

What constitutes a 'public correction' for the purpose of secondary market misrepresentation class actions?

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Introduction

In *Swisscanto v BlackBerry*(1) the Ontario Superior Court of Justice considered, for the first time, what constitutes a public correction of an alleged misrepresentation in a secondary market securities class action. The decision clarifies that the public correction requirement's primary purpose is to serve as a "time-post" for the assessment of damages; it is not meant to be a significant hurdle to obtaining leave to bring an action for damages.(2)

Plaintiffs can demonstrate evidence of a public correction under Section 138.3(1) of the Ontario Securities Act (and under the securities legislation of all other Canadian jurisdictions(3)), in the following manner:(4)

- The public correction must be pleaded with sufficient precision to provide notice to the defendant;
- There must be some link or connection between the pleaded public correction and alleged misrepresentation, although the public correction need not be a mirror image of the alleged misrepresentation;
- The public correction must be reasonably capable of revealing the existence of the alleged misrepresentation to the market; and
- The public correction may take any number of forms and need not emanate from the issuer.

In the wake of *Swisscanto*, the fact that an issuer reports a change in accounting policy may, if supported by the surrounding circumstances, be enough for a court to conclude that the previous policy was admitted to be an error. Accordingly, issuers face an increased risk that statements and disclosures not intended to be corrections of previous disclosures may form part of an action for damages for misrepresentation. That said, the court also confirmed that the significance of any corrective statement may be relevant at trial should a defendant raise a Section 138.5(3) defence; under this provision, damages may be reduced if the change in the market price of securities was not a result of the alleged misrepresentation.(5)

Facts

In early 2013 BlackBerry Limited introduced a new line of smartphones featuring the BlackBerry 10 operating system (the 'BB10 phones').(6) On launch, BlackBerry measured revenue from the sale of the BB10 phones using the 'sell-in' accounting method.(7) Under this method, BlackBerry booked revenue when BB10 phones were sold to distributors, rather than when they were ultimately purchased by consumers (an approach known as 'sell-through' accounting).(8) Under the generally

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accepted accounting principles (GAAP), sell-in accounting is appropriate only when a business can make reasonable estimates of pricing adjustments that may be required to achieve consumer sales.⁽⁹⁾

Consumer sales of the BB10 phones were disappointing; so much so that on August 31 2013 BlackBerry announced that it was writing off – by way of an inventory charge – approximately \$1 billion of unsold BB10 phones.⁽¹⁰⁾ In the same news release, BlackBerry indicated that it was switching to sell-through accounting and that revenue from such sales would "not be recognized until those devices are sold through to end customers".⁽¹¹⁾

The market price of BlackBerry shares dropped 15% in response to the August 31 2013 news release.⁽¹²⁾ Thereafter, a BlackBerry shareholder, Swisscanto Fondsleitung AG (the 'plaintiff'), launched a class action lawsuit in Ontario seeking – among other things – damages pursuant to the statutory right of action created by Section 138.3(1) of the Ontario Securities Act. Section 138.3(1) provides that where a responsible issuer (or a person with authority acting on the issuer's behalf) releases a document that contains a misrepresentation, anyone who acquires or disposes of the issuer's security after the misrepresentation, but before the misrepresentation is publicly corrected, has a right of damages against, among others, the responsible issuer and its directors and officers.

Issues

The court's decision was made in the context of the plaintiff's motion for leave. On such a motion, the court must be satisfied that the action is brought in good faith and the plaintiff has a reasonable chance of succeeding at trial.⁽¹³⁾

In its reasons, the court focused on whether the plaintiff could satisfy the requirements of Section 138.3(1). In that regard, the court identified two basic issues:

- if there was a misrepresentation, whether there was a misrepresentation (ie, whether BlackBerry's use of sell-through accounting was GAAP compliant); and
- whether there was a misrepresentation, whether the statement amounted to a public correction.⁽¹⁴⁾

Decision

Ultimately, the court granted leave and allowed the plaintiff to proceed to the next step of the litigation – certification of the class action.⁽¹⁵⁾

On the first issue, the court held that the plaintiff had a reasonable chance of establishing that BlackBerry, by issuing financial statements on the basis of sell-in accounting, had made a misrepresentation.⁽¹⁶⁾ On this issue, the court preferred the opinion of the plaintiff's expert, who highlighted that the newness of the BB10 phones coupled with recent negative experiences with other BlackBerry products meant that unexpected future concessions might be required to sell the BB10 phones through to consumers.⁽¹⁷⁾

On the second issue, BlackBerry submitted that its August 31 2013 statement was not a correction of anything. Instead, new facts unrelated to the financial quarters at issue had caused BlackBerry to switch to sell-through accounting. BlackBerry further argued that it was disclosing the change without commenting on disclosures regarding previously recognised revenue.⁽¹⁸⁾

In deciding that the statement amounted to a public correction, the court took a purposive approach to interpreting the phrase 'publicly corrected' (which is not statutorily defined and had been given little judicial consideration).⁽¹⁹⁾ The court noted that Part XXIII.1 of the Securities Act (which contains Section 138.8) targets the wrong of misrepresentation while balancing against the possibility of strike suits against issuers.⁽²⁰⁾ Within this regime, the public correction requirement serves to set a temporal end for the assessment of damages, the period for which opens upon the initial public misrepresentation.⁽²¹⁾ In the end, the court concluded that the statement, when read in context, could "fairly and reasonably be said to be a public correction of the sell-in method of revenue recognition that was used in the previous two quarters".⁽²²⁾

Comment

The *Swisscanto* decision confirms that the 'public correction' requirement in securities legislation serves as a temporal marker for the assessment of damages, rather than a substantive hurdle to obtaining leave to bring a secondary market securities class action on the basis of an alleged misrepresentation. Accordingly, at the outset of any proceeding, the legal resources of a defendant-reporting issuer may be better spent challenging – on other bases – whether the plaintiff has a reasonable chance of succeeding at trial, rather than disputing the existence or timing of any public correction.

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Endnotes

(1) 2015 ONSC 6434.

(2) *Ibid*, at para 58.

(3) AB (Securities Act, S 211.03(1)), BC (Securities Act, S 140.3(1)), MB (The Securities Act, SS 176 (1)-(2)), NB (Securities Act, S 161.2(1)), NL (Securities Act, Section 138.3(1)), NU (Securities Act, S 124(1)), NT (Securities Act, S 124(1)), PE (Securities Act, S 124(1)), QC (Securities Act, SS 225.8 and 225.12), SK (The Securities Act, 1998, S 136.11(1)) and YT (Securities Act, S 124(1)).

(4) *Swisscanto*, *supra* note 1 at paragraph 65.

(5) *Ibid*, at para 72.

(6) *Ibid*, at para 5.

(7) *Ibid*, at para 13.

(8) *Ibid*, at para 10.

(9) *Ibid*, at para 12.

(10) *Ibid*, at para 16.

(11) *Ibid*, at para 17.

(12) *Ibid*, at para 19.

(13) The Supreme Court recently clarified the test for obtaining leave in *Theratechnologies inc v 12185 Canada inc*. For further details please see "[Supreme Court raises bar for leave to bring secondary market securities class actions](#)".

(14) *Swisscanto*, *supra* note 1 at para 23.

(15) *Ibid*, at para 30.

(16) *Ibid*, at paras 47-49.

(17) *Ibid*, at paras 38 and 45.

(18) *Ibid*, at para 53.

(19) *Ibid*, at para 60.

(20) *Ibid*, at para 57.

(21) *Ibid*, at para 57.

(22) *Ibid*, at para 73.

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