Litigation - Canada

Sunshine north of the US border for the plaintiff securities class

Contributed by **Fraser Milner Casgrain LLP**

February 05 2013

Authors

Norm Emblem

Deepshikha Dutt

Introduction

On November 29 2012 the Supreme Court of Canada denied leave to appeal in *Abdula v Canadian Solar Inc*.(1) In this case, investors launched a securities class action against Canadian Solar Inc, alleging that it had misstated its financial results in 2009. The Court of Appeal of Ontario ruled on February 13 2012 that the statutory cause of action for secondary market misrepresentations can be raised against foreign-listed companies that maintain a "real and substantial connection" to the Province of Ontario.

This approach adopted by the Canadian courts stands in stark contrast to the approach that was recently taken by the US Supreme Court in *Morrison v National Australian Bank*,(2) in which it refused to assume jurisdiction because the securities at issue were not sold or purchased in the United States.

In *Morrison* National Australia Bank Ltd listed its common stock on exchanges in Australia, London, New Zealand and Japan; American depositary receipts,(3) representing its common stock, were listed on the New York Stock Exchange. In 1998 National Australia Bank acquired Florida-based mortgage service provider HomeSide Lending Inc. Several years later, it announced significant writedowns related to the value of HomeSide, which led to a decline in the price of its shares and American depositary receipts. Following the announcements, three Australian investors filed a suit against National Australia Bank and HomeSide in the Southern District of New York, alleging violations of Section 10(b) and Rule 10b-5 of the Securities Exchange Act 1934(4) seeking to represent a class of non-American investor. The US Supreme Court refused to assume jurisdiction over the case and stated that the application of Section 10(b) of the Securities Exchange Act is limited to the purchase or sale of a security listed on a US stock exchange and the purchase or sale of any other security in the United States.(5)

This update outlines the recent *Canadian Solar Inc* decision and discusses the impact of the diverging approaches of Canada and the United States' highest courts.

Facts

Canadian Solar Inc is incorporated under the Canada Business Corporations Act.(6) The company's principal place of business is located in China; a majority of its executive officers reside in China and its shares are publicly traded on NASDAQ. A group of shareholders represented by Mr Abdula, a resident of Markham, Ontario, filed a class action lawsuit against the company centred on misrepresentations contained in documents that were released or presented by the company in Ontario and made during investor conference calls. The investor bought 2,000 shares of Canadian Solar Inc between January 21 2010 and May 4 2010. The investor had a Bank of Montreal InvestorLine account and bought the shares online in Canada. There were various documents on which the investor relied to gain information about the company; however, he relied in particular on press releases that had been issued by the company in Toronto, Ontario in 2009 and the company's audited financial statements for the fiscal year ending December 31 2008, which had been released at the company's annual meeting in Toronto on June 29 2009.

However, the disclosure documents in question were filed exclusively with the US Securities and Exchange Commission rather than with any Canadian securities regulator, as the company was not a 'reporting issuer' under the Ontario Securities Act

(7) and consequently did not have to meet the filing and disclosure requirements for reporting issuers in Ontario.

The issue before the Ontario courts was whether the company was a 'responsible issuer' as defined by the Securities Act and accordingly was subject to a statutory cause of action by purchasers in the secondary market, notwithstanding that it was not a 'reporting issuer' under the Ontario Securities Act.

Decision

Section 138 of the Ontario Securities Act deals with the civil liability of issuers for secondary market disclosures. Section 138.1 defines a 'responsible issuer' as:

- a reporting issuer; or
- any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded.

On a motion for dismissal brought by the company before the Ontario Superior Court of Justice, Justice Taylor reasoned that the investor could assert a cause of action against the company under Section 138.3,(8) based on the definition above. The court further held that it is possible for an issuer to fall within the second clause of this definition without any publicly traded shares on an Ontario or Canadian exchange if the company has a real and substantial connection to Ontario.

