be exposed to liability... in a much wider range of circumstances than ...under US federal securities laws " (page 8). [Under section 10(b)-5,] the plaintiff must prove... "scienter". The Proposal establishes much lower pleading thresholds...the plaintiff will not have to plead...the defendant's state of mind" (pages 8-9).	The CSA understand the commenter to refer to the difference between the long-standing requirement under Canadian securities legislation for timely disclosure of all material changes and the more limited requirements under US federal securities laws. The Proposal should, in the view of the CSA, apply in respect of all disclosure of material changes required under Canadian securities legislation. The US provision is an anti-fraud measure that has been developed through jurisprudence into a compensatory scheme. The Proposal, by contrast, is designed as an incentive to good corporate disclosure practices, rather than a fully compensatory scheme. As such, the CSA believe the standards encouraged by the Proposal -- "Due diligence" in respect of core documents on the part of those responsible for them, and absence of gross misconduct in other cases -- to be appropriate.
	Davies, Ward & Beck (28/08/98) (continued): "...[T]hese exceptionally low pleading thresholds will invite strike suits..." (pages 8-9). "..'[L]oser pays' cost rules...will not deter judgment-proof plaintiffs...nor...meritless claims commenced in the expectation that they will be settled..." (page 13). "[L]awyer-driven" class action litigation motivated by contingency fees" (page 14).	Rules of civil procedure give courts an important role in screening out unmeritorious claims early in the litigation process in response to defence motions to strike out actions. The CSA have also made significant changes to the Proposal to (i) require that a plaintiff obtain leave of the court before commencing an action, which leave will only be granted if there is evidence of good faith and the plaintiff has a reasonable chance of success; and (ii) require court approval of any settlement agreement.

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177 (Operative "right of action" section, generally; continued)	**Davies, Ward & Beck** (28/08/98) (continued): "Terms of uncertain meaning": • "public oral statement" by individuals "whose status as 'authorized' representatives... may be questionable". • "...the Proposal fails to define the term 'knowledge'" (page 14).	The CSA have added a definition of "public oral statement" (discussed above). With that addition, the CSA consider these terms sufficiently clear to enable issuers, investors and others, as well as the courts, to understand the scope and purpose of the Proposal and apply it appropriately.
177 (Operative "right of action" section, generally; continued)	**The Fraser Institute: Law and Markets Project** (28/08/98): "...Canadian standards for notice pleading have never been tested in securities class actions". Contingency fees: available in some jurisdictions, "providing another incentive for forum shopping". (page 35) "...underestimates the degree to which plaintiff attorneys [sic] could shop between provinces". The Proposal would "invite the Courts to take a greater role in securities rule-making... the unleashing of Courts into questions of disclosure". (page 37) Discovery: "ability to compel testimony from directors" is "troubling" (page 35).	In respect of the Proposal specifically, see the CSA's comment above on procedural measures and revisions to the Proposal. The CSA infer from these comments a general concern about the role of courts in monitoring the performance by issuers, their directors and others of their public responsibilities. Established rules of civil procedure are designed to prevent the use of the discovery process by plaintiffs to conduct "fishing expeditions", against directors or others, to establish whether they might have the basis of a claim.
177 (Operative "right of action" section, generally; continued)	**Goodman Phillips & Vineberg** (26/08/98): (page 7). ..."[P]roposal does not encompass some of the most active players in the secondary market, namely dealers and brokers, who ... have Rule 10(b-5) liability in the United States...".	Both the Allen Committee and the CSA specifically considered whether the Proposal, should apply to registrants. Both decided that the civil remedy would not appropriately extend to registrants acting only in that capacity. This is largely a reflection of the underlying purpose of the Proposal, the encouragement of high quality disclosure on the part of issuers, and a recognition that registrants do not generally have a significant role in

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		preparing continuous disclosure. Note, however, that a registrant could fall within the definition of "influential person" in certain circumstances, in which case, if the person knowingly influenced a misrepresentation or a failure to make timely disclosure, liability would attach under the Proposal. Note also that the definition of "expert" has been expanded to refer specifically to financial analysts.
177 (Operative "right of action" section, generally; continued)	**Goodman Phillips & Vineberg** (26/08/98) (page 7) (continued): The Proposal is much stricter than US 10(b-5) liability which "requires evidence of 'scienter'". The Proposal is predicated on 'deemed reliance' whereas US jurisprudence only presumes reliance, the presumption being "rebuttable by, among others, a 'truth on the market' defence where sufficient current information is present in the marketplace" (citing Apple Computer).	See the CSA response to a similar comment by Davies, Ward & Beck, above. The CSA have amended the 1998 Draft Legislation to clarify that a person or company has a right of action for a misrepresentation without regard to whether the plaintiff relied on the misrepresentation. In this context, the revised legislation creates a purely statutory right of action. Section 175.4(3), however, allows the defendant to show that all or part of the loss to the plaintiff was caused by factors other than the misrepresentation or failure to disclose. This provision could arguably allow a defendant to raise a "truth in the market" defence.
177 (Operative "right of action" section, generally; continued)	**Investment Dealers Association of Canada** 29/09/98 to 02/10/98: (page 2) The Proposal "imposes strict liability" whereas US Rule 10b-5 requires "the plaintiff [to] prove intent on the part of the defendant". Rather than providing a remedy to investors, regulators should: • upgrade continuous disclosure rules to US standards; and	See the CSA response to a similar comment by Davies, Ward & Beck, above. The CSA agree with the commenter that continuous disclosure requirements should be upgraded and note that enhancements to continuous disclosure requirements are under consideration as part of separate CSA initiatives. These initiatives include the proposed Integrated Disclosure System, which was the subject of a Concept Proposal published for comment on January 28, 2000. The Proposal is designed to encourage practices that ensure compliance with disclosure requirements. That purpose would, in the view of the CSA, remain

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	• implement uniformly an equivalent to *Securities Act* (Ontario) section 128.	valid irrespective of changes in particular disclosure requirements. The commenter refers to a provision enabling the regulator to apply to a court for a remedial order. While some CSA members have such authority, the CSA do not consider that the availability or otherwise of such a provision would have a bearing on the appropriateness of a civil remedy available directly to investors.
177 (Operative "right of action" section, generally; continued)	**McCarthy Tétrault** (28/08/98): "The Proposal [section 177] contemplates strict liability...significantly tougher ...than in the United States where a *scienter* standard applies" (page 13). The commenter points to contingency fees and the practice of plaintiff firms financing class action litigation.	See the CSA response to a similar comment by Davies, Ward & Beck, above. See the CSA response to a similar comment by Davies, Ward & Beck, above.
177 (Operative "right of action" section, generally; continued)	**Ontario Municipal Employees Retirement Board** 30/09/98: "Tighten and improve the text of the Proposed Legislation".	The CSA have taken this comment into account in revising the Proposal.
177 (Operative "right of action" section, generally; continued)	**Osler Hoskin & Harcourt** (2708/98): (page 4). The Proposal fails to carry forward the Allen Committee recommendations to exclude professional advisers acting in that capacity, and to require actual awareness on the part of influential persons.	The change from the Allen Report recommendation was deliberate. In view of the CSA's objective of encouraging sound disclosure by issuers, and the almost universal involvement of external advisors in at least some aspects of issuer disclosure, the suggested exclusion is unjustifiable. Note, however, that an external advisor who is an "influential person" would be liable only for a misrepresentation or failure to make timely disclosure that the adviser "knowingly influenced", or if the influential person actually released the document or made the public oral statement containing the misrepresentation. This, in the view of the CSA, is the correct result and not

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		inconsistent with the commenter's objective.
177 (Operative "right of action" section, generally; continued)	**The Toronto Stock Exchange** (28/08/98): The Proposal fails to carry forward the Allen Committee's recommended distinct liability of a professional advisor acting in that capacity.	See the comments immediately above.
	The Toronto Stock Exchange (28/08/98) (continued): The Proposal does not achieve its objectives in that an investor who acquired securities after the correction would not have a cause of action (page 7).	The CSA are of the view that the Proposal is correct in not extending a cause of action to an investor who acquires securities after a misrepresentation has been corrected. The CSA generally agree with the conclusion of the Allen Committee as to who should have a cause of action.
Operative section 177 -- specific elements: **177(2)** (See above.)	**Canadian Bar Association (Ontario) Securities Subcommittee** (03/11/98): There should be a defence for an issuer that publicly disavows a public statement by a person with apparent but not actual authority.	The CSA are sympathetic to the suggestion. In an effort to more clearly balance the legitimate interests of issuers and investors, and in view of the underlying purpose of the Proposal, namely the encouragement of good disclosure practices on the part of issuers, the CSA have modified the "correction" defence as follows: **"175.2(7)** In an action under [subsection (2) or (3)], if the person or company that made the public oral statement had apparent, but not implied or actual, authority to speak on behalf of the issuer, no person is liable with respect to any of the responsible issuer's securities acquired or disposed of before that person became, or should reasonably have become, aware of the misrepresentation."
Operative section 177 -- specific elements: (continued) **177(2)** (See above.)	**Global Strategy Investment Fund** (30/09/98): The term "public oral statement" could	The CSA do not consider a specific

