CANADIAN SECURITIES LITIGATION OUTLOOK

Trends to Watch for Capital Markets Participants

2019 UPDATE

Cassels

TRENDS TO WATCH
for Capital Markets Participants

The Cassels Securities Litigation Team is pleased to present our fourth annual *Canadian Securities Litigation Outlook*. In this edition, we set out our analyses of key securities litigation developments over the past year and our thoughts on the topics and issues that we expect to see trending in the year to come.

Our feature piece this year highlights the increased focus on the adequacy of internal controls and culture of compliance by Canadian and US regulators, particularly given emerging risks associated with cybersecurity, corruption, and fraud. The article reviews recent enforcement actions and settlement agreements which have centred on failures to maintain adequate internal controls, outlines the statutory and factual bases for enforcement, discusses the general guidance that can be gleaned regarding securities regulators' expectations, and provides key takeaways for corporations, officers, and directors.

This year, we also examine the securities litigation implications of the rapidly expanding cannabis industry, the shifting shareholder activism and governance landscape, securities enforcement in the modern era, and current developments in the area of securities class actions.

We will continue to monitor and report on these and other developments and trends as they unfold.

Please contact any member of the Cassels Securities Litigation Team to discuss these developments and trends, and their impacts on market participants.

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1 OUT OF CONTROL NO MORE: Securities Regulators Focus on Adequacy of Internal Controls to Address Risks, from Corruption to Cybersecurity

Canadian securities regulators have signaled an increasing focus on enforcement actions against corporations and their directors and officers for failure to maintain adequate internal controls[1] and a "culture of compliance," even where no securities laws have been violated. This trend reflects the proliferation of emerging risks faced by issuers and their stakeholders globally — from cybersecurity to corruption — and clearly outlines the expectation of Canadian securities regulators that corporations and their directors and officers devise adequate internal control systems and calibrate these controls to the current risk environment.

Similarly, the Securities and Exchange Commission ("SEC") in the United States has also increasingly focused on holding corporations and their directors and officers liable for failure to guard against a variety of risks through robust internal controls.[2] Particular areas of focus have been risks associated with foreign corruption, cybersecurity, and fraud to ensure that issuers have implemented sufficient control and compliance regimes to protect their business and assets — and therefore, their stakeholders — from such risks.

Recent public statements, commission decisions, and negotiated settlements shed some additional light on the standards expected, but no clear guidance has been provided by either Canadian or US securities regulators. Accordingly, corporations and their directors, officers, and senior management must alone determine how to adequately assess and devise internal controls in an evolving risk environment, while the adequacy of such controls will be subject to hindsight scrutiny by securities regulators.

Canadian Developments

Canadian securities regulators are increasingly relying on their broad public interest jurisdiction to hold corporations and their directors and officers liable for inadequate internal controls and failure to enforce a culture of compliance, even where there is no violation of securities laws. The increasing use of the public interest standard in enforcement proceedings raises serious fairness concerns. The vague and discretionary nature of the public interest standard in enforcement actions allows the expansion of prohibited conduct on a case-by-case basis and leaves market participants without clear guidance regarding the boundaries of appropriate conduct. Corporations, their directors and officers, and internal and external advisors may all have differing views regarding the scope of prohibited conduct which ultimately may undermine the fair and efficient regulation of the capital markets.

In three recent enforcement matters involving internal control failures, the Ontario Securities Commission (the "OSC") has approved significant monetary payments against corporations and their officers and directors of more than $70 million — amounts much larger than prior monetary sanctions. This enforcement trend demonstrates that corporations with inadequate internal controls and risk management oversight, including maintenance of a strong culture of compliance, may find themselves subject to significant monetary penalties and other sanctions from securities regulators, as well as associated reputational harm and class action risk.

On December 18, 2018, the OSC approved a settlement with a global mining company relating to misstatements in its financial statements and risk disclosures, misleading statements regarding copper production, and internal controls failures in relation to its mining operations in Africa.[3] As part of the settlement approval, the mining company agreed to pay a $28.5 million penalty and $1.5 million towards costs of OSC Staff, and certain former and current officers and directors agreed to total penalties of $5.9 million and $350,000 in costs.[4] In addition, the company agreed to retain an independent consultant, approved by OSC Staff, to conduct a review of the policies, procedures, and effectiveness of its metal accounting system.

The mining company admitted, among other things, that it failed to maintain adequate disclosure controls and procedures and adequate internal controls over financial reporting and failed to adequately disclose certain material risks to its business and, in particular, the heightened risk of public sector corruption.

In addition, the settlement agreement contains strong statements regarding the importance of adequate internal controls on financial reporting, including the importance of ensuring adherence to such policies and the obligation to properly consider and disclose evolving or heightened entity-specific risks. Finally, the settlement agreement also contains strong statements that the directors and officers are responsible for setting the "tone from the top" by establishing and enforcing a culture of compliance, and that the directors and officers contributed to a culture in which employees failed to adhere policies and overrode controls and thereby engaged in conduct that undermined corporate governance and internal controls.

Canadian securities regulators are increasingly relying on their broad public interest jurisdiction to hold directors and officers liable for inadequate internal controls and failure to enforce a culture of compliance.

On August 30, 2019, the OSC approved settlement agreements with two financial institutions related solely to the failure to have adequate controls and supervision systems and promote a culture of compliance in its currency trading business.[5] The financial institutions agreed to make voluntary payments totaling approximately $25 million and to conduct an internal audit of their respective compliance with a global code for such currency trading and institute any necessary changes.

Notably, there were no violations of securities laws by either financial institution nor any allegation or finding of any actual harm suffered by market participants from the currency exchange trading. The Commission relied solely on its broad public interest jurisdiction on the basis that certain conduct was inconsistent with market integrity and potentially put customers at risk of harm.

The settlement agreements contain only general guidance regarding securities regulatory expectations, including that market participants are expected to identify, assess and manage appropriately the risks that their lines of business pose to ensure investor protection and capital market integrity.

Importantly, both settlements contain a statement that a market participant that identifies an internal controls problem or any other activity that compromises the integrity of the capital markets *should* promptly and fully self-report. There is no statutory or legal requirement to self-report under Canadian securities regime, although self-reporting is encouraged.[6] However, enforcement staff have now put forward a clear expectation that corporations self-report notwithstanding there is no statutory or other legal requirement to do so, and should do so even in cases where there is no violation of securities laws.

In addition, for the first time, OSC enforcement staff provided a detailed methodology for the calculation of the quantum of a voluntary payment as part of these settlement agreements. OSC enforcement staff provided a four-step methodology which considers first any financial benefit to the respondent, second the nature of the failure and the seriousness and impact of the misconduct, third an adjustment for deterrence, and fourth a settlement or cooperation discount. OSC enforcement staff advised that for the second step, they looked to the revenue generated from the activity — not profit — as an indication of potential harm and then applied a "seriousness of conduct" percentage factor in a range fixed at five fixed levels on a sliding scale between 0% to 20%.

In considering the nature of the failure, staff looked to the nature of the weaknesses in procedures, systems and controls, the failure to adequately address risk, and the potential for harm to customers and other market participants from the misconduct. In respect of the third step, staff increased the amount to ensure specific and general deterrence and determined that the amount of $1 million per each year of failures was appropriate. Finally, staff determined that the cooperation of the two financial institutions merited discounts of 30% and 12%, respectively. Given the recent trend towards larger and larger monetary sanctions — both penalties and voluntary payments — corporations should pay close attention to this new methodology for determining monetary sanctions, including the significant discount available for cooperation.

Finally, concurrent with the rise of regulatory actions, Canadian class actions are increasingly including claims relating to the adequacy of internal controls and compliance and risk management regimes.

