

Court clarifies scope of underwriter liability in securities class actions

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Introduction

In *LBP Holdings Ltd v Allied Nevada Gold Corp.*⁽¹⁾ the Ontario Superior Court of Justice considered a motion to add the underwriters of a bought deal secondary public offering as defendants to a proposed securities class action lawsuit. In allowing the motion with respect to only two of the plaintiff's five proposed causes of action (both of which were not contested by the underwriters), the court clarified the nature and extent of underwriter liability, particularly in the context of primary and secondary market misrepresentation claims under the Ontario Securities Act.⁽²⁾

Facts

In May 2013 Allied Nevada Gold Corp, a publicly traded company, completed a US\$150 million bought deal secondary public offering for which Dundee Securities and Cormack Securities, the underwriters, acted as principals.⁽³⁾

The plaintiff, LBP Holdings Ltd, purchased shares of Allied Nevada. After the price of Allied Nevada's shares collapsed in the wake of alleged corrective disclosures, it launched a proposed class action for damages in July 2014.⁽⁴⁾ In the action, LBP alleges that Allied Nevada made material misrepresentations regarding its operations and finances which were incorporated by reference in the prospectus filed for the offering.⁽⁵⁾

In March 2015 Allied Nevada filed for protection under US bankruptcy law and, two months later, LBP served its motion to add the underwriters as defendants to the action.⁽⁶⁾ In particular, LBP sought leave to amend its pleadings to assert five causes of action against the underwriters, of which the following were contested:

- a primary market statutory claim under Part XXIII of the Ontario Securities Act;
- a secondary market statutory claim under Part XXIII.1 of the Ontario Securities Act; and
- a claim for unjust enrichment seeking disgorgement of underwriting fees paid to the underwriters.⁽⁷⁾

Test to amend pleadings and add additional defendants

Under Rule 26.01 of Ontario's Rules of Civil Procedure,⁽⁸⁾ a court will grant leave to amend a pleading to add a new defendant unless the proposed defendant can show that:

- non-compensable prejudice would result from the amendment; or

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- the claim being advanced is untenable at law.(9)

The court determined that the underwriters would not suffer non-compensable prejudice if LBP's amendments were permitted. With respect to whether LBP's claims were untenable at law, the court confirmed that it must be "plain and obvious" that the proposed claim discloses no reasonable cause of action. Conversely, if a claim, read generously, has a reasonable prospect of success, it will be allowed.(10)

The court ultimately refused to grant leave to amend with respect to the three contested causes of action.

Prospectus misrepresentation claim is time barred

Under Section 130(1)(b) of the Ontario Securities Act, any underwriter required to certify a prospectus may be sued for damages by a purchaser of securities where the prospectus, together with any amendment to the prospectus, contains a misrepresentation.(11) On the motion, LBP sought leave to advance this cause of action in respect of the prospectus filed for the offering and certified by the underwriters. The underwriters established, however, that LBP's claim was time barred and, as a result, did not disclose a tenable cause of action.

Section 138(b) of the Ontario Securities Act provides that an aggrieved shareholder must bring an action under Part XXIII within the earlier of:

- 180 days after first having knowledge of the facts giving rise to the cause of action; or
- three years after the date of the transaction that gave rise to the cause of action.

In refusing to grant leave to amend, the court held that LBP's proposed primary market claim was time barred because LBP must have known about Allied Nevada's alleged corrective disclosures when it filed its notice of action, which occurred more than 180 days before the motion to amend was brought.(12)

Secondary market claim is untenable

The court held that LBP's proposed claim against the underwriters under Part XXIII.1 of the Ontario Securities Act, which deals with civil liability for secondary market disclosure, was "not viable in principle" and, therefore, not tenable.(13)

In assessing whether a reasonable cause of action existed, the court first noted that persons can be sued under Part XXIII.1 only if they fall within the list of potential defendants prescribed under Section 138.3(1).(14) Of these prescribed defendants, the court agreed that the only recognised category an underwriter could possibly fall under was that of an 'expert', defined at Section 138(1)(e) as follows:

"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 or lawyer, but not including a designated credit rating organization."

The court unequivocally held that underwriters are not experts within the meaning of Section 138(1), affirming that underwriters "are not intended to be caught by the secondary market liability provisions of Part XXIII.1".(15) The court offered several supporting reasons, first noting that 'underwriter' and 'expert' are given separate and different definitions throughout the Ontario Securities Act.(16) Further, the Section 138(1)(e) definition of an 'expert' contemplates professional membership which, the court held, did not apply given that underwriters are not part of a self-regulating or self-licensing profession.(17) Finally, reading the Ontario Securities Act as a whole, the court noted that the legislature expressly, and for sound policy reasons, exposed underwriters to primary market liability under Part XXIII, but deliberately chose not to expose them to secondary market liability under Part XXIII.1.(18)

Even if the underwriters were considered to be experts for the purpose of Part XXIII.1, the court

held that LBP's claim was untenable because, pursuant to Section 138.3(1)(e), in order to establish liability, a plaintiff must show that the expert, among other things, repeated the responsible issuer's misrepresentation in a report, statement or opinion. **(19)** The court found that merely certifying the offering prospectus did not result in a republication or restatement of Allied Nevada's alleged misrepresentations with the result that LBP's proposed claim was untenable. **(20)**

Unjust enrichment claim is untenable

To establish the viability of its claim in unjust enrichment for disgorgement of underwriting fees, LBP was required to show that:

- the underwriters were enriched;
- LBP suffered a corresponding deprivation; and
- there was no juristic reason for the underwriters' enrichment. **(21)**

The court held that LBP's proposed claim in unjust enrichment could not succeed for two reasons. First, in light of the fact that the underwriters' underwriting fees were paid pursuant to an unchallenged contract, LBP had no reasonable prospect of showing that there was no juristic reason for the enrichment. **(22)** Second, even if the fees received by the underwriters were unjustly paid and received, absent a derivative action, Allied Nevada (which paid the underwriting fees) was the only party with standing to assert a claim. **(23)**

Comment

In refusing to cast underwriters as experts for the purpose of secondary market misrepresentation claims under Part XXIII.1 of the Ontario Securities Act, the court's decision was consistent with its earlier ruling in *Dugal v Manulife Financial Corporation*, **(24)** in which it was held that Section 130 of the Ontario Securities Act offers a "complete code" for underwriter liability. **(25)** In the result, the court's decision provides welcome clarity with respect to the potential sources of underwriter liability under the Ontario Securities Act.

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Endnotes

(1) 2016 ONSC 1629 (SCJ) [Allied Nevada].

(2) Securities Act, RSO 1990, c s 5.

(3) *Allied Nevada*, *supra* at para 3.

(4) *Ibid*, at para 3.

(5) *Ibid*, at paras 4-6.

(6) *Ibid*.

(7) *Ibid*, at para 24.

(8) RRO 1990, Reg 194.

(9) *Allied Nevada*, *supra* at para 7.

(10) *Ibid*, at para 23.

(11) *Ibid*, at para 27.

(12) *Ibid*, at para 30.

(13) *Ibid*, at paras 38-39.

(14) *Ibid*, at para 41.

(15) *Ibid*, at para 47.

(16) *Ibid*, at para 48.

(17) *Ibid*, at paras 50-52.

(18) *Ibid*, at paras 55-56.

(19) *Ibid*, at paras 44-45.

(20) *Ibid*.

(21) *Ibid*, at para 66.

(22) *Ibid*, at paras 64-70.

(23) *Ibid*.

(24) 2011 ONSC 1764 (SCJ).

(25) *Allied Nevada, supra* at para 62.

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