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	describe the commenter's periodic market overview and, if so, the commenter is uncertain whether a genuinely-held, but ultimately inaccurate, view would relate "directly or indirectly to the business or affairs of an Issuer" and constitute a "misrepresentation". If excluded, the definitions need to be clearer. If intended to create liability, the legislation must more clearly distinguish between types of disclosure. Concern was also expressed about potential liability for a misrepresentation through omission, for example in a focussed discussion that does not cover certain areas.	exclusion of "market overviews" either practical or necessary. The CSA are of the view that the circumstances in which a publicly stated misrepresentation of facts could give rise to liability are appropriately limited under the Proposal. Liability under the Proposal would not attach merely by reason of an inaccuracy in a public oral statement. The statement, as noted, must amount to a "misrepresentation", which in turn under securities legislation constitutes either an untrue statement of a material fact or an omission to state a material fact that is either required to be stated or that must be stated to ensure that a statement is not misleading in the light of the circumstances in which it was made. A "material fact" refers, in most jurisdictions, to something that would reasonably be expected to have a significant effect on the market price or value of a security. In Québec, the term refers to something reasonably likely to have a significant effect on an investment decision. An "overview" of market conditions would not likely be considered a statement constituting a material fact. Moreover, a positive statement of an issuer's genuine and reasonable belief as to market conditions, characterized as such, would not likely be considered "untrue", if indeed it would constitute a material fact. Note also that the Proposal provides defences for all persons and companies that, after reasonable investigation ("due diligence"), reasonably believed that there had not been a misrepresentation, and for forward looking information that is accompanied by appropriate cautions and for which the person or company has a reasonable basis for making the forward-looking disclosure.
Operative section1 177 -- specific elements: (continued) **177(4)** Where there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of a specified security between the time when the material change was	**Canadian Investor Relations Institute** (28/09/98): Liability for failure to make "timely" disclosure is criticized as an extension	The CSA propose no "safe harbour" for failures to make timely disclosure. The

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required to be disclosed and the correction of the failure to make timely disclosure is deemed to have relied on the responsible issuer having complied with its disclosure requirements under the Act and has a right if action for damages against (a) the responsible issuer, (b) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure, and (c) each influential person or director or officer of an influential person, who is not also an officer or director of the responsible issuer, and who knowingly influenced (i) the responsible issuer or any person or company acting on behalf of the responsible issuer in the failure to make timely disclosure, or (ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the failure to make timely disclosure.	beyond US standards. There is no de minimus delay allowed and no reflection of the difficult judgements required for determining when disclosure becomes necessary or material. The commenter calls for "...a very expansive safe harbour" (page 6).	Proposal does not alter existing requirements for timely disclosure, which the CSA consider fundamental to the existing disclosure regime under Canadian securities law. The Proposal does, however, recognize the need on occasion to balance demands for reliability and timeliness of disclosure, primarily through the defence, available to all persons and companies, of reasonable investigation ("due diligence"). The legislation allows the court to consider a number of factors in assessing the reasonableness of investigation or whether the person or company is guilty of gross misconduct, including the time period within which the disclosure was required to be made.
178(4) In determining whether an investigation was reasonable, or whether any person or company has been grossly negligent, regard shall be had to all of the circumstances, including (a) the nature of the responsible issuer, (b) the knowledge, experience and function of the person or company, (c) the office held if the person was an officer, (d) the presence or absence of another relationship with the responsible issuer if the person was a director, (e) the reasonableness of reliance on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties	**KPMG** (28/08/98): The commenter expressed concern that the defence of "reasonable investigation" could be onerous for auditors, exposing them to judicial second-guessing as to the reasonableness of their audit investigation and the inevitable judgements that auditors must make about whether, and how far, to insist on changes to financial statements (page 7). The Proposal should specify what procedures constitute a "reasonable investigation" to support the auditor's belief that a released document fairly represents the auditor's report (page 8).	The CSA do not consider that any professional's participation in public disclosure should automatically be exempt from judicial review. Concerning the commenter's second point, the Proposal reflects the CSA view that guidance ought not to take the form of a procedural handbook. However, reference to relevant professional standards would give an appropriate degree of guidance to courts and certainty to experts. To clarify the role of the court, the CSA have changed the preamble to read: **"175.3(7)** In determining whether an investigation was reasonable under subsection (6), or whether any person or company is guilty of gross misconduct under subsection (1) or (3), the court shall consider all relevant circumstances, including..."

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should have given them knowledge of the relevant facts, (f) the time period within which disclosure was required to be made, (g) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement, and (h) in the case of a failure to make timely disclosure, the role and responsibility of the person or company in a decision not to disclose the material change.		To address the specific issue raised by the commenter, the CSA have also revised the provision by adding the following after paragraph: "(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert; " The requirement for the expert's written consent to the particular use to which the expert's work is put should go some way to address the commenter's concerns. In a similar vein, the CSA propose to add to the Proposal the following (not limited to expert statements): "(i) the extent to which the person or company knew or should reasonably have known the content and medium of dissemination of the document or public oral statement,"
178(5) No person or company is liable under section 177 where there has been a failure to make timely disclosure if the material change was disclosed by the responsible issuer on a confidential basis to the Commission and, (a) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis, (b) if the information contained in the confidential filing remains material, disclosure of the material change was made public promptly upon the end of the basis for confidentiality, and (c) the person or company or responsible issuer does not release a document or make a public oral statement that, due to the undisclosed material change, constitutes a misrepresentation, provided that, upon the material change becoming public, the responsible issuer promptly discloses the material change in the manner required under the Act.	**Canadian Bankers Association** (21/09/98): (page 5): Clarify which party has the burden of proof.	The CSA propose to revise the provision to make clear that the burden of demonstrating the grounds of this defence to liability rests with the defendant: "**175.3(8)** No person or company is liable in an action under section 175.2 in respect of a failure to make timely disclosure if, (a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis with the Commission under subsection 118(3) of the Act;..." The CSA consider this defence and the related burden of proof to be appropriate: knowledge concerning the existence or nonexistence of a confidential filing will rest with the issuer and other responsible persons acting on its behalf, and not with a plaintiff.

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178(5) (continued)	**The Toronto Stock Exchange** (28/08/98): The concluding words are circular because it is the issuer that will make the information public (page 6).	The comment assumes that confidential information can become public only by the issuer's action. This may not always be the case. The provision was meant to ensure that, if information is leaked, however justified confidentiality might have been, the information should be formally made public to ensure broad dissemination. The CSA propose to make several minor drafting changes to the section to clarify its operation. The CSA have revised the section to read as follows: "**175.3(8)** No person or company is liable in an action under section 175.2 in respect of a failure to make timely disclosure if, (a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis with the Commission under subsection 118(3) of the Act; (b) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis; (c) if the information contained in the report filed on a confidential basis remains material, disclosure of the material change was made public promptly when the basis for confidentiality ceased to exist; (d) the person or company or responsible issuer did not release a document or make a public oral statement that, due to the undisclosed material change, contained a misrepresentation, and (e) if the material change became publicly known in a manner other than as required under the Act, the responsible issuer promptly disclosed the material change in the manner required under the Act.

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178(6) No person or company is liable under section 177 for a misrepresentation in forward-looking information if, (a) the person or company proves that (i) the forward-looking information contained reasonable cautionary language proximate to the forward-looking information and, where reasonably practicable, an analysis of the sensitivity of the information to variations in the material factors or assumptions that were applied in reaching a conclusion or forecast contained in the forward-looking information, and (ii) the person or company had a reasonable basis for the conclusion or forecast, (b) securities of the responsible issuer are traded on a published market, and (c) the forward-looking information is not contained in the prospectus or securities exchange take-over bid circular of the responsible issuer filed in connection with the initial public distribution of securities of the responsible issuer.	**Canadian Bankers Association** (21/09/98): Remove the requirement for a sensitivity analysis owing to the uncertainty of the "where reasonably practicable" language. Give more guidance on cautionary language. (page 5)	The CSA propose revisions that would clarify and broaden the defence to liability in respect of forward-looking information, by (i) making clear that the requisite cautionary language must be proximate to but need not be part of the forward-looking information; (ii) clarifying elements of the requisite cautionary language; (iii) eliminating the requirement for a sensitivity analysis; and (iv) eliminating the condition relating to trading of the responsible issuer's securities. In this context, the CSA also propose to make some drafting changes to the definition of "forward looking information" to clarify its scope. The proposed definition would read as follows: **" "forward-looking information"** means all disclosure regarding possible events, conditions or results including future oriented financial information with respect to prospective results of operations, financial position or changes in financial position, based on assumptions about future economic conditions and courses of action, and presented as either a forecast or a projection ".
178(6) (continued)	**Canadian Investor Relations Institute** (28/09/98): "Safe harbour" for forward-looking information: Concerned about difficulty of establishing a "reasonable basis". "recommend instead...US standard" offering safe harbour with cautionary language and absence of "actual knowledge that the statements were false or misleading". Utility of sensitivity analysis doubted (page 7).	The CSA propose to remove the requirement for a sensitivity analysis and have proposed other modifications to the provision. See the response to the comment from the Canadian Bankers Association, immediately above. The CSA do not, however, consider that a defence conditional on a "reasonable basis" for a statement is unduly restrictive. The CSA do not agree with the proposition that forward-looking information should, in effect, be protected whether or not the

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		maker has any basis for making the statement, unless the plaintiff can prove actual knowledge that the statement was false. To do so would be tantamount to sanctioning fraudulent misrepresentations.
178(6) (continued)	**Goodman Phillips & Vineberg** (26/08/98): "Safe harbour" under the Proposal for forward-looking information shifts onto defendants the burden of proving a reasonable basis for the forecast information while in the US the plaintiff must prove that the defendant actually knew that the information is misleading (page 8).	The CSA consider the proposed defence, with the modifications described above, to be appropriate.
178(6) (continued)	**Osler Hoskin & Harcourt** (27/08/98): (page 5). The proposed "safe harbour" is not available to issuers whose securities are not traded on a public market, although they would be subject to general liability under the Proposal as soon as their "private company" restrictions are removed.	The CSA share the commenter's concern and have amended both the safe harbour and the definition of "responsible issuer" to address this concern. More broadly, however, the CSA do not consider the trading status of the responsible issuer's securities integral to this defence, and propose to remove that condition. See the response to comments of the Canadian Bankers Association, above.
178(7) Where the report, statement or opinion of an expert is included, referred to or quoted from in a document or in a public oral statement, the written consent of the expert to such use being made of the report, statement, or opinion shall be obtained by the responsible issuer prior to, (a) fling of the document with the Commission, or with a government or an agency thereof under applicable securities or corporate law, or any stock exchange under its by-laws, rules or other regulatory instruments or policies, (b) the document being released if the document has not already been filed with the Commission, or with a government or an agency thereof	**The Canadian Institute of Chartered Accountants** (03/09/98) (page 1): An expert should have a defence upon becoming "aware that the information on which they carried out services is altered".	Under the Proposal an expert would only be liable if the expert's report, statement or opinion contains a misrepresentation at the time the report, statement or opinion is made. If information changes after the report, statement or opinion is made, the expert would not be liable. Further, in order to attract liability, the expert must have given his consent to use the report, statement or opinion and not subsequently withdrawn his consent. For post-publication corrections, see the discussion below concerning subsection 179(1) of the 1998 Draft Legislation (now section 175.3(15) in the revised legislation).