US Developments

The SEC has also signaled an increased focus on internal control enforcement actions. However, such enforcement actions are based on a violation of specific statutory internal controls provision, s. 13(2)(b) of the *Securities Exchange Act*,[7] unlike the Canadian regime, which relies on a general public interest jurisdiction.

The SEC initially pursued internal controls violations as a means to penalize corporations and their directors and officers for a failure to properly address the risk of foreign bribery. This resulted in an evolving set of corporate best practices relating to foreign bribery risk over the last decade or so.

More recently, the SEC has shown a willingness to expand internal control enforcement actions to other contexts, including cybersecurity and fraud, and to hold corporations and their directors and officers liable for failure to guard against a variety of risks through robust internal controls. As noted by SEC Chief Accountant Wesley Bricker, corporations should maintain "adequate internal controls not just because internal controls are the first line of defense against preventing or detecting material errors or fraud in financial reporting, but also because strong internal controls are good for business and can have an impact on the companies' costs of capital."[8]

In October 2018, the SEC issued an investigative report on the adequacy of the internal control regimes of multiple public companies that were the victims of cyber-related frauds and had collectively lost nearly $100 million. While the SEC ultimately declined to pursue any enforcement actions, it nevertheless cautioned public companies about the importance of devising and maintaining a sufficient system of internal controls, and provided a

Boards should ensure management devotes sufficient resources to continually assessing and calibrating existing internal controls and procedures to ensure they are responsive to the current risk environment.

clear warning that future investigations of internal controls may result in enforcement action.

The SEC emphasized the importance of continually assessing and calibrating existing internal controls and procedures to ensure they are responsive to the current risk environment, including cyber-related threats. The SEC also noted certain deficiencies in the internal control regimes of the reviewed companies, and, in particular, inadequate personnel training, and reiterated that "cybersecurity risk management policies and procedures are key elements of enterprise-wide risk management, including as it relates to compliance with federal securities laws."[9]

In January 2019, the SEC settled enforcement actions against four public companies predicated solely on controls violations. In *Grupo Simec S.A.B. de C.V.*,[10] *Lifeway Foods, Inc.*,[11] *Digital Turbine, Inc.*,[12] and *CytoDyn Inc.*,[13] each company failed to maintain adequate internal controls over financial reporting and failed to remediate controls deficiencies over several years, although each had disclosed material weaknesses in their internal control regimes.

These cases demonstrate the SEC's current enforcement focus on internal controls and send a strong message that a continuing failure to maintain adequate controls will be prosecuted even if such failure in internal controls is fully disclosed and there are no disclosure violations.

In February 2019, the SEC made several strong statements regarding internal controls in *Hertz Global Holdings Inc.*,[14] a case involving inaccurate financial reporting. In particular, the SEC noted that Hertz's internal controls suffered from a series of material weaknesses that included:

- An inappropriate tone at the top;
- Insufficient and inadequately trained financial personnel;
- Unclear reporting lines;
- The distraction caused by multiple, conflicting business initiatives; and
- Ineffective controls over procurement.

Concurrent with increased SEC enforcement on control violations, there has been an increase in civil action claims relating to insufficient internal controls, including class action claims. Two recent noteworthy cases, *Equifax*[15] — a data breach class action with settlement damage payment of $700 million and agreement to spend $1 billion in improvements to cybersecurity regime — and *Marchand*[16] — an investor action in which the Delaware Supreme Court allowed a claim to proceed against directors for failure to provide adequate oversight of a key risk area and related information and controls systems — exemplify the increasing civil liability risks and financial cost arising from the failure to ensure adequate internal controls and risk management in an environment of evolving risks.

Looking Forward: Key Takeaways

Canadian and US securities regulators are more willing to denounce and levy fines against public companies who fail to maintain adequate internal control mechanisms and who fail to remediate inadequate internal control mechanisms once a weakness has been identified.

These developments serve as a strong warning that corporations and their directors, officers, and senior management should be proactive in the design of controls regimes and risk oversight, which includes a continuous assessment of the changing risk environment and the adequacy of internal controls and compliance regimes as well as evolving best corporate practices.

The lack of any specific guidance from Canadian securities regulators, and the risk of prosecution even in the absence of any securities law violations, will require the exercise of careful consideration and judgment by directors and officers in their assessment and prioritization of enterprise risk, their oversight in the design and recalibration of internal controls, and their oversight monitoring of the adequacy of such systems. Corporations must also carefully monitor the development of evolving corporate best practices.

2 THE GROWING CANADIAN CANNABIS INDUSTRY: Cultivating Expansion While Recognizing Risk

The Canadian cannabis industry has achieved world-wide prominence in the wake of legalization for recreational use. With over 240 licenses now issued to cultivate, process, or sell cannabis in the medical and recreational markets,[1] the trend toward growth is clear.

Canadian cannabis companies have enjoyed significant advantages over their global counterparts, such as access to capital and government support. However, with this head start, many Canadian cannabis companies are now turning to the US market and elsewhere to further develop their businesses. As this growth continues, cannabis companies, investors, and other stakeholders must remain cognizant of the risks that come with expansion into new or foreign markets.

The recent rise in regulatory actions and securities class actions against Canadian cannabis companies reflect the significant risks facing companies and their directors and officers in this rapidly growing industry.

Cannabis Across the Border: Opportunities on the Horizon

The Canadian capital markets continue to offer cannabis companies an unparalleled opportunity to grow. It is expected that, by 2020, the Canadian cannabis industry's retail value could grow to $6.8 billion, exceeding the retail value of the hard liquor market and nearing the retail value of the wine market.[2] In the US, on the other hand, some states permit cannabis production, dissemination, and use, while federal law still deems cannabis to be a controlled substance. As a result, growth in the US has been stunted.

Indeed, the conflict between state law and federal law has led Canadian cannabis companies to exercise caution when operating in or considering expansion into the US.

This year, however, creative transaction structures have been utilized which confirm Canadian optimism regarding US market opportunities. In April 2019, in an unprecedented transaction, Canopy Growth Corporation ("Canopy Growth") announced that it had acquired the right to buy the US multistate cannabis operator Acreage Holdings Inc. ("Acreage") based on a fixed exchange ratio.[3] However, Canopy Growth's decision to break into the significantly larger US market does not throw caution to the wind. Instead, this creative deal structure secures such participation at a certain deal price today with completion of the deal contingent on cannabis production and sale becoming legal in the US at the federal level within a seven-and-a-half-year period.[4]

Despite the unprecedented nature of this transaction, it was approved by over 99% of the voting shareholders of both companies and by the British Columbia Supreme Court.[5]

This deal is no doubt being watched closely by other Canadian cannabis companies keen to tap into the US market. As US cannabis legislation continues to evolve and closing of the Canopy Growth/Acreage transaction becomes imminent, more deals like this are likely to emerge.

High Class Action and Regulatory Risk

The current state of the cannabis industry, which is characterized by share price volatility and an evolving regulatory landscape, has given rise to a heightened risk of securities class actions and regulatory enforcement. In fact, since September of 2018, when shareholders of Cronos Group commenced a class action alleging that Cronos Group made materially false or misleading statements relating to the magnitude of its supply agreements, numerous Canadian-based cannabis companies and their directors and officers are facing disclosure-related securities class actions, regulatory investigations, and enforcement actions. Other defendants in cannabis securities class actions include Namaste Technologies, Inc., Liberty Health Services, and Wayland Group Corp.[6] The allegations against these companies span a wide range of securities breaches, from alleged misrepresentations to accusations of executives participating in non-arm's length transactions.

CannTrust Holdings ("CannTrust") is the latest Canadian company to be the subject of a securities class action. On July 9, 2019, CannTrust disclosed that Health Canada had found that CannTrust was growing cannabis in unlicensed facilities, which were actively concealed. As a result, CannTrust's shares plummeted by more than 75%, causing significant investor losses.

