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Ontario's top court overturns securities class action judgment against Danier Leather

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In a unanimous decision written by Laskin J.A. and released late yesterday[1], the Ontario Court of Appeal overturned Canada's first-ever class action judgment in favour of investors arising from misrepresentations by a corporation prior to its initial public offering. In doing so, Ontario's highest court has not only extinguished damages awards totalling an estimated $15 million in favour of disgruntled purchasers of Danier shares, but it has also arguably set the ground rules for future securities class actions in Ontario.

The class action in *Kerr v. Danier Leather* was brought under s. 130 of the Ontario *Securities Act*, which allows *initial* purchasers of securities from an issuing company to recover damages where the issuing company has made a misrepresentation in its prospectus. Initial purchasers of shares are *deemed* to have relied upon a company's misrepresentation. This alters the normal legal requirement that a plaintiff show it *actually* relied on a misrepresentation. Section 130 does not apply to purchasers of shares on the secondary market (i.e. a stock exchange). However, new legislation coming into force at the end of this month (Bill 198) will similarly make it easier for purchasers on the secondary market to sue for misrepresentations by public companies.[2]

In this case, the alleged misrepresentation involved the leather retailer's failure, after its May 6th prospectus, to release revised financial forecasts reflecting lower leather sales due to a warm spring. When this information was made public two weeks after the IPO, Danier's share price dropped. In finding for the plaintiffs, Lederman J. found that Danier's failure to release updated forecasts before the IPO was a material misrepresentation and it did not matter that its actual financial results later rebounded to approach those forecast in the May 6th prospectus. Lederman J. awarded share purchasers damages based on the difference between the purchase price for the shares and what they would have paid for their Danier shares on the IPO, had proper disclosure been made. A year after his trial decision, Lederman J. made a further order on costs that awarded plaintiffs a $1 million premium over and above the plaintiffs' actual assessed costs of the action.

In appealing, Danier and its directors argued the following grounds of appeal: 1) the trial judge erred in finding that Danier was obligated to disclose material facts occurring between the issuance of its prospectus and the closing of its IPO; 2) the trial judge erred in finding that Danier's May 6th prospectus contained an implied representation that its forecast was objectively reasonable; 3) the trial judge erred in failing to take into account the business judgment of Danier's senior management when assessing the objective reasonableness of the forecast; 4) the trial judge erred in his assessment of the plaintiffs' damages; and 5) the trial judge erred in awarding the plaintiffs a $1 million premium on the costs award.

In overturning the decision below, the Court of Appeal found that Lederman J. had indeed made errors numbered 1 through 3, any one of which was sufficient to overturn his decision and dismiss the action.

On the first ground of appeal, Laskin J.A. found that there was no obligation under s. 130 to disclose material facts arising before the closing of an IPO. In so finding, he highlighted the distinction under

the *Securities Act* between "material changes", which are serious changes to a corporation's circumstances that carry an obligation to issue a news release and report to the OSC, and "material facts," which are a broader class of less significant corporate events that carry no similar obligation to report. It is only a *material change*, Laskin J.A. found, that an issuer is obliged to disclose after the release of its prospectus. Because there is no obligation to disclose or report material facts, purchasers of Danier shares "were not entitled to assume that no facts had occurred after May 6 and before May 20 that would reasonably be expected to have a significant impact on the market price or value of Danier's securities."

On the second ground of appeal, Laskin J.A. agreed with the appellants that "there was no basis upon which the trial judge could have properly concluded that the Forecast [in Danier's prospectus] contained an implied representation of objective reasonableness." Laskin J.A. found that the existence of such an implied representation was an issue of fact (not an issue of law, as characterized by the trial judge) that was unsupported by any evidence.

Finally, on the third ground of appeal Laskin J.A. agreed with the appellants that the trial judge made a palpable and overriding error in assessing the objective reasonableness of the forecast without considering the business judgment of Danier's senior management and the fact that, in the end, Danier came close to actually achieving its forecasted revenues. Laskin J.A. indicated that it was an especially serious error by the trial judge to fail "to give any deference to the business judgment of Danier's senior management."

Having found three reasons to overturn the trial decision and dismiss the action, the court declined to address the fourth and fifth grounds of appeal relating to the trial judge's damages calculation and costs premium. However, the court did express serious doubts about whether a premium on costs is *ever* appropriate in class actions.

The Court of Appeal's decision in *Danier* will undoubtedly be an important one for future securities class actions in Ontario and, indeed, the rest of Canada. It contains a comprehensive and detailed discussion of the interpretation and interplay between numerous provisions of the *Securities Act* that is both far-reaching in its implications and far beyond the scope of this article. With Ontario on the verge of bringing into force Bill 198's provisions allowing shareholders to pursue public companies for misrepresentations on the secondary market, securities class actions are bound to remain on the minds of public companies' senior management, their lawyers, their auditors, and their insurers. It remains to be seen what impact *Danier* will have on the class actions by secondary market investors that will undoubtedly be brought against public companies after Bill 198 comes into force at the end of the year.

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[1] Link to the court's full decision at: http://www.ontariocourts.on.ca/decisions/2005/december/C41880.htm

[2] Link to a past *Litigator* article on these issues at http://www.agolaw.com/litigatorca.asp?file=litigator/jun05/page1