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under applicable securities or corporate law, or any stock exchange under its by-laws, rules or other regulatory instruments or policies, or (c) the person making the public oral statement.		
178(7) (continued)	**The Toronto Stock Exchange** (28/08/98): The requirement for written consent of the expert is criticized as superfluous and unnecessary, in that issuers and experts will obtain and give consents anyway (page 6).	The CSA agree with the comments and have removed the requirement from the Proposal. It should be noted, however, that any existing requirements under securities legislation for written consents in respect of specific disclosure documents are unaffected by the Proposal.
Derivative Information [new - No counterpart in the 1998 Draft Legislation]		The use by an issuer in its disclosure documents of information, containing a misrepresentation, that was derived from public disclosure by another issuer could expose the first issuer to liability. To make clear that disclosure, by or for a responsible issuer, of information in respect of another issuer that is derived from public disclosure by that other issuer, where the use of that information by or on behalf of the first issuer is not unreasonable, will not render the responsible issuer liable for a misrepresentation in the disclosure of the other issuer, the CSA have revised the Proposal by adding the following provision: **"175.3(14)** No person or company is liable in an action under section 175.2 for a misrepresentation in a document or a public oral statement, if the person or company proves that: (a) the misrepresentation was also contained in a document filed by or on behalf of another person or company, other than the responsible issuer, with the Commission or any other securities regulatory authority in Canada or a stock exchange and not corrected in another document filed by or on behalf of that other person or company with the Commission or that other securities regulatory authority in Canada or stock

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		exchange before the release of the document or the public oral statement made by or on behalf of the responsible issuer; (b) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation; and (c) at the time of release of the document or the making of the public oral statement, the person or company did not know and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation. "
179(1) No person or company, other than the responsible issuer, is liable under section 177 in respect of a misrepresentation or a failure to make timely disclosure that was made without the knowledge or consent of the person or company, for any loss or damage incurred by a plaintiff after (a) the person or company became aware of a misrepresentation or a failure to make timely disclosure, (b) the person or company promptly notified the board of directors of the responsible issuer of the misrepresentation or the failure to make timely disclosure, and (c) if no correction of the misrepresentation or no correction of the failure to make timely disclosure was made by the responsible issuer within two days after the notification under paragraph (b), the person or company (unless prohibited by law or by professional confidentiality rules) promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure.	**The Toronto Stock Exchange** (28/08/98): The commenter notes that the provision, which differs somewhat from the equivalent proposed by the Allen Committee, while perhaps intended to promote early third-party correction of a misrepresentation could actually discourage third-party correction (page 6).	The CSA are not convinced that the provision would, in fact, discourage third-party correction but do propose to revise the provision to make clear that, as under the Allen Committee' s proposal, qualifying defendants would have no liability: "**175.3 (15)** No person or company, other than the responsible issuer, is liable in an action under section 175.2 if the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the person or company and, if, after the person or company became aware of the misrepresentation before it was corrected, or the failure to make timely disclosure before it was disclosed in the manner required under the Act, (a) the person or company promptly notified the board of directors of the responsible issuer or such other persons acting in a similar capacity of the misrepresentation or the failure to make timely disclosure, and (b) if no correction of the misrepresentation or no subsequent disclosure of the material change in the manner required under the Act was made by the responsible issuer within two business days after the notification under paragraph (a), the

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		person or company, unless prohibited by law or by professional confidentiality rules, promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure. "
179(2) In an action under section 177 in respect of a misrepresentation or a failure to make timely disclosure, if the plaintiff acquired or disposed of specified securities on or before the tenth trading day after the public correction of the misrepresentation or the correction of the failure to make timely disclosure, the amount recoverable shall not exceed the amount of the plaintiff's actual loss, calculated taking into account the result of hedging or other risk limitation transactions undertaken by the plaintiff.	**The Toronto Stock Exchange** (28/08/98): The Proposal fails to distinguish between a plaintiff who sells before and one who sells after correction (page 7).	The comment is correct. The CSA do not consider it necessary to make such a distinction. These provisions do make a distinction in the computation of the loss recoverable depending on when, if ever, the loss is crystallized, in essence requiring that the loss be computed on the basis of a market price not more than 10 days after public correction, because it was considered that the variety of influences on market price during any longer period would tend to detract from the link between a later market price and the effect of the misrepresentation and its correction. The CSA do, however, propose revisions to make this distinction clearer: **"175.4(1)** Damages... shall be assessed in favour of a person or company that acquired an issuer's securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows: (a) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions; (b) in respect of any of the securities of the responsible issuer that the person or company subsequently disposed of after the 10th trading day after the public

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		correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the lesser of, (i) an amount equal to the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions, and (ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and, (A) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, or (B) if there is no published market, then the amount the court considers just; and (c) in respect of any of the securities of the responsible issuer that the person or company has not disposed of, assessed damages shall equal the number of securities acquired, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and, (i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10

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		day trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, or (ii) if there is no published market, then the amount that the court considers just. "
179(3) In an action under section 177 in respect of a misrepresentation or a failure to make timely disclosure, other than by a plaintiff described in subsection 179(2), the amount recoverable shall not exceed the aggregate of commissions paid in respect of the original acquisition or disposition and the lesser of, (a) where the plaintiff has subsequently acquired or disposed of the specified securities, the plaintiff's actual loss, calculated taking into account any hedging or other risk limitation transactions undertaken by the plaintiff, and (b) a loss amount calculated on the basis of the difference between the price paid or received by the plaintiff at the time of the initial transaction in which the plaintiff acquired or disposed of the specified securities in question and (i) where the specified securities trade on a published market, the market price of the specified securities on the principal market for the specified securities during the ten trading days following the public correction of the misrepresentation or the correction of the failure to make timely disclosure, or (ii) if there is no published market, then such amount as a court may deem just.	**The Toronto Stock Exchange** (28/08/98) (continued): Proposal fails to distinguish between a plaintiff who sells before and one who sells after correction (page 7).	See the comment immediately above concerning subsection 175.4(1).
179(4) In an action under section 177 in respect of a misrepresentation or a failure to make timely disclosure, no amount shall be recoverable for any loss or damage that the defendant proves was not caused by the misrepresentation or the failure to make timely disclosure.	**Goodman Phillips & Vineberg** (26/08/98) (page 7): Proposal shifts burden of proving "causation" to the defendant; the burden rests on the plaintiff under 10b-5 (citing Huddleston).	The provision parallels, as intended, securities legislation governing liability for misrepresentations in a prospectus. The Proposal is fundamentally different

1998 Draft Legislation	Public Comments	CSA Response
		than Rule 10b-5. The former is a specific and comprehensive code whereas the latter is a general anti-fraud rule which leaves to determination by the courts matters such as the elements of the cause of action and apportionment of damages. The Proposal attempts to strike a fair balance between the interests of responsible issuers and plaintiffs. The plaintiff is not required to prove that a misrepresentation or failure to file caused him damage. It is assumed from the element of materiality inherent in the definition of "misrepresentation" and in the requirement to file a material change report that the misrepresentation or failure to file would be expected to affect the price at which the plaintiff purchases or sells the security. However subsection 175. 4(3) excludes liability for any portion of the plaintiff's damages which do not represent a change in value of the security resulting from the misrepresentation or failure to file.
179(4) (continued)	**Canadian Bankers Association** (21/09/98): (page 6): The Proposal "goes too far by relieving the Plaintiff of the burden of proving... any cause or factors" -- "low pleading threshold will encourage ...strike suits...".	See the CSA response to similar comments by Davies, Ward & Beck in connection with section 177, above. The CSA have amended the Proposal to require that a plaintiff obtain leave of the court before commencing an action, which leave will only be granted if there is evidence of good faith and the plaintiff has a reasonable chance of success.
179(5) The aggregate amount for which a particular person or company is found liable in an action under section 177 in respect of a misrepresentation or a failure to make timely disclosure shall not exceed the amount prescribed..." [namely the following, for the persons or companies specified:] (a) for a responsible issuer, the greater of (i) 5% of its market capitalization, and (ii) $1 million, (b) for each director or officer of a	**The Fraser Institute: Law and Markets Project** (28/08/98): The proposed caps on damages will penalize "Canada's largest and arguably most successful companies" (page 39).	The CSA do not propose to modify the damage caps. The CSA remain of the view that damage exposure must, if the system is to have deterrent value be sufficient to make it worthwhile for a plaintiff to undertake an action but, on the other hand, reflect an issuer's ability to pay and recognize that it is the non-plaintiff shareholders who ultimately bear the economic burden of providing compensation. In this context, the CSA have amended the legislation to introduce a "gatekeeper" mechanism (section 175.7) and a requirement to seek court approval

1998 Draft Legislation	Public Comments	CSA Response
responsible issuer, the greater of (i) $25 000, and (ii) 50% of the aggregate of the director's or officer's total compensation from the responsible issuer and its affiliates, (c) for an influential person, where the influential person is not an individual, the greater of (i) 5% of its market capitalization, and (ii) $1 million, (d) for an influential person where the influential person is an individual, the greater of (i) $25 000, and (ii) 50% of the aggregate of the influential person's total compensation from the responsible issuer and its affiliates, (e) for each director or officer of an influential person, the greater of (i) $25 000, and (ii) 50% of the aggregate of the director's or officer's total compensation from the influential person and its affiliates, (f) for an expert, the greater of (i) $1 million, and (ii) the revenue that the expert and its affiliates have earned from the responsible issuer and its affiliates during the twelve months preceding the misrepresentation, and (g) for each individual, not described in subsection (a), (b), (c), (d), (e) or (f), who made a public oral statement containing a misrepresentation, the greater of (i) $25 000, and (ii) 50% of the aggregate of each		for settlements (section 175.9). The CSA believe that these procedural safeguards coupled with the "loser pay" cost provision (section 175.10) and the provision apportioning liability among defendants (section 175.5) included in the 1998 Draft Legislation will reduce the risk of strike suits.