What's Changing in the US?

The legalization of hemp in the US has kicked off a cultural shift likely to result in the legalization of cannabis at the federal level.[7]

This shift was marked by Charlotte's Web announcing that it would move its listing from the Canadian Stock Exchange ("CSE") to the Toronto Stock Exchange ("TSX"), becoming the first US-based licensed hemp producer listed on Canada's senior exchange.[8] We expect to see other US-based hemp companies seeking to do the same in the coming months.

The legalization of hemp also permitted Canadian industry leader Canopy Growth to break ground on a hemp industrial park in New York, with expansion into seven more states to follow.[9]

Further legislative change could be on the horizon, with the US House of Representatives recently passing the *Secure and Fair Enforcement (SAFE) Banking Act* which, if it becomes law, would allow state-licensed cannabis businesses to access banking services. This is expected to transform the US cannabis industry, which is largely still cash-dominant.

To become law, the bill must pass in the Senate, where many commentators expect it will face opposition, and must also be signed into law by the president.[10]

CannTrust's shares were listed for trading on both the TSX and the New York Stock Exchange, placing the company in the cross-hairs of class action plaintiffs in both Canada and the US. Almost immediately following CannTrust's stock tumbling, four Canadian law firms and as many as 14 US law firms launched class action lawsuits against the company and certain directors and officers alleging misleading and inaccurate disclosure by the company regarding its operations and financial position. Additionally, and not surprisingly, the Ontario Securities Commission indicated that it commenced an enforcement investigation relating to CannTrust's disclosure.[11]

While dual-listed cannabis companies receive the benefit of increased access to capital and additional liquidity, the CannTrust class actions should serve as a reminder that dual-listed cannabis companies are also exposed to the risk of being subjected to parallel proceedings in multiple jurisdictions, including in regard to proceedings by regulators who may have or may be willing to deploy more resources than regulators in Canada. The evolving and fragmented regulatory regime governing cannabis production and distribution world-wide, and the dramatic share price fluctuations that have characterized the industry, render dual-listings comparatively lucrative but also risky.

Short Attacks on Cannabis Companies

More than ever, cannabis companies need to be aware of the increasing number of short seller attacks on stock prices. Over the past decade, Canadian companies such as Sino-Forest, Valeant, Concordia, and Home Capital have all been targeted by short sellers, who aim to borrow and sell shares while prices are high, buy them back when prices drop, and keep the profits. While the share price fallout from each of these attacks has varied, a securities class action has been launched shortly after the publication or promotion of a short seller's report or position in each case. In many cases, there has also been a parallel securities regulatory investigation.

Although short sellers who expose the truth about a company may provide a valuable service to Canadian investors, companies are increasingly facing abusive short seller attacks. Abusive short sellers aim to "short and distort" by publishing misleading or outright false information in an attempt to drive share prices down. Companies have limited tools to defend against these attacks because investors often have knee-jerk reactions to bad news, whether substantiated or not.[12]

Cannabis companies are particularly vulnerable to short seller attacks due to share-price volatility, which is common across the sector. Aphria Inc. ("Aphria") has already experienced the fallout of being a short-seller's target. In December 2018, short seller Quintessential Capital Management co-authored and published a report with Hindenburg Research which alleged, among other things, that Aphria was a "shell game" that had invested upwards of $700 million, or nearly half of its total net assets, in "worthless" M&A deals designed to enrich its insiders.[13] Within days of the report being released, Aphria's shares plunged approximately 50% and, within weeks, Aphria was hit with its first securities class action.

Every publicly-listed cannabis company should have strategies in place to prevent a short attack and, if attacked, be in a position to defend itself on a timely basis to minimize the fallout.

Prevention tactics include the timely release of any negative news, meticulous compliance with regulatory requirements, and an immediate response to any disclosure criticism. Creating a consistent procedure for addressing criticisms by short sellers — or even forming a specific team to address responses — can be a first step to ensuring that the proper infrastructure is in place if quick responses are needed. Other defensive tactics can include making acquisitions, increasing dividends, and considering when and how to respond to short seller attacks.[14] Cannabis companies may also find some comfort or support from financial institutions as it has recently been reported that the Bank of Montreal is no longer allowing investors to obtain a short position in any cannabis stock.[15] Similar actions by financial institutions could help to prevent other cannabis companies from undergoing the harm experienced by Aphria.

What's Next?

Cannabis companies need to be aware that the risks they face are not limited to potential class actions and short seller attacks as regulators are closely monitoring the industry as well. On September 13, 2019, the OSC issued its first Statement of Allegations concerning allegations of various breaches of securities law by a cannabis company and its principals, who allegedly defrauded its investors. While this is the first regulatory fraud proceeding against a cannabis company in Ontario, it is unlikely the last.[17] Cannabis companies need to ensure that they have robust compliance regimes in place, and directors need to exercise appropriate oversight of such regimes to reduce the likelihood of attracting regulatory scrutiny, being named in a class proceeding, or being the target of a short seller.

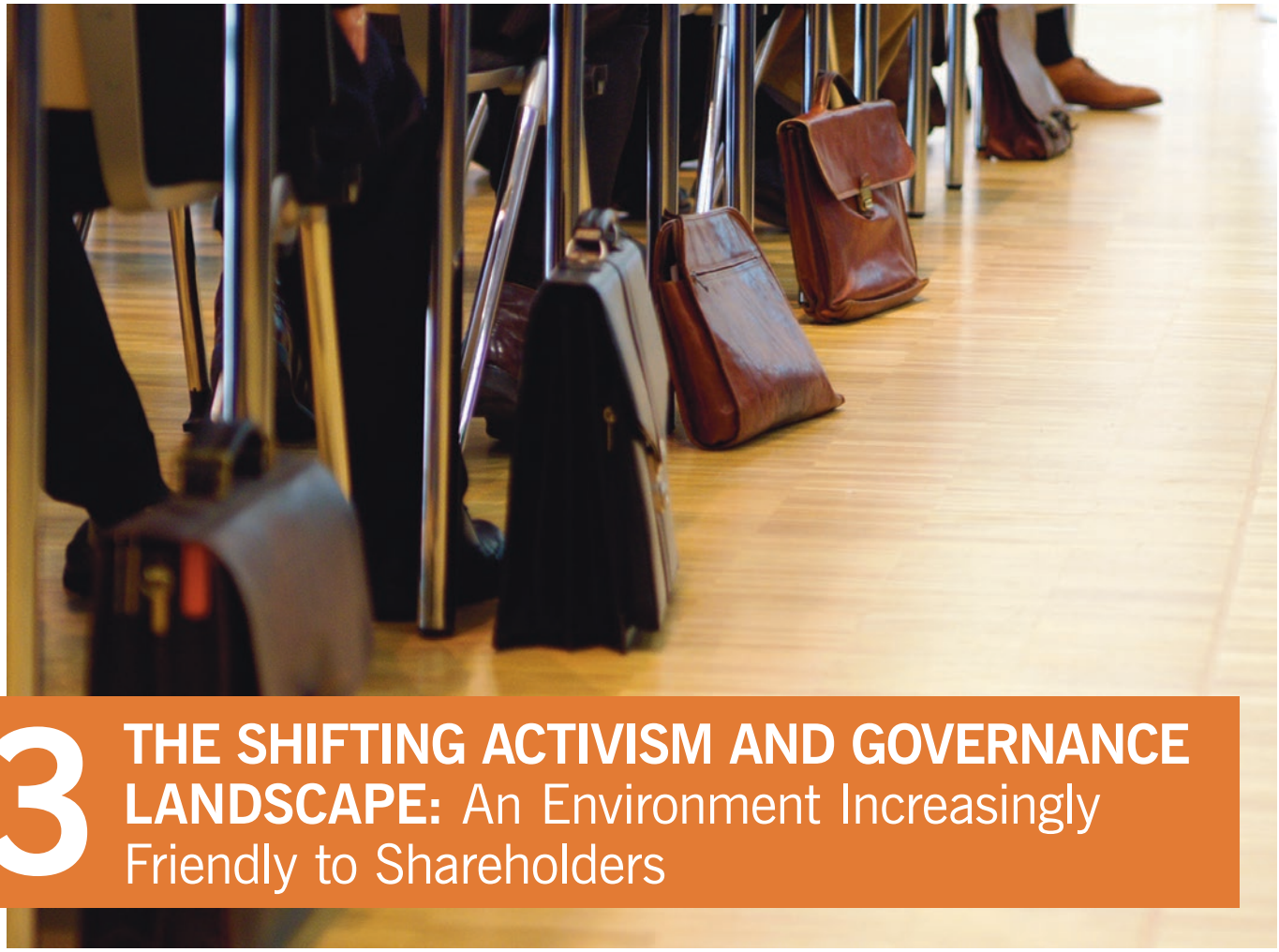
The Canadian cannabis market has been growing since the federal legalization of cannabis late last year, and people are paying attention. US cannabis companies are making moves to enter into the Canadian market, and Canadian companies are taking advantage of the changing US legislation by taking bold steps to secure engagement in the US market. However, with growth comes risk. Cannabis companies looking to take advantage of the current market conditions or to expand into cross-border markets need to stay current on all regulatory requirements in markets in which they operate and have strategies in place to manage any potential short seller attacks.

