"Regulation"

Affleck Greene Orr LLP

of businesses in Canada through private litigation

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The term "regulation" usually connotes regulation of private activities by government. In most sectors of the Canadian economy, businesses operate unhampered by sector-specific government regulation. Instead, they are subject to a variety of rules of general application. While many of these are enforced by government regulators (such as competition and environmental laws), court decisions arising from private litigation under the common law (in Quebec, the Civil Code), and statutory remedies that supplement the common law, are an essential and often overlooked component of the regulation of businesses in Canada.

For example, common law principles relating to contracts, employment, confidential communications, fraud and business torts regulate various aspects of business activities. Statutory causes of action supplement this framework. These include the oppression remedy and dissenting shareholder rights in corporate statutes, primary and secondary market liability provisions in securities legislation, private actions under the *Competition Act*, and class action legislation. Even though these tools are in the hands of private actors, they are powerful regulatory forces.

This article canvasses a few recent developments in the "regulation" of businesses through private litigation.

Regulating inter-corporate transactions through the oppression remedy

Corporate statutes in Canada provide a remedy for conduct by a corporation that oppresses minority shareholders or creditors, or unfairly disregards their interests. A recent decision of the Ontario Court of Appeal demonstrates how this remedy provides guidelines for businesses with complex corporate structures.

The case involved the intercorporate transfer price system in place between Ford Motor Company of Canada and its US parent, Ford Motor Company. In early 2006, the Ontario Court of Appeal held that this system was unfair and contrary to representations in Ford's financial statements, and thus, oppressive toward Ford Canada's minority shareholders.

The court's decision is replete with lessons for parent companies of non-wholly-owned subsidiaries, including:

- Treating a partly-owned subsidiary as though it were wholly-owned may be oppressive toward minority shareholders of the subsidiary.
- Intercorporate transactions should be on the same basis as the subsidiary would negotiate if it were a truly independent entity.
- Disparity in profitability between a parent and a subsidiary can lead to a finding that intercorporate transactions are unfair, and thus oppressive, toward minority shareholders of the subsidiary.
- The subsidiary's managers have a duty to apply business judgment to, and negotiate, intercorporate transactions; they cannot simply take the terms imposed by the parent.
- It may even be oppressive *not to change* the way in which a parent and a subsidiary do business with one another in response to changing economic circumstances.

As well, this decision establishes potentially far-reaching principles relevant to oppression claims involving any public company:

- The court will presume that shareholders of public companies have certain reasonable expectations about how the business of the company will be carried out.
- Statements in financial statements and annual reports can give rise to reasonable expectations by shareholders and, if untrue, found an action in oppression.

A public company that does not meet general "shared expectations about the way in which a public company should be run" may be liable for oppression.

Regulating public company statements through shareholders' claims

Securities legislation contains provisions facilitating claims by investors for misleading corporate statements. Ontario's *Securities Act* contains provisions that establish a presumption that investors in primary markets relied on statements in a corporate prospectus. More recent amendments create a similar presumption that investors on the secondary market (for example, a stock exchange) relied on public statements by public companies. These provisions overcome the difficulty of showing that purchasers actually relied on corporate misrepresentations, making suits by for investors in the secondary market easier, especially class actions by disgruntled shareholders. Moreover, corporate advisors such as auditors, can also be found liable to shareholders under the new secondary market liability provisions, a reversal of the common law rule that a corporation's auditors cannot be liable directly to its shareholders.

Around the same time as the secondary market provisions came into force, Ontario's Court of Appeal delivered a decision that helps to delineate the obligations of public companies when communicating with shareholders.

Kerr v. Danier Leather was brought under provisions that establish a presumption that initial purchasers of securities from an issuing company relied upon that company's misrepresentation. After issuing a prospectus, the leather retailer did not release revised financial forecasts reflecting lower leather sales due to a warm spring. When this information was made public after Danier's IPO, its share price dropped. The trial judge held that Danier's failure to release updated forecasts before the IPO was a material misrepresentation.

In overturning the trial judge's decision, the Court of Appeal established three important principles that will govern future actions of this kind:

- Under the *Securities Act*, public companies are not obliged to report "material facts", but only more significant developments that amount to "material changes". Shareholders cannot assume that no material facts have changed after the issuance of a prospectus.
- Forecasts in a prospectus do not contain an implied representation of objective reasonableness, absent evidence to support such an implication.
- Some deference must be given to the business judgment of a company's senior management in issuing a forecast in a prospectus.

Regulating commercial relationships through Competition Act private actions

The *Competition Act* contains two very different private action provisions that allow private "regulation" of certain corporate behaviours. Anyone who has suffered a loss as a result of a price fixing cartel (or other criminal offence under the Act) can sue for damages. This has led to large class actions and massive settlements. For instance, several multi-national vitamin producers paid C$132m to settle a class action after collectively paying total fines of C$ 95m. Settlements of this magnitude effectively double the deterrent effect of Canada's competition legislation.

The *Competition Act* also allows parties to apply to a special tribunal, the Competition Tribunal, for leave to bring a private application in cases of refusals to deal, exclusive dealing, tied selling and market restriction. This allows customers to challenge their suppliers' distribution arrangements. The first ever full hearing in such a private application is scheduled for this autumn. However, in past cases, brought by the Commissioner of Competition (a federal government official), the Tribunal has intervened to force manufacturers to resume supplying parts to competitors in servicing markets, and to prohibit anti-competitive exclusive dealing and tied selling by dominant firms.

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