1998 Draft Legislation	Public Comments	CSA Response
person's total compensation from the responsible issuer and its affiliates ", [unless, in the case of a person or company other than the responsible issuer, 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.]		
179(5) (continued)	**Goodman Phillips & Vineberg** (26/08/98) (page 10): "By linking the limits on total liability of individual defendants to their compensation, the Proposal will lead to the anomalous result that an individual [with]... the greatest responsibility for the misleading disclosure could pay less in damages than a less 'culpable' individual who happens to be better compensated". Similar result for corporate defendants with differing capitalization. Multiple categories of defendants, defences and documents: "Proposal is unduly complex". The effectiveness of the Proposal hinges on class actions, not available across Canada.	This result follows from the emphasis on deterrence rather than full compensation. No change is proposed. See the CSA response to a similar comment raised by The Fraser Institute above Difficult to further simplify categories of defendant. Class actions are not a prerequisite of the Proposal. It should be noted, however, that B.C. class proceeding legislation permits the inclusion of plaintiffs that reside outside B.C. on an "opt-in" basis as a sub-class. Moreover, Ontario courts have recently decided that the absence of an explicit mention of foreign plaintiffs in the Ontario class proceeding legislation does not preclude their participation under that statute unless they specifically "opt out" (see, *Carom v. Bre-X Minerals Ltd.*, 43 O.R. (3d) 441).

1998 Draft Legislation	Public Comments	CSA Response
179(5) (continued)	**McCarthy Tétrault** (28/08/98): "The Proposal is unfair to large cap issuers with significant share equity" (page 2). "The gate keeping of provincial securities administrators should not be altered" by supplementing regulatory oversight with private enforcement (page 9). There is little reason to believe that Canadians are truly less litigious than their American brethren. It is more likely that our system of justice has simply not allowed... the ... approach taken in the United States. This may be changing..." (page 11).	See the CSA response to a similar comment raised by The Fraser Institute above. The CSA view a so-called "gatekeeping role" as an important element of the role of a court in assessing any motion to dismiss an action before it, or in considering a motion to join plaintiffs or to certify a class action. The CSA do not consider that it would be appropriate for a securities regulatory authority to be obligated, in essence, to intervene in and possibly terminate an action before it reaches the courts. Securities regulatory authorities would, however, be notified of actions and entitled to intervene where such intervention would be in the public interest.
179(5) (continued)	[No public comment]	The CSA have clarified in the Proposal that the proposed caps on damages are aggregate amounts that apply to all actions commenced across Canada. Specifically, the amount of damages a defendant must pay are reduced by the amount of any prior award made against, or settlement paid by, the defendant relating to the same misrepresentation under a similar action in any Canadian jurisdiction (see section 175.6 of the revised legislation).
180(1) In an action under section 177, where damages have been caused or contributed to by the fault or neglect of two or more defendant persons or companies, the court shall determine each defendant's responsibility for the damage or loss incurred by all plaintiffs in the action, expressed as a percentage of all defendants' responsibility, and each defendant shall be liable to the plaintiffs only for that percentage of the aggregate amount of damages awarded to the plaintiffs. **180(2)** Despite subsection (1), if, in an action under section 177 in respect of a misrepresentation or a failure to make timely disclosure, a court determines that a particular defendant (other than the responsible issuer) authorized, permitted or acquiesced in the making of the	**KPMG** (28/08/98): Because audited financial statements are the joint responsibility of auditors, directors and management, • the liability of auditors should never exceed 50%; and • directors and officers should not be able to assert as a defence reliance on the auditor. (page 8)	The CSA do not agree with the comment and do not believe that an arbitrary apportionment of liability as between auditors and others is appropriate. The recommendations would remove from the courts the decision deliberately left to them under the Proposal, a decision to be made on the basis of all relevant circumstances of a particular case.

1998 Draft Legislation	Public Comments	CSA Response
misrepresentation or the failure to make timely disclosure while knowing it to be a misrepresentation or a failure to make timely disclosure, that defendant will be liable jointly and severally with each other defendant, other than the responsible issuer, in respect of whom the court has made a similar determination, for the aggregate amount of damages awarded in the action.		
190.1 [Comparable provision as proposed in Ontario version of 1998 Draft Legislation] Notwithstanding anything to the contrary in the *Courts of Justice Act* (Ontario) and the *Class Proceedings Act* (Ontario), the prevailing party in an action under[section 177] shall be entitled to costs determined by a court in accordance with applicable rules of civil procedure.	**Canadian Bankers Association** (21/09/98): (page 6): The CBA supports the Proposal but calls for its extension to existing prospectus liability provisions.	The CSA may consider this comment separately from this Proposal.

APPENDIX B
TO
CSA NOTICE 53-302

Summary of Comments Received on the Request for Comment
Proposed Changes to the Definitions of "Material Fact" and "Material Change"

Certain members of the Canadian Securities Administrators (the "CSA") published for comment proposed changes to the definitions of "material fact" and "material change". The amended definitions were first published for comment in November 1997[1] (the "Request for Comment") and did not form a part of the recommendations contained in the Allen Committee's Final Report.[2] The CSA received the following 7 submissions in response to this Request for Comment:

1. Securities Advisory Committee (Ontario) by letter dated December 4, 1997.
2. Canadian Bankers Association by letter dated December 17, 1997.
3. Osler, Hoskin & Harcourt (Corporate Department) by letter dated December 19, 1997.
4. Phillip Anisman on behalf of The Toronto Stock Exchange by letter dated December 22, 1997.
5. McCarthy Tétrault by letter dated December 29, 1997.
6. CBAO Securities Law Sub-Committee of the Business Law Section by letter dated January 23, 1998 (subsequent submission dated April 19, 1998).
7. Aur Resources Inc. by letter dated January 27, 1998.

At the time the 1998 Draft Legislation was being published the CSA were still considering the comments received on the proposed amended definitions and a final decision had not been made to recommend to our respective governments that the definitions be revised as proposed. In the meantime, a decision was made to reflect the proposed revised definitions in the 1998 Draft Legislation and publish the entire package for comment.

The CSA thank all the commenters for providing their comments. The comments provided in these submissions have been considered by the CSA. However, as the CSA do not propose at this time to proceed with the amendments to these two definitions as published in the 1998 Draft Legislation (other than the changes noted previously in the CSA Report), the CSA is only providing a summary of the comments received without a specific response to each of these comments. The summary has been organized by topic. In this context, it should be noted that the CSA received a number of drafting comments on the proposed definitions which have not been specifically included in this summary.

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[1] In Alberta, at (1997) 6 ASCS 3118.

[2] With the exception of one aspect of the proposed change to the definition of "material fact" to remove the retroactive aspect of the current definition which was recommended by the Allen Committee.

A. Single and Uniform Materiality Standard

Four commenters supported the proposed changes in principle and agreed that a single and uniform standard of materiality for all purposes under securities laws would be desirable. However, one commenter noted that this cannot be accomplished merely by changing the two definitions addressed in the Request for Comments, as Canadian securities laws contain requirements reflecting materiality standards not based on the definitions of "material fact" and "material change".[3] It was the commenter's view that a change in the standard of materiality must address all of the materiality standards in Canadian securities laws to avoid creating unintended ambiguities. The commenter's support of the proposed changes was premised on the assumption that the consequential amendments necessary to ensure a single standard of materiality for all purposes would be made to the securities acts, regulations, rules and policies of each province when the new definitions are enacted. If the review necessary to ensure a consistent standard of materiality throughout Canada could not be accomplished within the CSA's time frame for implementation of the Allen Report's civil liability regime, the commenter noted that it would be preferable to amend the definition of "material fact" only to remove its retroactive element when the civil liability regime is enacted and defer the remaining changes to a later date.

B. Effect of Proposed Reasonable Investor Standard

Commenters were divided as to the likely impact on disclosure obligations if the CSA moved from a market impact standard of materiality to a reasonable investor standard.

One commenter expressed concern that the proposed definitions will make determining whether a material change or material fact has occurred very difficult and will make the threshold more subjective. In this context, the commenter suggested that the implementation of the new materiality/disclosure standard be delayed until Canadian capital markets adjust to the implementation of the limited statutory civil liability regime for continuous disclosure.