Continued Consolidation

The cannabis sector continues to experience increased consolidation.

In Canada, consolidation has been occurring for several years with Canopy Growth at the forefront of this trend. In the US, consolidation is a new and growing trend. In April 2019, Cresco Labs Inc., one of the largest multistate cannabis operators in the US, announced its acquisition of Origin House in an all-stock transaction valued at $825 million, representing, at the time, the largest acquisition in the history of the US cannabis industry.

Continued industry consolidation in Canada and the US will undoubtedly have an impact on smaller, independent businesses within the industry. However, consolidation will also impact ancillary companies that service and drive the industry, including track-and-trace systems, security companies, and point of sale providers, as these service providers must adapt to the needs, regulatory requirements, and compliance procedures of large-scale international businesses in order to remain relevant.[16]



3 THE SHIFTING ACTIVISM AND GOVERNANCE LANDSCAPE: An Environment Increasingly Friendly to Shareholders

The shareholder activism and corporate governance landscape continues to shift, animated by a legislative focus on greater protections for shareholders. Recent amendments to the *Canada Business Corporations Act* ("CBCA") relating to majority voting, codification of the fiduciary duty owed by directors to the corporation, and say on executive pay, are decidedly shareholder-friendly. Additionally, a recent securities commission decision appears to confirm that shareholders will be able to scrutinize and contest corporate conduct on multiple fronts by initiating parallel court and regulatory proceedings, even when the same remedies are sought in both venues.

It has been an interesting and exciting year for activism and governance. As predicted in our Securities Litigation Outlook last year, new rules and new initiatives have continued to change the activism and governance environment in Canada.

Shareholder Democracy: More Majority Voting on the Horizon

Last year, we reported on amendments to the CBCA which introduced majority voting for all federally incorporated companies. Once in force, this shift in the shareholder democracy landscape will influence issuers and activists alike.

The introduction of majority voting marks the end of the plurality voting system for federally incorporated companies: shareholders of CBCA companies will no longer be presented with the option to vote "for" or "withhold" when electing directors. Rather, companies will soon be required to present

the voting option for each director as either "for" or "against" in uncontested elections.[1] Under this system, a director may only be elected when the majority of votes cast are "for" his or her election to the board.

This is a welcome change. The plurality voting system — a global outlier — essentially ignores "withhold" votes because a director may be elected with a single vote "for" (even if that director is the shareholder casting that single vote), regardless of the number of votes withheld. Majority voting gives actual weight to all shareholder votes and is a positive step toward enhanced shareholder democracy.

While the TSX Company Manual generally requires majority voting, thousands of companies listed for trading on the TSX Venture Exchange ("TSXV") and the Canadian Securities Exchange ("CSE") are not subject to those majority voting rules. Shareholders of companies without those rules cannot easily campaign to remove directors without a potentially expensive and uncertain proxy contest. The ability to vote "against" as opposed to "withhold" is also a useful tool to effect change without the risk to reputation and dedication of resources that go hand-in-hand with a full-blown proxy fight. As such, we expect to see significantly more "vote no" campaigns for federally incorporated TSXV- and CSE-traded companies once the majority voting amendments to the CBCA come into force.

Activism at a Glance

Although the total number of proxy contests remains down from 2015, which saw a peak in activity, 2019 has already seen more activism campaigns (although not full-blown proxy contests) than last year. This increase in activity has been accompanied by a slightly increased rate of success for management (58%) as compared to 2018 (54%).[2]

Corporate Governance Clarified: Codification of the Fiduciary Duty

More than ten years ago, the Supreme Court of Canada in *BCE Inc. v. 1976 Debenture Holders* clarified that a director's fiduciary duty is owed to and must be directed to the best interest of the corporation, which includes consideration of more than just the interests of the corporation's shareholders.[3] Amendments to the CBCA this year, which are now in force, have codified the scope of this duty to be consistent with the case law. Now, pursuant to the CBCA, when acting with a view to the best interest of the corporation, the directors of the corporation may consider, but are not limited to, the following factors:

- The interest of shareholders, employees, retirees and pensioners, creditors, consumers, and governments;
- The environment; and
- The long-term interests of the corporation.

Notably, these amendments expressly expand the categories of stakeholders that may be considered by directors to include retirees and pensioners and the environment, categories which were not specifically mentioned by the Supreme Court of Canada in *BCE*.

Although the amendment is a clear legislative rejection of the "shareholder primacy" model of corporate governance (which has not been the law in Canada since *BCE* and has been losing ground in the United States), it is nevertheless a shareholder-friendly development, at least to the extent that it clarifies the parameters within which a board of directors may operate and carry out its function.

Whether provincial corporate statutes will likewise be amended to include the express fiduciary duty remains to be seen. This may depend, in part, on how the case law surrounding these duties develops in respect of CBCA companies once these amendments have been subject to scrutiny by the courts.

Say on Pay

Another shareholder-friendly amendment to the CBCA that has been enacted will require an advisory vote on executive compensation by the company's shareholders. Currently, the board of directors of a CBCA company, in its discretion, is responsible for determining the remuneration of the company's directors and officers. Once this amendment comes into force (and certain details are provided for in the regulations), the board will be required to develop an approach to remuneration for directors and senior management, which must be sent to shareholders in advance of a non-binding vote to be held at the company's annual general meeting. Although the vote is non-binding, the result of the vote must be disclosed.

While say on pay votes are required by regulators in other jurisdictions, such as the United States and the United Kingdom, the issue has previously been driven by shareholder engagement in Canada rather than regulatory requirement. According to the Shareholder Association for Research and Education, 71% of companies on the TSX Composite Index and 52 of the TSX60 Index companies have already adopted a non-binding advisory shareholder vote on executive compensation practices.[4]

Canada continues to be an outlier in the say on pay arena. We expect that say on pay will receive increased attention once the amendments to the CBCA come into force, with either provincial legislatures or, more likely, securities regulators, adopting the requirement for all publicly traded companies. This would be a welcome development for shareholders. Say on pay votes offer shareholders an effective and efficient opportunity to express concerns with executive compensation.

Diversification of Leadership?

According to the most recent Annual Report Card by the Canadian Board Diversity Council, last year there was:

- An increase in the number of women serving on boards of directors of FP500 companies;[5] and
- A decrease in the number of women in the C-Suite of FP500 companies.