The court applied the real and substantial connection test, as applied in *Incorporated Broadcasters Ltd v Canwest Global Communications Corp*,(9) recently redefined by the Supreme Court of Canada in *Van Breda v Village Resorts Ltd*,(10) and considered the history of the Ontario Securities Act to conclude that the purpose of the act is to protect investors, and that security holders have the same rights in provinces where the issuer is not a 'reporting issuer'. Thus, the court stated that:

> "*Canadian Solar Inc. has Canada written all over it… and it should come as no surprise to Canadian Solar Inc. that it is potentially subject to the Ontario Securities Act for misrepresentation that it makes in its public disclosure in Ontario*."(11)

On appeal, the focal point of the defendants' argument was that Section 138.1 has an implied built-in limitation. The defendants argued that the definition of a 'responsible issuer' in Section 138.1 of the Securities Act should be read as "any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded in Canada".(12)

The court of appeal reviewed the statutory history and interpretation of the Ontario Securities Act, and considered cases such as *Unifund Assurance Co v Insurance Corp of British Columbia*.(13) In *Unifund* the Supreme Court of Canada held that provincial legislation may be constitutionally inapplicable to extraterritorial matters that do not possess a "sufficient connection" to the enacting province.(14) The court of appeal rejected the argument that Unifund precluded Section 138.1 from applying to foreign-listed issuers. It made three main points.

First, it applied the real and substantial connection test and concluded that there was a sufficient connection between the company and Ontario. It reasoned that:

> "*The general principles with respect to extra-territorial regulation do not require that the definition of 'responsible issuer' be interpreted as confined to issuers any of whose securities are publicly traded in Canada… Mr. Abdula's case deals with an Ontario plaintiff seeking to have Ontario law apply to a defendant carrying on business in Ontario… Canadian Solar Inc. is a CBCA corporation with its registered office, its principal executive office and business operations in Ontario…[and] at least some of [the] disclosure emanated from Ontario*."(15)

Second, it reviewed the legislative history of the securities regulations in Ontario and other Canadian provinces. It observed that secondary market liability provisions were specifically added to the Ontario Securities Act to introduce civil liability for secondary market disclosure and to increase the accountability of issuers. The fact that Section 138.7 of the act reduces the cap on an issuer's liability only by the damages assessed under comparable legislation in other Canadian provinces and territories, but not by the damages assessed under foreign statutory claims, such as under the US Exchange Act,(16) does not indicate that Section 138.3 is confined to reporting issuers in Canadian jurisdictions or issuers whose securities are listed on the Canadian stock exchange.(17)

Third, the court of appeal also reaffirmed the lower court's reasoning that cases such as *Pearson v Boliden Ltd*,(18) which dealt with the territorial reach of Section 130(1) of the Ontario Securities Act and the statutory cause of action for prospectus misrepresentations, did not apply to the present case. Section 138.3 of the Ontario Securities Act refers not only to a prospectus, but also to any document that contains a

misrepresentation. Thus the territoriality of Section 138.3 could not be limited.(19)

Thus, the court of appeal concluded that:

> "*The definition of 'responsible issuer' is not confined to persons who are reporting issuers in Ontario and therefore have a continuous disclosure obligation in Ontario. Extra-territorial application is specifically envisaged by the paragraph (b) of the 'responsible' issuer, with its reference to issuers with a 'real and substantial'"connection to Ontario*."(20)

Comment

Although the issue of jurisdiction has been a matter of debate in a number of cases, this was the first time that the Court of Appeal of Ontario dealt with the extraterritorial application of statutory secondary market claims in Canada. *Canadian Solar Inc* is a landmark decision for shareholders looking to commence a secondary market securities class action in Ontario in the case of non-reporting issuers whose shares are not publicly traded on a Canadian exchange. *Canadian Solar Inc* has reaffirmed the 'real and substantial connection' test that courts have used to set out the circumstances in which they can assume jurisdiction.

On the other hand, in *Morrison* the US Supreme Court abandoned the longstanding 'conduct' and 'effects' tests, which were similar to the 'real and substantial connection' test in Canada. These tests focused on where the fraudulent conduct occurred and whether the conduct had an effect in the United States. Instead, the US Supreme Court adopted the new 'bright line transactional' test, which states that Section 10(b) and Rule 10b-5 of the Securities Exchange Act will apply only if the purchase or sale of securities is made in the United States, or involves a security listed on a domestic exchange.(21)

The discussion generated by the recent decisions in *Van Breda,*(22) *Canadian Solar Inc* and *Morrison* focuses on whether the 'real and substantial connection' test applied by the Canadian courts makes Canada a more attractive destination than the United States for investors seeking to commence class actions against multinational companies whose shares might be traded on a foreign exchange and which have a significant presence in North America, specifically Ontario. In the words of US Supreme Court Justice Scalia, Canada might become a "Shangri-La of class action litigation for lawyers representing those allegedly cheated in foreign securities markets".(23)

Although these new developments are a source of comfort for shareholders investing in an ever-shrinking global economy, and a wake-up call to issuers regarding their market and disclosure responsibilities, many questions still remain unanswered.