One commenter was of the view that the disclosure obligations imposed by the current definitions and those proposed would not differ in practice in most cases. In this context, the commenter noted that a perceived impact of information on share prices invariably influences and is influenced by its importance to investors. Information that is significant to investors will almost always be likely to affect the market price of an issuer's securities (except with respect to mutual funds). In the commenter's view, it is difficult to envisage circumstances in which a fact that would not be likely to affect the market price would be material under

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[3] For example, the commenter noted that in contrast to the proposed definitions, a takeover bid circular describes matters, in addition to material facts, which "would reasonably be expected to affect the decision" of the offeree security holders with respect to the bid. In addition, concepts of materiality are often used to require disclosure of events, transactions and contracts in a statutory context in which the current definition of "material facts" does not apply (common instances are in the forms specifying disclosure under securities legislation).

the proposed standard. If the CSA intends the new standard to encompass facts that do not have financial consequences for issuers and their
securities, the commenter suggested that the CSA define such circumstances and the intended purpose of including them, and in doing so, should proceed with caution. If the proposed changes
are enacted, the commenter suggested that an interpretive policy be published addressing the practical implications of the new standard for issuers.

Finally, one commenter expressed doubt about whether the adoption of an "investment decision" standard would advance things much. The commenter noted that while *Basic Inc. v. Levinson* extended the *TSC Industries* standard of materiality in the U.S. from voting decisions to timely disclosure obligations, ultimately, the essential test is whether the information in question would likely be price sensitive. The commenter argued that the price impact test is the true test in the United States, at least for disclosure purposes and insider trading purposes. Therefore, the commenter cautioned against a change in Canada that would obfuscate the likely meaning to be given to such language in the courts. The commenter noted that the preferred route would be to remove the *ex post facto* test and apply a test based on the current approach which focuses on expected price impact.

C. <u>Scope of proposed materiality standard</u>

Commenters were divided as to whether the proposed materiality standard should be applied to all disclosure obligations and to insider trading.

Offering Documents

One commenter expressed the view that the proposed definitions are appropriate for offering documents, such as prospectuses, offering memoranda, take-over bid circulars and directors circulars.

Conversely, another commenter expressed concern that amending the definition of "material fact" could result in extremely lengthy prospectus documents disclosing facts which would be material to a wide spectrum of reasonable investors in making an investment decision. To the extent that the CSA is concerned that the length of prospectuses is not conducive to allowing investors to make reasoned investment decisions, the proposed amendments could further serve to exacerbate the situation.

Proxy Circulars

Two commenters recommended that the materiality standard not apply to information in a management information circular ("proxy circular"). In this context, one of the commenters expressed concern that applying the proposed standard misconstrues the purpose of the proxy circular, which is to provide all relevant information to investors in order for them to be able to make a reasoned decision about the matters to be submitted to the meeting. The commenter was concerned that the proposed materiality standard will cause the information to extend beyond

information about a proposal to information as to the likelihood of success of the proposal (which would be of primary concern to some market participants).

One commenter believed that the proposed standard must be applied to proxy circulars, as documents used by a corporation for one purpose may be used by investors for another. For example, a proxy circular issued in connection with an amalgamation may influence investment decisions and the information in the circular will likely affect the price of the issuer's securities. A misrepresentation in the circular would affect the validity of the shareholders' meeting and could give rise to civil liability. The materiality standard should be the same for both purposes. However, in other contexts, a misrepresentation that affects the validity of a meeting or specific resolution may not be likely to influence an investment decision but rather may affect a voting decision (for example, information with respect to a nominee to the board of directors). The proposed standard of materiality must be applied in the context of the decision to which it relates. To make it clear that this is the intended approach, the definition of "material fact" should provide that the standard inherent in the definition is to be applied in the relevant circumstances.

Insider Information

One commenter believes that the proposed standard is appropriate for the purpose of preventing insiders from buying or selling securities if they have knowledge of a material fact or material change that has not been generally disclosed. The commenter believes that the proposed standard should simplify the decision about whether disclosure is required because there is no longer a requirement to focus on market reactions. Further, if the proposed definitions lower the threshold and more information is disclosed, the possibility of inadvertent trading on non-disclosed information should be reduced.

Conversely one commenter was of the view that the move from a market standard to a reasonable investor standard, as proposed, could potentially be problematic when applied to insider trading provisions. For example, it was in the commenter's view, a questionable proposition as to whether someone should be prohibited from trading with knowledge of undisclosed information which would not affect the market price of the securities.

Continuous Disclosure

One commenter expressed the view that the current "move the market" test is inappropriate for continuous disclosure obligations. The commenter believes that it forces a consideration of the operations of the market and for some issuers, a difficult admission of the potentially negative effect of adverse developments, both of which may result in decisions about disclosure that are inconsistent with an investor's interest in the information. The commenter believes that some issuers are reluctant to make the decision to disclose potentially adverse information as this is tantamount to a determination by the issuer that the information negatively affects shareholder value. The proposed new definition of "material change" will result in less stigma associated with determining that a material change has occurred in the business of a reporting issuer.

D. "Total mix" concept

One commenter questioned whether the new materiality standard incorporated the "total mix concept.[4] Under that concept, there is no liability under U.S. securities laws because of an alleged failure to disclose information that is already available to the public and therefore is part of the "total mix" of available information. The commenter felt that the standard would have to presume that a reasonable investor would not consider an omitted fact or change important if the information was already in the market from other sources. However, this presumption requires the recognition of the efficient market theory by our courts which has not been done yet. The commenter suggested that the "total mix" concept be expressly included in the civil liability section as a defence.

E. Timely Disclosure Obligations

One commenter provided comments directed at extending the timely disclosure obligations to both "material facts" and "material changes" (i.e. to "material information" generally).[5] The commenter did not object to expanding the reporting obligations to "material facts", but noted that there would also have to be an expansion of the confidential material change report filing procedure because, in the commenter's view, the provision is too narrow.

F. Loser-Pay Costs Rules

One commenter recommended that in order to protect issuers from meritless claims, a "loser-pays" cost rule should be adopted by British Columbia and uniform rules for securities class action litigation should be included in the legislation across the country. The commenter also expressed concern that the "loser-pays" rules would not deter all meritless claims and that additional protection is required to ensure that issuers are not subject to "strike suits".

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[4] The U.S. court in *TSC Industries, Inc v. Northway Inc.* ("*TSC Industries*") stated that the issue of materiality turned on whether there is "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available.

[5] Although the interim report of the Allen Committee included this recommendation, the final report of the Allen Committee is silent on this issue.

APPENDIX C
TO
CSA NOTICE 53-302

Consolidated Text of CSA Proposed 2000 Draft Legislation

I. Proposed Amendments to *Securities Act* (the "Act")

Interpretation

***Substitute the following for the respective current definitions in section 1 of the Act*:**

(k.1) **"material change"** means,

(i) when used in relation to an issuer other than an investment fund,

(A) a change in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer, or

(B) a decision to implement a change referred to in subparagraph (A) made by the board of directors or other persons acting in a similar capacity or by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, and

(ii) when used in relation to an issuer that is an investment fund,

(A) a change in the business, operations or affairs of the issuer that would be considered important by a reasonable investor in determining whether to purchase or continue to hold securities of the issuer, or

(B) a decision to implement a change referred to in subparagraph (A) made

(I) by the board of directors of the issuer or the board of directors of the investment fund manager of the issuer or other persons acting in a similar capacity,

(II) by senior management of the issuer who believe that confirmation of the decision by the board of directors or such other persons acting in a similar capacity is probable, or

(III) by senior management of the investment fund manager of the issuer who believe that confirmation of the decision by the board of

directors of the investment fund manager of the issuer or such other persons acting in a similar capacity is probable;

(l) **"material fact",** when used in relation to securities issued or proposed to be issued, means a fact that would reasonably be expected to have a significant effect on the market price or value of the securities;

(m.1) **"mutual fund"** includes

(i) an issuer

(A) whose primary purpose is to invest money provided by its security holders, and

(B) whose securities entitle the holder to receive on demand, or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the whole or in part of the net assets, including a separate fund or trust account, of the issuer, or

(ii) an issuer or a class of issuers that is designated as a mutual fund by an order of the Commission in the case of a single issuer or otherwise in a regulation which is made for the purposes of this definition

but does not include

(iii) an issuer or a class of issuers that is designated not to be a mutual fund by an order of the Commission in the case of a single issuer or otherwise in a regulation which is made for the purposes of this definition.

Add the following definitions to section 1 of the Act:

(i.2) **"investment fund"** means

(i) a mutual fund, or

(ii) a non-redeemable investment fund;

(i.3) **"investment fund manager"** means a person or company who has the power and exercises the responsibility to direct the affairs of an investment fund;

(m.02) **"non-redeemable investment fund"** includes

(i) an issuer

(A) whose primary purpose is to invest money provided by its security holders,

(B) that does not invest for the purpose of exercising or seeking to exercise control of an issuer or for the purpose of being actively involved in the management of the issuers in which it invests, other than other mutual funds or non-redeemable investment funds, and

(C) that is not a mutual fund, or

(ii) an issuer or a class of issuers that is designated as a non-redeemable investment fund by an order of the Commission, in the case of a single issuer, or otherwise in a regulation which is made for the purposes of this definition,

but does not include

(iii) an issuer or a class of issuers that is designated not to be a non-redeemable investment fund by an order of the Commission, in the case of a single issuer, or otherwise in a regulation which is made for the purposes of this definition.

Delete and substitute the following for section 118 of the Act:

118. Disclosure of material changes – (1) Subject to subsection (3), if a material change occurs in the affairs of a reporting issuer, it shall promptly issue and file a news release authorized by a senior officer disclosing the nature and substance of the change.

(2) Subject to subsection (3), the reporting issuer shall file with the Executive Director a report of such material change in accordance with the regulations as soon as practicable and in any event within 10 days of the date on which the change occurs.