Additionally, there remained many FP500 companies without any women on their boards notwithstanding that 91.3% of board members claim that they know between two to six FP500 board-ready women in their network.[6] According to the Canadian Securities Administrators, only 50% of issuers have adopted a policy relating to the representation of women on their boards.[7]

Fighting on Multiple Fronts: Challenging Corporate Conduct in Parallel Proceedings

Earlier this year, the British Columbia Securities Commissions ("BCSC") released its decision in *Imex Systems Inc*.[8] While this decision provides important guidance relating to the focus of securities commissions when reviewing stock exchange approval of equity financing, it is particularly interesting because it confirms that commissions will allow shareholders to contest corporate conduct before the court and the commission at the same time, even when the remedies sought in both venues are the same.

In *Imex*, the BCSC considered an application by a significant shareholder for a hearing and review of TSXV approval of a private placement by the company and sought, among other things, orders to cease trading the private placement shares and requiring that such shares not be voted pending shareholder approval of the private placement. The shareholder had also commenced an application before the Ontario Superior Court of Justice seeking the same remedies sought before the BCSC.

In response to the shareholder applications, the company sought to have them dismissed or stayed on the basis that it was an abuse of process to seek the same remedies in multiple proceedings. The company also submitted that it was patently unfair to subject it to concurrent proceedings in two provinces where the relief sought was the same. Finally, the company raised concerns relating to the possibility of the two proceedings resulting in inconsistent findings and orders.

Relying heavily on the decision of the British Columbia Court of Appeal in *Harrington Global Opportunities Fund Ltd. v. Eco Oro Minerals Corp.*,[9] the BCSC held that the parallel proceedings did not amount to an abuse of process and that the application for a hearing and review should proceed.

In coming to that decision, the BCSC held that its role in the context of a hearing and review is tied to its oversight of the stock exchange, ensuring that its decisions are consistent with the public interest, which is completely different from the role and focus of a court hearing an application under corporate legislation. In the words of the British Columbia Court of Appeal, the different statutory functions of the commission and the court, respectively, are "like apples and oranges."

The BCSC ultimately determined that the TSXV decision was made in error but declined to grant any further relief.

In light of this decision, as well as what appears to be an increased willingness to commence applications for a hearing and review of stock exchange decisions,[10] we expect that the Ontario and British Columbia securities commissions will continue to consider challenges to decisions of stock exchanges by shareholders while similar or identical relief is sought in a parallel court proceeding, possibly in another jurisdiction.

Forcing an issuer to defend on multiple fronts while focusing on managing the business, often at tumultuous times, can produce a tactical advantage in the right circumstances. With the door now open to employing such a strategy, issuers would be well-advised to begin preparing for a court application whenever a shareholder brings an application before a securities commission for a hearing and review.

A Note on Shareholder Dissent Proceedings

In 2016, the Yukon Court of Appeal overturned the approval of a plan of arrangement in *InterOil Corporation v. Mulacek*.[12] The plan of arrangement was ultimately approved after a revised corporate process which included increased oversight by independent directors and an independent fairness opinion. Dissenting shareholders then commenced proceedings

Ambush by Blank Proxy?

Another tactic that may be used by activist shareholders to catch management off guard and take control without a proxy contest is blank voting — where shareholders use the management form of proxy to appoint a non-management proxyholder and do not provide voting instructions.

This tactic was successfully used by a dissident shareholder of Synex International Inc., a TSX-listed company, who was able to replace the company's entire board by collecting forms of proxy representing a majority of shareholder votes and then nominating a slate of directors and voting for that slate at the meeting.

Although the chair of the meeting disallowed the dissident's proxies, that decision was overturned by the British Columbia Supreme Court,[11] which focused on the importance of protecting the right to vote and of giving effect to shareholders' intentions when voting.

While this case is certainly a fascinating example of a creative tactic being used by a dissident to effect change, it is equally a warning to management to be prepared — this ambush would easily have been prevented if the company had an advance notice by-law.

What about Mini Tender Attacks?

Quebec's financial markets administrative tribunal has recently cease traded an offer by Mach Group Inc. ("Mach") to acquire 19.5% of certain voting shares of Transat A.T. Inc. ("Transat"). This marks the first time in Canada that a securities regulator has considered the use of a mini tender to secure voting control over certain shares in connection with a pending transaction.

The offer was made in the face of a plan of arrangement whereby Air Canada was to acquire all of the outstanding shares of Transat. It was conditional on depositing shareholders providing proxies to representatives of Mach so that all of the tendered shares could be voted against the deal and so that dissent rights could be exercised in respect of all of those shares, despite the fact that if more than 19.5% of the shares were tendered, a pro rata take-up would occur. Moreover, Mach retained the ability to withdraw its offer even if it exercised the proxies and the dissent rights tied to the tendered shares.

Finding that the offer was abusive to both shareholders and capital markets, the majority of the tribunal identified a number of problems. First, the offer was found to be coercive because it was only open for acceptance for seven business days, notwithstanding that it was complex and implicated the same type of decision-making as tendering for a takeover bid. Second, the structure of the offer was found to be questionable, including because it was directed at securing votes and not shares. Finally, certain disclosure about the offer was unclear and, in some cases, contradicted previous disclosure.

Interestingly, while agreeing that the tribunal had broad jurisdiction to intervene with respect to the offer, the minority of the tribunal would not have cease traded it. Whether this means that the tactical use of mini tenders in similar circumstances — especially in other provinces — may be a viable strategy for an activist looking to upset a transaction remains to be seen.

seeking to be paid "fair value" for their shares. Shareholders who did not dissent were paid a total of approximately $50 per share.

This year in *Carlock v. ExxonMobil Canada*, the Yukon Supreme Court awarded dissenting shareholders more than $70 per share, finding that the deal price was not an appropriate starting point to determine fair value given that it "was established in a flawed corporate governance process." The Court instead adopted the discounted cash flow analysis offered by the dissenting shareholders' expert witness.[13]

This decision contrasts with the US experience where deal price less synergies is the prevailing metric for determination of fair value and only compelling evidence of market failure will justify departing from the deal price, as in the recent decision of *Dell, Inc. v. Magnetar Global Event Drive Master Fund Ltd.*[14] Delaware courts have also used unaffected market price as a reliable indicator of fair value and awarded dissenting shareholders an amount less than the deal price — as in *Appraisal of Jarden Corporation,*[15] which has resulted in a chill on appraisal rights cases.

There is limited Canadian jurisprudence relating to dissent rights, and Canadian cases have largely focused on valuation methodologies rather than governance matters. Whether the decision in *Carlock* withstands the scrutiny of an appeal remains to be seen.

The Focus into the Future

The activism and governance landscape is undoubtedly shifting, and more changes affecting issuers and investors are on the horizon. More than ever before, issuers and activists alike must consider creative legal strategies and solutions to accomplish their business objectives.

4 ENFORCEMENT IN THE MODERN ERA: Regtech, Artificial Intelligence, and Whistleblowers

The modern era of enforcement has arrived. Securities regulators across Canada and the world are increasingly relying on technology, whistleblowers, and alternative dispute resolution to pursue their mandates. As these trends continue to facilitate regulation and drive enforcement activity, we expect a more nimble and effective approach to protecting the capital markets, aided by greater application of artificial intelligence tools (known broadly as "RegTech"). Understanding this environment is more important to capital markets participants than ever.

