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No New Duty, No Negligence: Ontario Court Dismisses Class Action Certification Motion Against Underwriters

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The Ontario Superior Court of Justice has declined to certify a class action against underwriters in LBP Holdings Ltd. v. Hycroft Mining Corporation, holding for the first time that underwriters do not owe a duty of care to potential investors to perform due diligence or price securities in a particular way.

Key Takeaways

- **No recognized duty of care at common law.** The Court found that the ostensible duty of care advanced by the plaintiff did not fall into a recognized category for claims of pure economic loss.
- **No basis to recognize a new duty of care.** The Court also found that no new duty of care should be recognized in the circumstances, holding that the novel duty proposed by the plaintiff was neither foreseeable, proximate, nor justified on public policy grounds.
- **Not the preferable procedure in any event.** Despite finding that the cause of action criterion was met for the negligent misrepresentation claim advanced by the plaintiff, the Court declined to certify that claim on the basis that a class proceeding would not be the preferable procedure.

Summary and Background

The Ontario Superior Court of Justice refused to certify a negligence and negligent misrepresentation class action against underwriters of a secondary public offering, holding that (i) the negligence claim did not disclose a reasonable cause of action and (ii) a class action would not be the preferable procedure to pursue either the negligence claim (had it met the cause of action criterion) or the negligent misrepresentation claim.[1]

The plaintiff commenced proceedings against a corporate defendant and two of its senior executives for primary market misrepresentation under section 130 of the Ontario *Securities Act* and equivalent securities legislation in other provinces in relation to a secondary public offering.[2] The plaintiff also advanced a statutory claim against the underwriters of that offering, but subsequently abandoned that claim and opted to proceed against the underwriters only in respect of common law claims of negligence and negligent misrepresentation.

The plaintiff's claim against the underwriters was based on the allegation that the prospectus for the offering contained misrepresentations. The plaintiff argued that the underwriters owed the prospective class a duty to perform due diligence to ensure that all material facts had been disclosed in the prospectus and a duty to price the shares in a particular way. The plaintiff contended that those duties emerged from the underwriting agreement between the issuer of the shares and the underwriter.

In dismissing the motion for certification as against the underwriters, the Court held that the duty of care asserted by the plaintiff was novel and should not be recognized. The Court also held that a class action was not the preferable procedure to pursue a claim in negligence or negligent misrepresentation.

No New Duty of Care

With respect to duty of care, given that the claim was for pure economic loss, the Court first addressed whether the alleged duty fell within one of the following established categories: (i) negligent misrepresentation; (ii) professional negligence; (iii) products liability; (iv) the liability of public authorities; or (v) relational economic loss. The Court held that the plaintiff's claim did not fit into one of these categories. The Court then addressed whether a new duty of care should be established, having regard to questions of foreseeability, proximity, and public policy.

With respect to foreseeability, the Court asked whether the harm that occurred was the reasonably foreseeable consequence of the underwriters' actions. In this regard, the Court held that "even in the circumstances of a bought deal, an underwriter would not anticipate that purchasers would be relying on it to act as a gatekeeper beyond and distinct from its duties of care under s. 130 of

the Ontario *Securities Act* and its common law duties with respect to misrepresentations in the prospectus."

With respect to proximity, the Court held that underwriters, "in their role in a distribution of securities pursuant to a prospectus, do not stand in the same relationship of proximity to shareholders as do the others involved in the distribution." Rather, underwriters only make "weak representations" that the prospectus contains full, true and plain disclosure to the best of their knowledge, information and belief.

Finally, the Court asked whether there were broad policy considerations that would make the imposition of a duty of care unwise in the event that harm was a reasonably foreseeable and proximate (after finding that it was neither). In doing so, the Court considered the six policy factors identified by the Supreme Court of Canada as relevant to determining whether a duty of care for pure economic loss should be recognized:[3]

- Whether extending recovery for pure economic losses would create circumstances of indeterminate liability;
- Whether extending recovery for pure economic losses would deter useful economic activity;
- Whether extending recovery for pure economic losses would encourage or discourage economically efficient conduct;
- Whether extending recovery for pure economic losses would interject tort law as after-the-fact insurance against failures to pursue alternative strategies or opportunities or to act with due diligence or self-vigilance, a necessary ingredient of commerce;
- Whether extending recovery for pure economic losses would introduce the courts to a significant regulatory function when other causes of action already provide remedies for misconduct; and
- Whether extending recovery for pure economic losses would encourage needless litigation and a multiplicity of lawsuits in place of allowing market forces to operate.

Ultimately, the Court held that these policy factors would negate any duty of care because extending an underwriter's liability for pure economic loss beyond what is currently recognized (i.e., for negligent misrepresentation or for statutory liability under the Ontario *Securities Act*) would, in effect:

- Deter useful economic activity where the parties are best left to allocate risks through the autonomy of contract, insurance, and due diligence;
- Encourage a multiplicity of inappropriate lawsuits;
- Arguably disturb the balance between statutory and common law actions envisioned by the legislator; and
- Introduce the courts to a significant regulatory function when existing causes of action and the marketplace already provide remedies.

Not the Preferable Procedure

With respect to preferable procedure, the Court approached its analysis through the lens of judicial economy, behaviour modification, and access to justice. The Court found that "the elements of reliance, causation, and damages are matters that raise highly individual issues that must be proven at individual issues trials," and that individual issue trials against the underwriters in this case were inevitable. Further, the plaintiff's claims against the underwriters did not have the same factual or legal basis as the claims advanced against the corporate and individual defendants, and any findings made in connection with the statutory claim would be of little benefit to the a resolution of the common law claims as a result.

The Court also considered practical alternatives and noted that, given the size of the individual claims and the plaintiff's position that it would proceed as against the underwriters whether its claims were certified or not, an alternative route for access to justice – namely joinder – was reasonably available.

The Upshot

Ultimately, the significance of this decision (in addition to its development of the law relating to whether the cause of action and preferable procedure requirements are met on a motion for certification) is the finding that underwriters do not owe a duty of care to prospective investors to perform due diligence or price securities in a particular way.

The decision in *LBP Holdings Ltd. v. Hycroft Mining Corporation* is available here.

If you have any questions concerning this case or securities class actions generally, please contact Wendy Berman, Lara Jackson, John M. Picone, or any other member of the Cassels Securities Litigation Group.

[1] The Court also held that the negligence claim was subsumed by the negligent misrepresentation claim, but went on to consider the negligence claim independently in any event on the basis that it was "doctrinally possible that a defendant may be concurrently liable for negligent misrepresentation and negligence."

[2] Cassels Brock represents the corporate and individual defendants.

[3] *Martel Building Ltd. v. Canada*, 2000 SCC 60.