(3) If

(a) in the opinion of the reporting issuer, provided that such opinion is arrived at in a reasonable manner, the disclosure required by subsection (2) would be unduly detrimental to the interests of the reporting issuer, or

(b) the material change consists of a decision to implement a change made by senior management of the issuer who believe that confirmation of the decision by the board of directors is probable and senior management of the issuer has no reason to believe that person with knowledge of the material change have made use of such knowledge in purchasing or selling securities of the issuer,

the reporting issuer may, in lieu of compliance with subsection (1), forthwith file with the Executive Director the report required under subsection (2) marked to indicate that it is confidential, together with written reasons for non-disclosure.

(4) If a report has been filed with the Executive Director under subsection (3), the reporting issuer shall advise the Executive Director in writing if it believes the report should continue to remain confidential within 10 days of the date of filing of the initial report and every 10 days thereafter until the material change is generally disclosed in the manner referred to in subsection (1) or, if the material change consists of a decision of the type referred to in paragraph (3)(b), until that decision has been rejected by the board of directors of the issuer.

(5) Notwithstanding that a report has been filed with the Executive Director under subsection (3), the reporting issuer shall promptly generally disclose the material change in the manner referred to in subsection (1) upon the reporting issuer becoming aware or having reasonable grounds to believe that persons or companies are purchasing or selling securities of the reporting issuer with knowledge of the material change that has not been generally disclosed.

Add the following after section 175 section of the Act:

PART 16.1 – CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

175.1. Definitions and Application. – (1) In this Part,

(a) **"compensation"** means compensation received during the 12 month period immediately preceding the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred, together with the fair market value of all deferred compensation including, without limitation, options, pension benefits and stock appreciation rights, granted during the same period, valued as of the date that such compensation is awarded;

(b) **"core document"** means,

(i) if used in relation to

(A) a director of a responsible issuer who is not also an officer of the responsible issuer,

(B) an influential person, other than an officer of the responsible issuer or an investment fund manager if the responsible issuer is an investment fund, or

(C) a director or officer of an influential person, other than an officer of an investment fund manager, who is not also an officer of the responsible issuer,

a prospectus, a take-over bid circular, an issuer bid circular, a directors' circular, a rights offering circular, MD&A, an annual information form, an information circular, and annual financial statements of the responsible issuer, or

(ii) if used in relation to

(A) an officer of a responsible issuer,

(B) an investment fund manager if the responsible issuer is an investment fund, or

(C) an officer of an investment fund manager if the responsible issuer is an investment fund,

a prospectus, a take-over bid circular, an issuer bid circular, a directors' circular, a rights offering circular, MD&A, an annual information form, an information circular, annual financial statements, interim financial statements, and a report required under subsection 118(2), of the responsible issuer, and

(iii) such other documents as may be prescribed by regulation for the purposes of this definition;

(c) **"derivative security"** means, in respect of a responsible issuer, a security

(i) the market price or value of which, or payment obligations under which, are derived from or based on a security of the responsible issuer, and

(ii) which is created by a person or company on behalf of the responsible issuer or is guaranteed by the responsible issuer;

(d) **"document"** means any written communication, including a communication prepared and transmitted only in electronic form, that is

(i) required to be filed with the Commission or with the Executive Director,

(ii) other than a communication referred to in clause (i),

(A) filed with the Commission or with the Executive Director,

(B) filed or required to be filed with a government or an agency of a government under applicable securities or corporate law or with any exchange or quotation and trade reporting system under its by-laws, rules, or regulations, or

(C) any other communication the content of which would reasonably be expected to affect the market price or value of a security of the responsible issuer;

(e) **"expert"** means a person or company whose profession gives authority to a statement made in a professional capacity by the person or company including, without limitation, an accountant, actuary, appraiser, auditor, engineer, financial analyst, geologist and lawyer;

(f) **"failure to make timely disclosure"** means a failure to disclose a material change in the manner and when required under the Act;

(g) **"forward-looking information"** means all disclosure regarding possible events, conditions or results including future oriented financial information with respect to prospective results of operations, financial position or changes in financial position, based on assumptions about future economic conditions and courses of action and presented as either a forecast or a projection;

(h) **"influential person"** means, in respect of a responsible issuer,

(i) a control person,

(ii) a promoter,

(iii) an insider, other than a director or senior officer of the responsible issuer, or

(iv) an investment fund manager if the responsible issuer is an investment fund;

(i) **"issuer's security"** means a security of the responsible issuer and includes, without limitation, a derivative security;

(j) **"liability limit"** means, in the case of

(i) a responsible issuer, the greater of

(A) 5% of its market capitalization (as such term is defined in the regulations), and

(B) $1 million,

(ii) a director or officer of a responsible issuer, the greater of

(A) $25,000, and

(B) 50% of the aggregate of the director's or officer's compensation from the responsible issuer and its affiliates,

(iii) an influential person that is not an individual, the greater of

(A) 5% of its market capitalization (as such term is defined in the regulations), and

(B) $1 million,

(iv) an influential person who is an individual, the greater of

(A) $25,000, and

(B) 50% of the aggregate of the influential person's compensation from the responsible issuer and its affiliates,

(v) a director or officer of an influential person, the greater of

(A) $25,000, and

(B) 50% of the aggregate of the director's or officer's compensation from the influential person and its affiliates, or

(vi) an expert, the greater of

(A) $1 million, and

(B) the revenue that the expert and its affiliates have earned from the responsible issuer and its affiliates during the twelve months preceding the misrepresentation,

(vii) each person or company who made a public oral statement, other than an individual under subparagraphs (i), (ii), (iii), (iv), (v) or (vi), the greater of

(A) $25,000, and

(B) 50% of the aggregate of the person or company's compensation from the responsible issuer and its affiliates;

(k) **"MD&A"** means the section of an annual information form, annual report or other document that contains management's discussion and analysis of the financial condition and results of operations of a responsible issuer as required under Alberta securities laws;

(l) **"public oral statement"** means an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed;

(m) **"release"** means

(i) to file with the Commission or with the Executive Director, with any other securities regulatory authority in Canada or with an exchange, or

(ii) to otherwise make available to the public;

(n) **responsible issuer"** means

(i) a reporting issuer, or

(ii) any other issuer with a substantial connection to Alberta, any securities of which are publicly traded; and

(o) **"trading day"** means a day during which the principal market (as defined in the regulations) for the security is open for trading.

(2) This Part does not apply to

(a) the acquisition of an issuer's security under a prospectus,

(b) the acquisition of an issuer's security pursuant to an exemption from section 54 or 81, except as may be prescribed by regulation,

(c) the acquisition or disposition of an issuer's security in connection with or pursuant to a take-over bid or an issuer bid, except as may be prescribed by regulation, or

(d) such other transactions or class of transactions as may be prescribed by regulation.

175.2. Liability for Secondary Market Disclosure

(1) **Documents Released by Responsible Issuer --** If a responsible issuer or a person or company with actual, implied or apparent authority to act on behalf of a responsible issuer releases a document that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the document was released and the time when the misrepresentation contained in the document was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against

(a) the responsible issuer,

(b) each director of the responsible issuer at the time the document was released,

(c) each officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document,

(d) each influential person, and each director and officer of an influential person, who knowingly influenced

(i) the responsible issuer or any person or company on behalf of the responsible issuer to release the document, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the release of the document, and

(e) each expert if

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released by a person or company other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document.

(2) **Public Oral Statements by Responsible Issuer** -- If a person with actual, implied or apparent authority to speak on behalf of a responsible issuer makes a public oral statement that relates to the business or affairs of the responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the public oral statement was made and the time when the misrepresentation contained in the public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against

(a) the responsible issuer,

(b) the person who made the public oral statement,

(c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the making of the public oral statement,

(d) each influential person, and each director and officer of the influential person, who knowingly influenced

(i) the person who made the public oral statement to make the public oral statement, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the making of the public oral statement, and

(e) each expert if

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the person making the public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the public oral statement was made by a person other than the expert, the

expert consented in writing to the use of the report, statement or opinion in the public oral statement.

(3) **Documents or Public Oral Statements by Influential Persons** -- If an influential person or a person or company with actual, implied or apparent authority to act on behalf of the influential person releases a document or makes a public oral statement that relates to a responsible issuer and that contains a misrepresentation, a person or company who acquires or disposes of an issuer's security during the period between the time when the document was released or the public oral statement was made and the time when the misrepresentation contained in the document or public oral statement was publicly corrected has, without regard to whether the person or company relied on the misrepresentation, a right of action for damages against

(a) responsible issuer, if a director or officer of the responsible issuer or, if the responsible issuer is an investment fund, the investment fund manager, authorized, permitted or acquiesced in the release of the document or the making of the public oral statement,

(b) the person who made the public oral statement,

(c) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement,

(d) the influential person,

(e) each director and officer of the influential person who authorized, permitted or acquiesced in the release of the document or the making of the public oral statement, and

(f) each expert if

(i) the misrepresentation is also contained in a report, statement or opinion made by the expert,

(ii) the document or public oral statement includes, summarizes or quotes from the report, statement or opinion of the expert, and

(iii) if the document was released or the public oral statement was made by a person other than the expert, the expert consented in writing to the use of the report, statement or opinion in the document or public oral statement.

(4) **Failure to Make Timely Disclosure** -- If there is a failure to make timely disclosure by a responsible issuer, a person or company who acquires or disposes of an issuer's security between the time when the material change was required to be disclosed and the subsequent disclosure of the material change in the manner required under the Act has, without regard to whether the person or company relied on the responsible issuer having complied with its disclosure requirements, a right of action for damages against

(a) the responsible issuer,

(b) each director and officer of the responsible issuer who authorized, permitted or acquiesced in the failure to make timely disclosure, and

(c) each influential person, and each director and officer of an influential person, who knowingly influenced

(i) the responsible issuer or any person or company acting on behalf of the responsible issuer in the failure to make timely disclosure, or

(ii) a director or officer of the responsible issuer to authorize, permit or acquiesce in the failure to make timely disclosure.

