

DIRECTORS' AND OFFICERS' LIABILITY UPDATE

MARCH 2011

LEAVE TO APPEAL DENIED IN *SILVER V. IMAX CORPORATION ET. AL.*

On December 14, 2009, Justice van Rensburg of the Ontario Superior Court of Justice delivered two related rulings in respect of a proposed class action asserting secondary market liability commenced by Marvin Silver and Cliff Cohen against IMAX Corporation ("IMAX") and various of its officers and directors (collectively, the "IMAX Defendants"). The first of these two decisions (the "Leave Decision") granted the Plaintiffs leave to proceed with their class action against the IMAX Defendants (except the two outside directors) under Section 138.8 of the Ontario Securities Act. The Leave Decision was the first to consider the threshold for granting leave for a statutory misrepresentation claim under the recent amendments to the Ontario Securities Act. The second decision (the "Certification Decision") certified both the statutory and common law claims asserting secondary market liability as a class proceeding.

The IMAX Defendants sought leave to appeal from both the Leave Decision and the

Certification Decision arguing that these decisions were matters of general importance and that Justice van Rensburg erred in, among other things, setting the bar too low for granting leave to proceed with a statutory cause of action for misrepresentation. In a decision dated February 14, 2011 Justice Corbett dismissed the motion for leave to appeal in its entirety.

The Facts

IMAX is a public issuer on both the Toronto Stock Exchange and the NASDAQ exchange in New York. The Plaintiffs are shareholders of IMAX who commenced an action against the IMAX Defendants arising from an alleged decline in the price of their shares that they assert was caused by misrepresentations in IMAX's 2005 form 10-K, its 2005 Annual Report and in press releases issued in February and March of 2006. The Plaintiffs allege that the IMAX Defendants represented that those documents had been prepared in accordance with generally accepted accounting principles and those representations were false. The Plaintiffs further allege

BILL 198 BACKGROUND

The passage of Bill 198 introduced a statutory regime that provides a statutory cause of action for misrepresentations made in the secondary market. Bill 198 was meant to promote accurate continuous disclosure and deter misrepresentations in the secondary market. To protect potential defendants, the legislation included a requirement that a potential plaintiff obtain leave from the Court before commencing an action under the statute. This leave requirement directed the Court to act as a gatekeeper and grant leave to proceed only when claims are brought in good faith and have a reasonable possibility of success at trial.

that IMAX's revenues for its fiscal year 2005 were overstated.

Based on these allegations, the Plaintiffs asserted common law causes of action for negligence, negligent misrepresentation, "reckless" misrepresentation and conspiracy, in addition to a statutory cause of action for misrepresentations affecting the secondary market under Section 138.3 of the Ontario *Securities Act*.

Justice Corbett Denies Leave to Appeal

The IMAX Defendants brought a motion seeking leave to appeal both the Leave Decision and the Certification Decision. In the Leave Decision, Justice van Rensburg interpreted the language in section 138.3 of the Securities Act such that a Court will grant leave when (i) a plaintiff brings an action to hold a defendant accountable for misrepresentations and/or to deter similar conduct, and (ii) there is something more than a *de minimus* chance that the plaintiff will succeed at trial. This is a low threshold for plaintiffs to meet, and will undoubtedly encourage, rather than discourage, claims of this kind.

In the Certification Decision, Justice van Rensburg determined that (i) an issuer and its officers and directors owe a duty of care to the investing public when releasing continuous disclosure documents and (ii) at the

certification stage, reliance on a misrepresentation can be pled on a class-wide basis by reference to the "efficient market theory" (i.e. an individual relies on a misrepresentation by purchasing shares that trade in an efficient market since all publicly available information is impounded in the share price). This decision was controversial, since it seemed inconsistent with previous jurisprudence holding that such a common law duty of care did not exist.

Justice Corbett denied leave to appeal both the Leave and Certification Decisions. In coming to this conclusion, Justice Corbett explained that because the Leave Decision was the first decision on this issue, there could be no conflicting decisions and, therefore, the only basis for granting leave to appeal would be if the IMAX Defendants could establish that there was good reason to doubt the correctness of the Leave or Certification Decision. Justice Corbett then determined that "on the facts, as found by van Rensburg J., this was not a close call that turned on the precise test used to grant leave." In other words, Justice Corbett determined that whatever the precise formulation for the test for granting leave was, the evidence in this case was sufficient to satisfy that threshold and, therefore, there was no reason to doubt that

Justice van Rensburg was correct in granting leave.

Justice Corbett also addressed Justice van Rensburg's handling of the affirmative defences put forward by the IMAX Defendants on the leave motion and stated that "I see no reason to doubt the correctness of the proposition that the onus lies on the Defendants to make out their affirmative defences." Again, Justice Corbett concluded that whatever the precise formulation of the IMAX Defendants' onus in respect of their affirmative defences, the evidence in this case was such that the IMAX Defendants could not satisfy that onus on the leave motion. Therefore, Justice Corbett found no reason to doubt that Justice van Rensburg was correct in concluding that the affirmative defences put forward by the IMAX Defendants did not preclude the granting of leave to proceed.

Lastly, Justice Corbett addressed Justice van Rensburg's Certification Decision and, in particular, the issues related to the duty of care and individual reliance. In respect of both of these issues, Justice Corbett determined that the "issues are important, complex and controversial" but that the appellate Courts will "be in a better position to address them on a full factual record, after trial." Justice Corbett concluded that there was no reason to

doubt the correctness of the Certification Decision as it “does no more than permit the Plaintiffs to proceed to trial.”

Conclusion

Justice Corbett’s decision denying leave to appeal is significant. It leaves intact the precise formulation of the threshold for granting leave under Section 138.8(1) of the *Ontario Securities Act* articulated by Justice van Rensburg. Justice Corbett noted that Justice van

Rensburg’s Leave Decision “is the first word on the test for leave under Section 138.8(1) of the *Ontario Securities Act*. Doubtless it is not the last.” However, it may be some time before an appellate court considers this issue. In the interim, other courts will undoubtedly apply the low threshold articulated by Justice van Rensburg, likely encouraging more litigation in the securities field. On the certification motion, the decision of Justice van

Rensburg appears to have expanded the duties that a public issuer and its officers and directors owe, by creating a new duty to the investing public and permitting class action plaintiffs to circumvent the individual reliance component of a common law misrepresentation claim (through the “efficient market theory”), at least at the certification stage.

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