Big Data: "RegTech" and Artificial Intelligence Activity on the Enforcement Front

RegTech

RegTech is a catch-all term that refers to the use of machine-learning software and other technology to bolster regulatory compliance. Heralded as "the new FinTech," RegTech has rapidly risen to prominence over the past year. RegTech products are used by regulators to monitor compliance and by institutions to ensure compliance with regulatory standards. To encourage the development of RegTech in Ontario, the Ontario Securities Commission ("OSC") established a LaunchPad in 2016 and the Canadian Securities Administrators ("CSA") created the

Regulatory Sandbox in 2017 to provide guidance and administrative support to FinTech and RegTech firms with "a flexible approach to fulfilling regulatory requirements."[1] The purpose of these platforms is to allow firms to test new technology without the full burden of regulatory regimes while giving the OSC and CSA access to the information stored by these large data-gathering firms.[2]

In 2019, the OSC reported that the LaunchPad supported 74 FinTech businesses and provided guidance to businesses that include online lending and crowdfunding platforms, private investment funds, and crypto asset businesses.[3]

Regulatory regimes like the OSC Launchpad and CSA Regulatory Sandbox have also been introduced in other countries. The UK's securities regulator, the Financial Conduct Authority ("FCA"), launched the Global Financial Innovation Network ("GFIN") in 2018 to create a global "regulatory sandbox."[4] GFIN is intended to encourage the sharing of data between regulators and firms and to allow firms to test cross-border trials of products and services.[5]

As of June 2019, 35 financial services regulators and 7 observers, including the IMF and World Bank, had joined GFIN.[6] Canadian members include the OSC, Quebec's Autorité des marchés financiers ("AMF"), the British Columbia Securities Commission ("BCSC"), and the Alberta Securities Commission ("ASC"). Firms that are admitted to test products through GFIN will have a 6-month trial period to convince regulators that their technology should be introduced to a given market.[7]

International and Domestic Cooperation

Canadian securities regulators have made recent efforts to collaborate with international governing bodies signaling a recognition of the importance of cooperation between securities regulators as key to enforcement. Participation in GFIN will facilitate data sharing and "create easier cross-border navigation for innovative firms."[8] In addition, throughout 2019, the OSC has made efforts through their seat on the International Organization of Securities Commissions to collaborate in the regulation of new financial technologies such as crypto assets and initial coin offerings.[9] The OSC has also collaborated with the US Securities and Exchange Commission ("SEC") in 2019 in an effort to scrutinize short seller practices in violation of securities laws.[10]

What are the Impacts?

Arguably, if "done right, the ultimate output of this exchange should lead to improved supervision, better regulatory models and ultimately better products and services."[11] Nevertheless, there is good reason to approach the rise of RegTech with caution. The mandate of global organizations such as GFIN has been criticized as being too broad and ambitious on the basis that setting up a global sandbox might require coordination that is not achievable within a reasonable time frame.[12] Moreover, relaxing regulatory restrictions for large data-gathering firms could result in unexpected and unintended consequences, including jeopardizing investor privacy.

Artificial Intelligence

A major part of the RegTech market is composed of Artificial Intelligence ("AI") and machine learning technology. Spending on AI reached $19.1 billion in 2018 and is expected to grow to $52.2 billion in 2021.[13]

> *Securities regulators have begun to embrace AI to more efficiently and effectively ensure compliance..*

Securities regulators have begun to embrace AI to more efficiently and effectively ensure compliance. The Australian Securities and Investments Commission ("ASIC") is currently funding studies and pilot programs that employ AI to analyze speech and text in order to identify patterns in misconduct.[14] ASIC's pilot programs employ this technology to scrutinize financial planning documentation, online promotions, and advertisements to ensure compliance with current regulation.[15] In the US, the SEC has also begun incorporating machine learning programs for market risk assessment and for identifying potential fraud and misconduct."[16]

Canadian securities regulators are also increasingly using technology to investigate and prosecute securities law violations. In recent years, Canadian securities regulators have introduced new digital tools to analyze large data sets and created dedicated enforcement teams focused on

advance analytics, with such teams including data analysts, data scientists, and blockchain specialists.[17] In addition, Canadian securities regulators are currently working on launching a new data repository and analytics system, the Market Analysis Platform ("MAP"), an automated centralized analytics system to more efficiently analyze large amounts of data and identify securities misconduct.[18]

Looking Ahead

In the coming years the OSC and other Canadian securities regulators will likely continue to embrace RegTech and AI as a means of ensuring compliance. The creation of regulatory sandboxes, joining GFIN, formation of a FinTech advisory committee and development of MAP demonstrate an interest by Canadian securities regulators in software-based solutions to monitoring and enforcement.

Whistleblower Program

The OSC's Whistleblower Program was launched in July 2016 to provide a financial incentive for individuals to come forward with information about possible violations of Ontario securities law. Policy 15-601 establishes the guidelines for which individuals may receive a financial award as a whistleblower.[19]

A key requirement is that individuals who come forward to report conduct must do so voluntarily. This excludes information offered in response to a request or requirement from the OSC or another securities regulator, law enforcement agency, or any other self-regulatory organization.[20]

To receive an award, whistleblowers must offer information in respect of a proceeding where at least $1 million in sanctions are ordered or paid voluntarily to the OSC.[21] This means that information that results in a No-Contest Settlement may lead to an award. The award itself is 5% to 15% of the total monetary sanctions or voluntary payments made and cannot exceed $5 million. The award is paid only after all rights to appeal have expired.[22]

Based on the information released by the OSC, only 7% of tips to the Whistleblower Program have resulted in active investigations, few of which have translated into awards.[23] As a result, the low probability of receiving an award may deter many potential whistleblowers from reporting tips. Furthermore, the current cap of $5 million may not be enough to encourage more senior members of organizations to risk their jobs to provide tips.[24]

In contrast, the comparable whistleblower program maintained in the US by the SEC does not impose a cap on whistleblower awards. Since 2012, roughly $376 million has been awarded to 61 whistleblowers.[25]

The $7.5 Million Award

In 2019, despite OSC policy limitations, the OSC provided the first-ever financial award to whistleblowers by a Canadian securities regulator. The awards totaled $7.5 million and were awarded to three separate whistleblowers.[26]

Alternatives to Dispute Resolution

Mediation

In 2015 the OSC began a pilot program for mediation that became permanent on April 9, 2019 with the stated goal to "resolve outstanding enforcement related issues or matters in a timely, efficient, and cost-effective way."[27] The program is the only one of its kind in Canada.[28]

Like traditional mediation, mediations in the context of OSC proceedings will be confidential, privileged, and facilitated by a neutral third-party mediator.[29] Either side may end the mediation at any time, the mediator reserves the right to withdraw, and costs are divided equally.[30] In order to prevent abuse of the program, the OSC also requires that settlement agreements be approved at a settlement approval hearing, until which time they will lack any force and effect.[31] Furthermore, mediation will not be permitted to negatively impact investigations or proceedings, or delay any pre-hearing obligations.[32]

No-Contest Settlements

No-Contest Settlements allow for parties charged by the OSC to seek a resolution without an admission of liability in exchange for compensation.[33]

This year, the OSC approved one no-contest settlement with two registered firms, where they had self-reported that clients paid excess fees. As part of the settlement, the firms undertook to pay compensation totaling roughly $11 million to the affected clients and committed to taking corrective action, including implementing enhanced procedures, controls, and monitoring systems designed to prevent a recurrence of the alleged inadequacies.

A Critical Lens on the Alternatives

Critics point out that No-Contest Settlements, which mediation will likely encourage, allow guilty parties to avoid admission of wrongdoing and lessen deterrence as a result.[34] In addition, these settlements are negotiated and discussed in a non-public forum and consequently cannot inform future proceedings, limiting the development of securities law.[35]

In contrast, the former vice-chair of the OSC argued that No-Contest Settlements allow the OSC to bring cases to light that would otherwise go unprosecuted,[36] while targeting bad actors who are intentionally harming and defrauding investors, making best use of the OSC's limited resources.[37]

In any event, while the OSC has relied more heavily on alternatives to hearings in recent years, it continues to prosecute investigations involving serious allegations of fraud. In the recent decision in *Hung et al v Ontario (Securities Commission)*,[38] the Divisional Court considered an appeal brought by four senior officers of Sino-Forest Corporation (the Appellants) in one of Canada's largest frauds in history.