(5) **Multiple Roles** – In an action under this section 175.2, a person that is a director or officer of an influential person is not liable in that capacity if the person is liable in their capacity as a director or officer of the responsible issuer.

(6) **Multiple Misrepresentations** – In an action under this section 175.2

(a) multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation; and

(b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common subject matter may, in the discretion of the court, be treated as a single failure to make timely disclosure.

(7) **No Implied or Actual Authority** – In an action under subsection 175.2(2) or (3), if the person that made the public oral statement had apparent, but not implied or actual, authority to speak on behalf of the issuer, no other person is liable with respect to any of the responsible issuer's securities acquired or disposed of before that person became, or should reasonably have become, aware of the misrepresentation.

175.3. Burdens of Proof and Defences

(1) **Standard for Non-Core Documents and Public Oral Statements** – In an action under section 175.2 in relation to a misrepresentation in a document that is not a core document, or a misrepresentation in a public oral statement, no person or company is liable, subject to subsection (2), unless the plaintiff proves that the person or company,

(a) knew, at the time that the document was released or public oral statement was made, that the document or public oral statement contained the misrepresentation,

(b) at or before the time that the document was released or public oral statement was made, deliberately avoided acquiring knowledge that the document or public oral

statement contained the misrepresentation, or

(c) was, through action or failure to act, guilty of gross misconduct in connection with the release of the document or the making of the public oral statement that contained the misrepresentation.

(2) A plaintiff is not required to prove any of the matters set out in subsection (1) in an action under section 175.2 in relation to an expert.

(3) **Standard for Failure to Make Timely Disclosure** – In an action under section 175.2 in relation to a failure to make timely disclosure, no person or company is liable, subject to subsection (4), unless the plaintiff proves that the person or company

(a) knew, at the time that the failure to make timely disclosure first occurred, of the change and that the change was a material change,

(b) at the time of or before the failure to make timely disclosure first occurred, deliberately avoided acquiring knowledge of the change or that the change was a material change, or

(c) was, through action or failure to act, guilty of gross misconduct in connection with the failure to make timely disclosure.

(4) A plaintiff is not required to prove any of the matters set out in subsection (3) in an action under section 175.2 in relation to

(a) a responsible issuer,

(b) an officer of a responsible issuer,

(c) an investment fund manager, or

(d) an officer of an investment fund manager.

(5) **Knowledge of the Misrepresentation or Material Change** – No person or company is liable in an action under section 175.2 in relation to a misrepresentation or a failure to make timely disclosure if that person or company proves that the plaintiff acquired or disposed of the issuer's security with knowledge

(a) that the document or public oral statement contained a misrepresentation; or

(b) of the material change.

(6) **Reasonable Investigation** – No person or company is liable in an action under section 175.2 in relation to

(a) a misrepresentation if that person or company proves that

(i) before the release of the document or the making of the public oral statement containing the misrepresentation, the person or company conducted or caused to be conducted a reasonable investigation, and

(ii) at the time of the release of the document or the making of the public oral statement, the person or company had no reasonable grounds to believe that the document or public oral statement contained the misrepresentation, or

(b) a failure to make timely disclosure if that person or company proves that

(i) before the failure to make timely disclosure first occurred, the person or company conducted or caused to be conducted a reasonable investigation, and

(ii) the person or company had no reasonable grounds to believe that the failure to make timely disclosure would occur.

(7) **Factors to be Considered** – In determining whether an investigation was reasonable under subsection (6), or whether any person or company is guilty of gross misconduct under subsection (1) or (3), the court shall consider all relevant circumstances, including

(a) the nature of the responsible issuer,

(b) the knowledge, experience and function of the person or company

(c) the office held if the person was an officer,

(d) the presence or absence of another relationship with the responsible issuer if the person was a director,

(e) the existence, if any, and the nature of any system to ensure that the responsible issuer meets its continuous disclosure obligations,

(f) the reasonableness of reliance by the person or company on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts,

(g) the time period within which disclosure was required to be made under applicable law,

(h) in respect of a report, statement or opinion of an expert, any professional standards applicable to the expert,

(i) the extent to which the person or company knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement,

(j) in the case of a misrepresentation, the role and responsibility of the person or company in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement, and

(k) in the case of a failure to make timely disclosure, the role and responsibility of the person or company involved in a decision not to disclose the material change.

(8) **Confidential Disclosure** – No person or company is liable in an action under section 175.2 in respect of a failure to make timely disclosure if

(a) the person or company proves that the material change was disclosed by the responsible issuer in a report filed on a confidential basis to the Executive Director under subsection 118(3),

(b) the responsible issuer had a reasonable basis for making the disclosure on a confidential basis,

(c) if the information contained in the report filed on a confidential basis remains material, disclosure of the material change was made public promptly when the basis for confidentiality ceased to exist,

(d) the person or company or responsible issuer did not release a document or make a public oral statement that, due to the undisclosed material change, contained a misrepresentation, and

(e) if the material change became publicly known in a manner other than as required under the Act, the responsible issuer promptly disclosed the material change in the manner required under the Act.

(9) **Forward-Looking Information** – No person or company is liable in an action under section 175.2 for a misrepresentation in forward-looking information if the person or company proves that

(a) the document or public oral statement containing the forward-looking information contained, proximate to the forward-looking information,

(i) reasonable cautionary language identifying the forward-looking information as such and identifying material factors that could cause actual results to differ materially from a forecast or projection in the forward-looking information, and

(ii) a statement of the material factors or assumptions that were applied in making

a forecast or projection in the forward-looking information, and

(b) the person or company had a reasonable basis for making the forecasts or projections in the forward-looking information.

(10) Subsection 175.3(9) does not apply to a person or company in respect of forward-looking information contained in the prospectus of the responsible issuer filed in connection with the initial public distribution of securities of the responsible issuer or contained in financial statements prepared by the responsible issuer.

(11) **Expert Report, Statement or Opinion** – No person or company, other than an expert, is liable in an action under section 175.2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert in respect of which the written consent of the expert to the use of the report, statement or opinion was obtained by the responsible issuer and that consent had not been withdrawn in writing prior to the release of the document, or the making of the public oral statement, if the person or company proves that

(a) the person or company did not know and had no reasonable grounds to believe that there had been a misrepresentation in the part of the document or public oral statement made on the authority of the expert, and

(b) the part of the document or public oral statement fairly represented the report, statement or opinion made by the expert.

(12) No expert is liable in an action under section 175.2 with respect to any part of a document or public oral statement that includes, summarizes or quotes from a report, statement or opinion made by the expert, if the expert proves that, the written consent previously provided was withdrawn in writing before the release of the document or making of the public oral statement.

(13) **Release of Documents** – No person or company is liable in an action under section 175.2 in respect of a misrepresentation in a document, other than a document required to be filed with the Commission or with the Executive Director, if the person or company proves that, at the time of release of the document, the person or company did not know and had no reasonable grounds to believe that the document would be released.

(14) **Derivative Information** – No person or company is liable in an action under section 175.2 for a misrepresentation in a document or a public oral statement, if the person or company proves that

(a) the misrepresentation was also contained in a document filed by or on behalf of another person or company, other than the responsible issuer, with the Commission or the Executive Director, with any other securities regulatory authority in Canada or with an exchange, and not corrected in another document filed by or on behalf of that other person or company with the Commission or the Executive Director, with that other securities regulatory authority in Canada or with that exchange before the release

of the document or the public oral statement made by or on behalf of the responsible issuer,

(b) the document or public oral statement contained a reference identifying the document that was the source of the misrepresentation, and

(c) at the time of release of the document or the making of the public oral statement, the person or company did not know and had no reasonable grounds to believe that the document or public oral statement contained a misrepresentation.

(15) **If Corrective Action Taken** – No person or company, other than the responsible issuer, is liable in an action under section 175.2 if the misrepresentation or failure to make timely disclosure was made without the knowledge or consent of the person or company and, if, after the person or company became aware of the misrepresentation before it was corrected, or the failure to make timely disclosure before it was disclosed in the manner required under the Act

(a) the person or company promptly notified the board of directors of the responsible issuer or such other persons acting in a similar capacity of the misrepresentation or the failure to make timely disclosure, and

(b) if no correction of the misrepresentation or no subsequent disclosure of the material change in the manner required under the Act was made by the responsible issuer within 2 business days after the notification under paragraph (a), the person or company, unless prohibited by law or by professional confidentiality rules, promptly and in writing notified the Commission of the misrepresentation or failure to make timely disclosure.

175.4. (1) **Assessment of Damages** – Damages in an action under section 175.2 shall be assessed in favour of a person or company that acquired an issuer's securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows:

(a) respect of any of the securities of the responsible issuer that the person or company subsequently disposed of on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions;

(b) respect of any of the securities of the responsible issuer that the person or company subsequently disposed of after the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the lesser of

(i) an amount equal to the difference between the average price paid for those securities (including any commissions paid in respect thereof) and the price received upon the disposition of those securities (without deducting any commissions paid in respect of such disposition), calculated taking into account the result of hedging or other risk limitation transactions, and

(ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and,

(A) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, or

(B) if there is no published market, then the amount the court considers just; and

(c) in respect of any of the securities of the responsible issuer that the person or company has not disposed of, assessed damages shall equal the number of securities acquired, multiplied by the difference between the average price per security paid for those securities (including any commissions paid in respect thereof determined on a per security basis) and,

(i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, or

(ii) if there is no published market, then the amount that the court considers just.