The court of appeal did not clarify what factors it found most relevant in deciding that Ontario could assume jurisdiction of the matter. *Van Breda* suggests that the fact that the company had an office in Canada would be enough to establish a presumptive connection with Ontario. However, it would appear that the court took a more contextual approach in *Canadian Solar Inc*, and the fact that the misrepresentations were contained in the disclosure documents that were released in Ontario tipped the balance against the company.

In a global economy where securities can be bought with the touch of a button, the courts perhaps must be cautious in not imposing insurmountable obligations on foreign issuers. Issuers cannot choose where investors that purchase their securities in secondary markets will reside. However, investors can choose not to purchase securities of issuers that are not reporting issuers in their jurisdiction. They can also choose not to purchase shares over exchanges that are located in jurisdictions that do not support the types of shareholder remedy that are provided in the Securities Act. On the other hand, issuers can surely control the manner in which they market their securities.

Finally, the approach taken by the court of appeal in *Canadian Solar Inc* diverges from the approach taken by the Supreme Court of Canada in *British Columbia v Imperial Tobacco Canada Ltd*.(24) In *Imperial Tobacco* the court said that it respects the legislative sovereignty of other jurisdictions and that "no territory could possibly assert a stronger relationship to that cause of action than the enacting province".(25) Canadian Solar Inc's securities were not listed on any Canadian stock exchange; therefore, Ontario was not the enacting province in the matter. However, the court decided that Ontario could assume jurisdiction over the matter and thus applied the Ontario Securities Act.

How these jurisdictional issues unfold on both sides of the border remains to be seen, but at the moment, in light of all these developments, Canada increasingly is being sought out by plaintiff's counsel looking to initiate securities class actions.

For further information on this topic please contact Norm Emblem or Deepshikha Dutt at Fraser Milner Casgrain LLP by telephone (+1 416 863 4511), fax (+1 416 863 4592) or email (norm.emblem@fmc-law.com or deepshikha.dutt@fmc-law.com).

Endnotes

(1) 2012 ONCA 211.

(2) (2010) 130 SCt 2869.

(3) The stocks of most foreign companies that trade in the US markets are traded as American depositary receipts. US depositary banks issue these stocks. Each depositary receipt represents one or more shares of foreign stock or a fraction of a share. An owner of a depositary receipt has the right to obtain the foreign stock that it represents, but US investors usually find it more convenient to own the depositary receipt. The price of a depositary receipt corresponds to the price of the foreign stock in its home market, adjusted to the ratio of the depositary receipts to foreign company shares.

(4) 15 USC § 78a *et seq*.

(5) *Supra* note 2 at pages 2893 and 2894.

(6) RSC 1985, c C-44.

(7) RSO 1990, c S5.

(8) Liability for secondary market disclosure

Documents released by responsible issuer

> *138.3 (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 the 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 acting 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 where,*
> *(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.*

2002, c 22, s 185; 2004, c 31, Sched 34, s 12 (1, 2).

(9) (2003), 63 OR (3d) 431 (CA).

(10) 2012 ONCA 234 (CA); 2012 SCC 17, [2012] 1 SRC 572. [*Van Breda*]. The Supreme Court of Canada simplified the test for determining jurisdiction to a three-step inquiry:

- Does the court have presumptive jurisdiction?
- Can the court's presumptive jurisdiction be rebutted?
- Whether the court has jurisdiction (meaning that if the answer to the first is 'yes' and the answer to the second question is 'no', should it decline to exercise its jurisdiction in favour of a clearly more appropriate forum?

(11) 2011 ONSC 5105 (SCJ) at para 21 and 41. [*Abdula v Canadian Solar Inc*].

(12) *Supra* note 1 at para 11.

(13) [2003] 2 SCR 63 [*Unifund*].

(14) *Supra* note 1 at para. 11.

(15) *Ibid* at paras 41, 47 and 49.

(16) *Supra* note 4.

(17) *Supra* note 1 at para 77.

(18) 2002 BCCA 624. The court of appeal also referred to other similar cases such as *Coulson v Citigroup Global Markets Inc* 2010 ONSC 1596; *Dobbie v Arctic Glacier Income Fund* 2012 ONSC 773; *McKenna v Gammon Gold Inc* 2010 ONSC 1591.

(19) *Supra* note 1 at paras 82 to 87.

(20) *Ibid* at para 88.

(21) *Supra* note 2 at page 2894.

(22) *Supra* note 9.

(23) *Supra* note 2 at page 2886.

(24) 2005 SCC 49 [*Imperial Tobacco*].

(25) *Ibid* at para 38.