The Appellants sought to set aside the OSC's decision which found that the Appellants engaged in deceitful and dishonest conduct related to Sino-Forest's standing timber assets and revenues knowing they constituted fraud, contrary to s. 126.1 of the *Ontario Securities Act*. The OSC ordered, *inter alia,* that the Appellants permanently cease trading or acquiring securities, resign and be prohibited from acting as a director or officer of any issuer and pay administrative penalties in the amount of $11,650,000. The Divisional Court found that the OSC's decision was reasonable and dismissed the appeal.

BCSC Proposes Strengthening Enforcement Powers

On October 21, 2019, the BC provincial government announced the first major amendments to the BC *Securities Act* in almost a decade. The amendments will strengthen the BCSC's ability to collect penalties and improve enforcement of white-collar investment offences. There are over 100 amendments to the *Securities Act*, which include increased fine enforcement and collection capabilities of the BCSC, development of a regulatory regime for over-the-counter derivatives, and modernization and strengthening of the legislative framework for securities in BC.

The proposed amendments include:

- Increasing maximum fine and jail term amounts and introducing minimum sentences for people who are convicted of significant offences multiple times;
- Expanding the BCSC's investigative powers, including powers to obtain information;
- Strengthening obligations and sanctions relating to records;
- Adding an ability to order administrative monetary penalties without a hearing for contraventions of regulations or decisions;
- Adding protection for whistleblowers;
- Providing the BCSC with enhanced powers to freeze and seize property transferred by fraudsters to third parties for below market value;
- Allowing the BCSC to direct the Insurance Corporation of BC to refuse to issue or renew a driver's licence or licence plates; and
- Allowing the BCSC to seize registered retirement savings plans.

In addition to enhancing the BCSC's collection and enforcement powers, the amendments modernize the *Securities Act* to ensure it is keeping pace with evolving markets and systemic risks. Specifically, the amendments will modernize the legislative framework for regulating derivatives, expand the BCSC's powers with respect to corporation transactions and modernize the prohibition on securities registrants using another registrant's

name, among other things. For example, the proposed amendments permit the BCSC to make an order to rescind a transaction, require any person to dispose of any securities acquired in connection with a takeover bid, or prohibit any person from exercising a voting right attached to a security, if the BCSC considers that a person is acting contrary to the public interest.

The BCSC will also be provided with the clear power to regulate trade repositories and the ability to regulate benchmarks consistent with the framework for regulating benchmarks which are already established in other jurisdictions across Canada.

The new legislation, unprecedented in Canada, is positioned as a large part of the BC provincial government's work to crack down on white collar crime. Whether other provincial governments will follow suit is unclear at this time.

Moving Towards a More Efficient OSC

Current trends in securities enforcement in Canada suggest that regulators are prioritizing efficiency in the way they monitor and regulate capital markets. Developments such as the increased adoption of RegTech, the Whistleblower Program, and alternative dispute resolution all demonstrate a desire to reduce the cost of monitoring and enforcement in order to pursue a greater number of regulatory breaches by market participants. The OSC Launchpad, CSA Regulatory Sandbox, FinTech Advisory Group, and creation of MAP indicate an interest by the Canadian regulators in using AI and RegTech to improve their monitoring and enforcement efficiency. In the coming years, we expect to see increased use of these new technologies, which will facilitate domestic and international cooperation and enhance securities enforcement mechanisms in Canada.

5 IN A CLASS OF THEIR OWN: Recent Trends in Securities Class Actions

Two key trends this year have confirmed the court's important gatekeeper function in securities and other class actions. First, the court has continued to actively develop and interpret its role in determining whether to grant leave to bring an action for statutory misrepresentation.[1] Second, the court has demonstrated increased scrutiny over the value of "ice-breaker settlements" in multi-defendant class actions.

Balancing Act

The continued development of the court's gatekeeper role in leave motions may explain the trend towards fewer new securities class action filings on an annual basis.[2] Recent leave decisions confirm that each case is unique and the application of the leave test, despite clarity from the Supreme Court of Canada, remains the great unknown for plaintiffs and defendants alike.

The Ontario Superior Court of Justice's decision in *Kauf v. Colt Resources, Inc.*[3] is a useful reminder of the balancing act inherent to the court's gatekeeper function. The court granted leave to commence a statutory misrepresentation claim in a proposed class action relating to a company's failure to disclose an unauthorized investment, finding that the plaintiff satisfied the leave requirement and demonstrated a reasonable possibility of success for the two misrepresentation allegations that it pursued.

This decision is the latest in a series of decisions in which the court has applied the Supreme Court's guidance that the leave requirement is more than just a "speed bump,"[4] but rather is designed to act as a "robust deterrent screening mechanism"[5] to ensure that meritless claims do not proceed. On the other hand, courts must be cautious about allowing a leave application to turn into a "mini-trial" with onerous evidentiary requirements.[6]

The decision in *Kauf* provides further guidance on the court's gatekeeper role:

- The court's gatekeeper function must be applied to each discrete misrepresentation claimed. A plaintiff must demonstrate to the court a reasonable possibility of success for each allegation.[7]
- The court may grant leave to proceed with a view of all the evidence, including appropriate inferences.[8] A plaintiff does not necessarily need direct evidence (including expert evidence) in order to satisfy the lower threshold for leave to proceed.[9]
- The court may still grant leave to proceed even if the misrepresentation at issue is ultimately found to be tenuous, which will be for the trial judge to decide.[10]
- The court should conduct its gatekeeper analysis with a view to the purposes of the *Act*, namely to protect investors, foster fair and efficient capital markets, and contribute to the stability of the financial system.[11]

Despite such helpful guidance, the recent October 2019 decision in *DALI Local 675 Pension Fund (Trustees) v. Barrick Gold* demonstrates that the court's interpretation of what is more than a "speed bump" will vary depending on the unique facts of each case.[12] The court granted leave to the plaintiffs to proceed against Barrick in respect of alleged misrepresentations regarding the construction of a multi-billion dollar gold mining project in Chile and Argentina, which ultimately came to a halt. The court appeared to revert to a more relaxed standard in stating that the reasonable possibility threshold may be satisfied even where the judge believes that "the chances of the defendant succeeding at trial are excellent — 80 or even 90 percent."[13]

The *Barrick* decision is also noteworthy for its consideration of whether and when an opinion can be a misrepresentation. The defendants had argued that the impugned statement from the quarterly report could not be a misrepresentation because it was a legal opinion. The court found that there was nothing in the statement that qualified it as an opinion rather than a statement of fact. The takeaway for issuers is that opinions and predictions should be framed properly to minimize the chances of their subsequent characterization as a misrepresentation.

Finally, the role of financial restatements in establishing corrective disclosure was brought into question in the recent decision in *Cappelli v. Nobilis Health Corp.*[14] Prior leave decisions, including the *Paniccia v. MDC Partners Inc.*[15] discussed in last year's trends publication, suggested that while the absence of restatement of financial statements was a powerful fact for defendants, the presence of a restatement almost guaranteed the satisfaction of the corrective disclosure aspect of the leave test. In the *Nobilis* decision, the court departed from this precedent by finding that a restatement of admission of control weaknesses can be, but is not necessarily, sufficient to grant leave.[16] In contrast to the *Barrick* decision, the *Nobilis* decision demonstrates the application of a higher evidentiary burden at the leave stage.