(2) Damages in an action under section 175.2 shall be assessed in favour of a person or company that disposed of securities after the release of a document or the making of a public oral statement containing a misrepresentation or after a failure to make timely disclosure as follows:

(a) in respect of any of the securities of the responsible issuer that the person or company subsequently acquired on or before the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the difference between the average price

received upon the disposition of those securities (deducting any commissions paid in respect of such disposition) and the price paid for those securities (without including any commissions paid in respect thereof), calculated taking into account the result of hedging or other risk limitation transactions;

(b) respect of any of the securities of the responsible issuer that the person or company subsequently acquired after the 10th trading day after the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, assessed damages shall equal the lesser of

(i) an amount equal to the difference between the average price received upon the disposition of those securities (deducting any commissions paid in respect of such disposition) and the price paid for those securities (without including any commissions paid in respect thereof), calculated taking into account the result of hedging or other risk limitation transactions, and

(ii) an amount equal to the number of securities that the person disposed of, multiplied by the difference between the average price per security received upon the disposition of those securities (deducting any commissions paid in respect of such disposition determined on a per security basis) and,

(A) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the public correction of the misrepresentation or the disclosure of the material change in the manner required under the Act, or

(B) if there is no published market, then the amount the court considers just; and

(c) in respect of any of the securities of the responsible issuer that the person or company has not acquired, assessed damages shall equal the number of securities that the person or company disposed of, multiplied by the difference between the average price per security received upon the disposition of those securities (deducting any commissions paid in respect of such disposition determined on a per security basis) and,

(i) if the issuer's securities trade on a published market, the trading price of the issuer's securities on the principal market (as such terms are defined in the regulations) for the 10 trading days following the disclosure of the material change in the manner required under the Act, or

(ii) if there is no published market, then the amount that the court considers just.

(3) Notwithstanding subsections (1) and (2), damages assessed in an action under section 175.2 shall not include any amount that the defendant proves is attributable to a change in the market price of securities unrelated to the misrepresentation or the failure to make timely disclosure.

175.5. (1) **Proportionate Liability** – In an action under section 175.2 the court shall determine, in respect of each defendant found liable in the action, the defendant's responsibility for the damages assessed in favour of all plaintiffs in the action, and each such defendant shall be liable, subject to the limits set out in subsection 175.6(1), to the plaintiffs only for that portion of the aggregate amount of damages assessed in favour of the plaintiffs that corresponds to that defendant's responsibility for the damages.

(2) Notwithstanding subsection (1), if, in an action under section 175.2 in respect of a misrepresentation or a failure to make timely disclosure, a court determines that a particular defendant, other than the responsible issuer, authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing it to be a misrepresentation or a failure to make timely disclosure, the whole amount of the damages assessed in the action may be recovered from such defendant.

(3) Each defendant in respect of whom the court has made a determination under subsection (2) is jointly and severally liable with each other defendant in respect of whom the court has made a determination under subsection (2).

(4) Any defendant against whom recovery is obtained under subsection (2) is entitled to claim contribution from any other defendant who is found liable in the action.

175.6. (1) **Limits on Damages** -- Notwithstanding section 175.4, the amount of damages payable by a person or company in an action under section 175.2 is the lesser of

(a) the aggregate damages assessed against the person or company in the action, and

(b) the liability limit for such person or company less the aggregate of all damages assessed after appeals, if any, against the person or company in all other actions brought under section 175.2 and under comparable legislation in other provinces or territories in Canada, in respect of that misrepresentation or failure to make timely disclosure, and less any amounts paid in settlement of any such actions.

(2) Subsection (1) does 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.

175.7. (1) **Leave to Proceed** -- No action may be commenced under section 175.2 without leave of the court granted upon motion with notice to each defendant.

(2) The court shall grant leave to proceed under subsection (1) only if it 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.

(3) Upon an application under this section 175.7, the plaintiff and each defendant shall serve and file one or more affidavits setting forth the material facts upon which each intends to rely.

(4) The maker of an affidavit referred to in subsection (3) may be examined thereon in accordance with the rules of court as to discovery.

(5) A copy of the application for leave to proceed and any affidavits filed in connection therewith under this section 175.7 shall be sent to the Commission when filed.

175.8. Notice -- A person or company that has been granted leave to commence an action under section 175.2 shall

(a) promptly issue a news release disclosing that leave has been granted to commence an action under section 175.2,

(b) within 7 days send a written notice to the Commission together with a copy of the news release, and

(c) send a copy of the statement of claim or other originating document to the Commission when filed with the court.

175.9. Court Approval to Settle -- An action brought under section 175.2 shall not be stayed, discontinued, settled or dismissed for delay without the approval of the court given on such terms as the court thinks fit including, without limitation, as to costs, and in determining whether to approve the settlement of an action brought under section 175.2 the court shall consider, among other things, whether there are any other actions outstanding which have been brought under section 175.2 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation or failure to make timely disclosure.

175.10. Costs -- Notwithstanding anything to the contrary in the *Court of Queen's Bench Act*, the *Court of Appeal Act*, the *Judicature Act* or the *Provincial Court Act* , the prevailing party in an

action under section 175.2 shall be entitled to costs determined by a court in accordance with applicable rules of civil procedure.

175.11. Power of the Commission – The Commission may intervene in an action under section 175.2 and in an application for leave under section 175.7.

175.12. No Derogation from Other Rights – The right of action for damages under section 175.2 and the defences to an action under section 175.2 are in addition to and without derogation from any other rights or defences the plaintiff or defendant may have in an action brought other than under this Part.

175.13. Limitation Period – No action shall be commenced under section 175.2,

(a) in the case of misrepresentation in a document, later than the earlier of

(i) 3 years after the date on which the document containing the misrepresentation was first released, and

(ii) 6 months after the issuance of a news release disclosing that leave has been granted to commence an action under section 175.2 or under comparable legislation in another province or territory in Canada in respect of the same misrepresentation,

(b) in the case of a misrepresentation in a public oral statement, later than the earlier of

(i) 3 years after the date on which the public oral statement containing the misrepresentation was made, and

(ii) 6 months after the issuance of a news release disclosing that leave has been granted to commence an action under section 175.2 or under comparable legislation in another province or territory of Canada in respect of the same misrepresentation,

(c) in the case of a failure to make timely disclosure, later than the earlier of

(i) 3 years after the date on which the requisite disclosure was required to be made, and

(ii) 6 months after the issuance of a news release disclosing that leave has been granted to commence an action under this section 175.2 or under comparable legislation in another province or territory of Canada in respect of the same failure to make timely disclosure.

Add the following to section 196 of the Act:

(m)(viii) designating issuers or classes of issuers as mutual funds or non-redeemable investment funds, or designating issuers or classes of issuers not to be mutual funds or non-redeemable investment funds;

(dd) prescribing, for the purposes of paragraphs 175.1(2)(b), (c) and (d), exemptions from the prospectus requirement under the Act, take-over bids and issuer bids, and transactions or classes of transactions;

(ee) prescribing documents for the purposes of the definition of "core document" in paragraph 175.1(1)(b);

(ff) prescribing the meanings of “market capitalization”, “trading price” and “principal market” and other terms used in Part 16.1 and not otherwise defined in the Act.

II. Proposed Amendments to the *Alberta Securities Commission Rules*

Add the following after section 192:

PART 16.1 – CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

192.1. For the purposes of Part 16.1 of the Act:

(a) **"equity securities"** means securities of an issuer that carry a residual right to participate in earnings of the issuer and, on liquidation or winding up of the issuer, in its assets;

(b) **"market capitalization"** means, in respect of an issuer, the aggregate of the following:

(i) for each class of equity securities for which there is a published market, the amount calculated by multiplying (A) the average of the number of outstanding securities of the class at the close of trading on each of the 10 trading days immediately before the day on which the misrepresentation was made or before the day on which the failure to make timely disclosure first occurred, by (B) the trading price of the securities of the class, on the principal market on which the securities trade, as determined in accordance with this Part, for the 10 trading days before the day on which the misrepresentation was made or before the day on which the failure to make timely disclosure first occurred; and

(ii) for each class of equity securities not traded on a published market, the fair market value of the outstanding securities of that class as of the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred;

(c) **"trading price"** means, for a security of a class for which there is a published market,

(i) except as provided in clauses (ii) or (iii),

(A) if the published market provides a closing price, the average of the closing prices of securities of that class on the published market for each trading day on which there was a closing price for the period during which the trading price is being determined, weighted by the volume of securities traded on each day, and

(B) if the published market does not provide a closing price, but provides only the highest and lowest prices of securities traded, the average of the weighted averages of the highest and lowest prices of the securities of that class for each of the trading days on which there were highest and lowest prices for the period during which the trading price is being determined,

(ii) if there has been trading of the securities of the class in the published market on fewer than half of the trading days for the period during which the trading price is being determined, the average of the following amounts established for each trading day of the period during which the trading price is being determined,

(A) the average of the highest bid and lowest ask prices as of the close of trading for each trading day on which there was no trading, and

(B) either

(I) the average of the closing price of the securities of that class for each trading day on which there has been trading, if the published market provides a closing price, or

(II) the weighted average of the highest and lowest prices of the securities of that class for each trading day on which there has been trading, if the published market provides only the highest and lowest prices of securities traded on a trading day, or

(iii) if there has been no trading of the securities of the class in the published market on any of the trading days during which the trading price is being determined, the fair market value of the security; and

(d) **"principal market"** means, for a class of securities of a responsible issuer,

(i) the published market in Canada on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred, or

(ii) if there is no published market in Canada, the market on which the greatest volume of trading in securities of that class occurred during the 10 trading days immediately before the day on which the misrepresentation was made or on which the failure to make timely disclosure first occurred.

192.2. For the purposes of paragraph 175.1(2)(b) of the Act, the exemption from section 54 or 81 of the Act prescribed is the exemption contained in subsection 112(1) of the Act.

192.3. For the purposes of clause 175.1(2)(c) of the Act,

(a) the take-over bids prescribed are those described in paragraphs 132(1)(a), (b) and (e) of the Act, and

(b) the issuer bids prescribed are those described in subsections 133(e), (f) and (h) of the Act.