The Role of "Ice Breaker" Settlements

In a recent class action settlement approval hearing, the Ontario Superior Court opined on the benefit of "ice breaker settlements": that is, the first partial settlement in a multi-defendant class action. In *Di Filippo and Caron v. Bank of Nova Scotia et al.*[17] the court approved an "ice-breaker settlement" in the face of an objection that it was simply a token settlement that did not adequately reflect the defendant's exposure. The proposed settlement would resolve two class actions involving the same defendants, which alleged that the defendants conspired to fix the price of gold and silver instruments. The court had to consider whether a $5.47 million settlement with the first settling defendant was fair and reasonable where the plaintiffs claimed a total of $1 billion in damages against all of the defendants.

In response to the objection, the court asked the plaintiffs to provide additional evidence that would justify the modest or "token" settlement. The plaintiffs provided evidence regarding the relatively small percentage of trades that took place in Canada and also demonstrated that the payment as a percentage comparison to the settlement paid in the companion US class action was consistent with other settlements approved by Ontario courts.

The plaintiffs also provided evidence regarding the value of ice-breaker settlements. It was this latter information that the court focused on as the more important factor in justifying the "token" settlement. The court emphasized that the settlement included, in addition to the payment, a promise of future cooperation from the settling defendant. The court stated that "the first settling defendant's agreement to cooperate with class a counsel is one of the most significant and valuable features of settlement" because the settlement assists in advancing claims against

non-settling defendants and encourages settlement with non-settling defendants. The court emphasized previous case law which held that "the non-monetary-benefit of having one alleged conspirator cooperate with the plaintiffs is of 'inestimable value' in price-fixing litigation."

This decision demonstrates that while courts are willing to apply different considerations to the approval of "ice-breaker settlements" in recognition of the benefits they provide to the class, they still have to be satisfied that, in approving the settlement, it is fair and reasonable and in the best interests of the class.[18] This means that the settling parties must lead evidence to justify the settlement amount and demonstrate that it bears some logical connection to the potential exposure in the litigation. Further, the promise of cooperation may not be enough where the court determines that the plaintiffs would be entitled to the evidence provided by the settling defendant anyway (even though the benefit of an ice-breaker settlement is typically receiving that evidence earlier than through the discovery process).

An Opportunity for Defence Counsel

The Court's role as gatekeeper in securities class actions provides a unique opportunity for defence counsel. Defendants have the benefit of engaging with the court early on to prevent leave from being granted but must also satisfy the court through persuasive evidence. The court's gatekeeper role also informs the dynamics of settlement negotiations, since the ultimate settlement terms must satisfy not only the parties, but the court.

Endnotes

Out of Control No More: Securities Regulators Focus on Adequacy of Internal Controls to Address Risks, from Corruption to Cybersecurity

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The Growing Canadian Cannabis Industry: Cultivating Expansion While Recognizing Risk

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The Shifting Activism and Governance Landscape: An Environment Increasingly Friendly to Shareholders

1 These amendments have also done away with slate voting such that each director must stand on his/her own for election to the board.

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Enforcement in the Modern Era: Regtech, Artificial Intelligence, and Whistleblowers

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In a Class of Their Own: Recent Trends in Securities Class Actions

1 Section 138.8(1) provides that the court will only grant leave to proceed with an action for misrepresentation if it is satisfied that: (a) the action is being brought in good faith; and (b) there is a reasonable possibility that the action will be resolved at trial in favour of the plaintiff.

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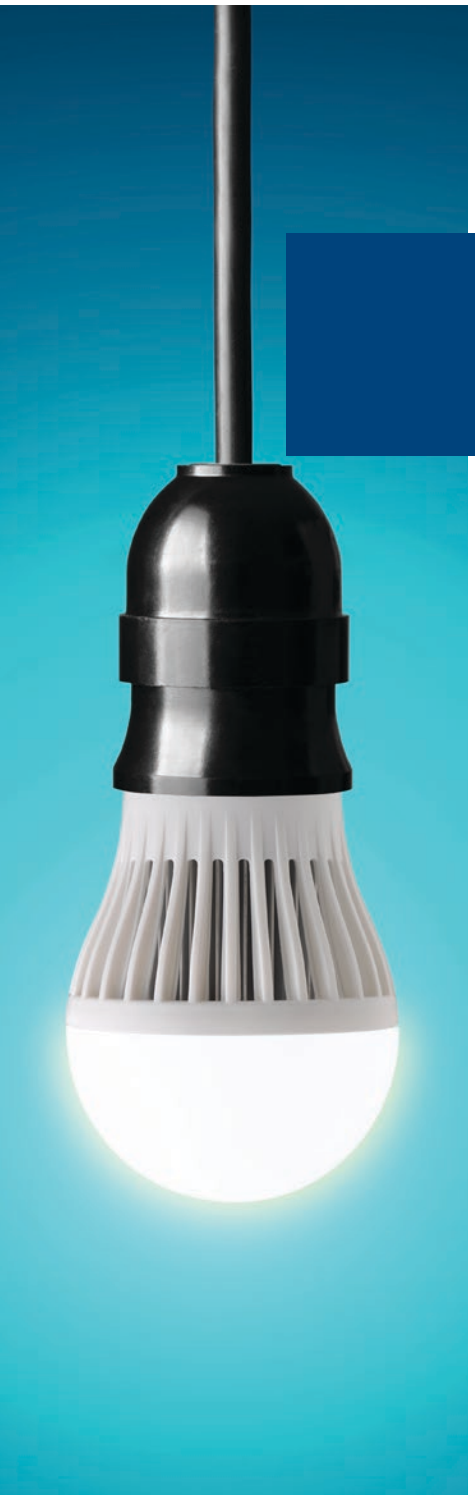
NOTES



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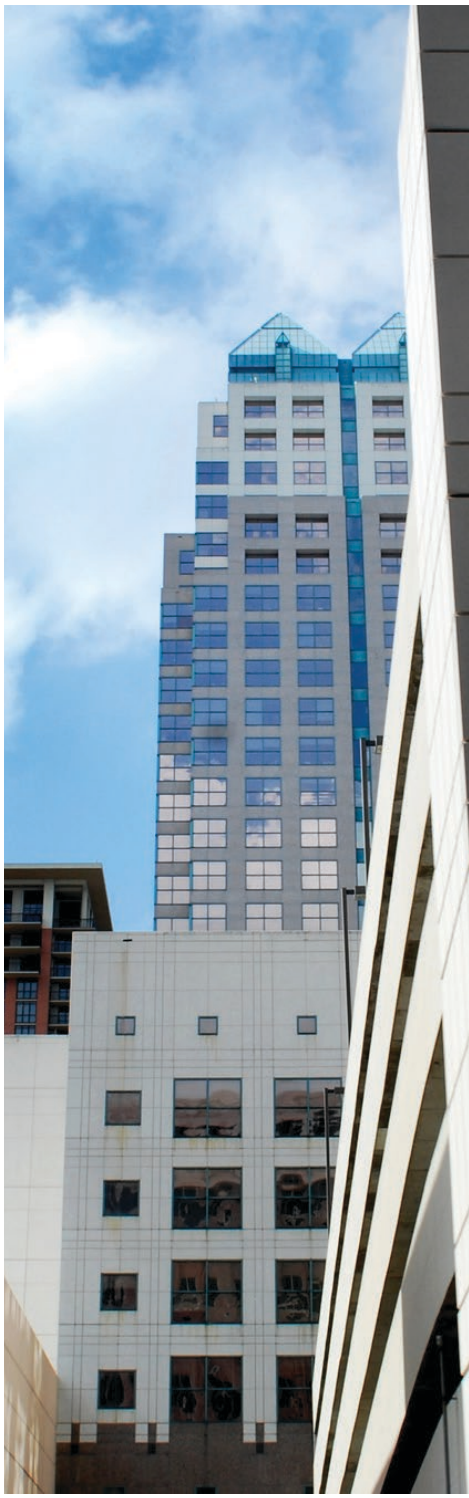

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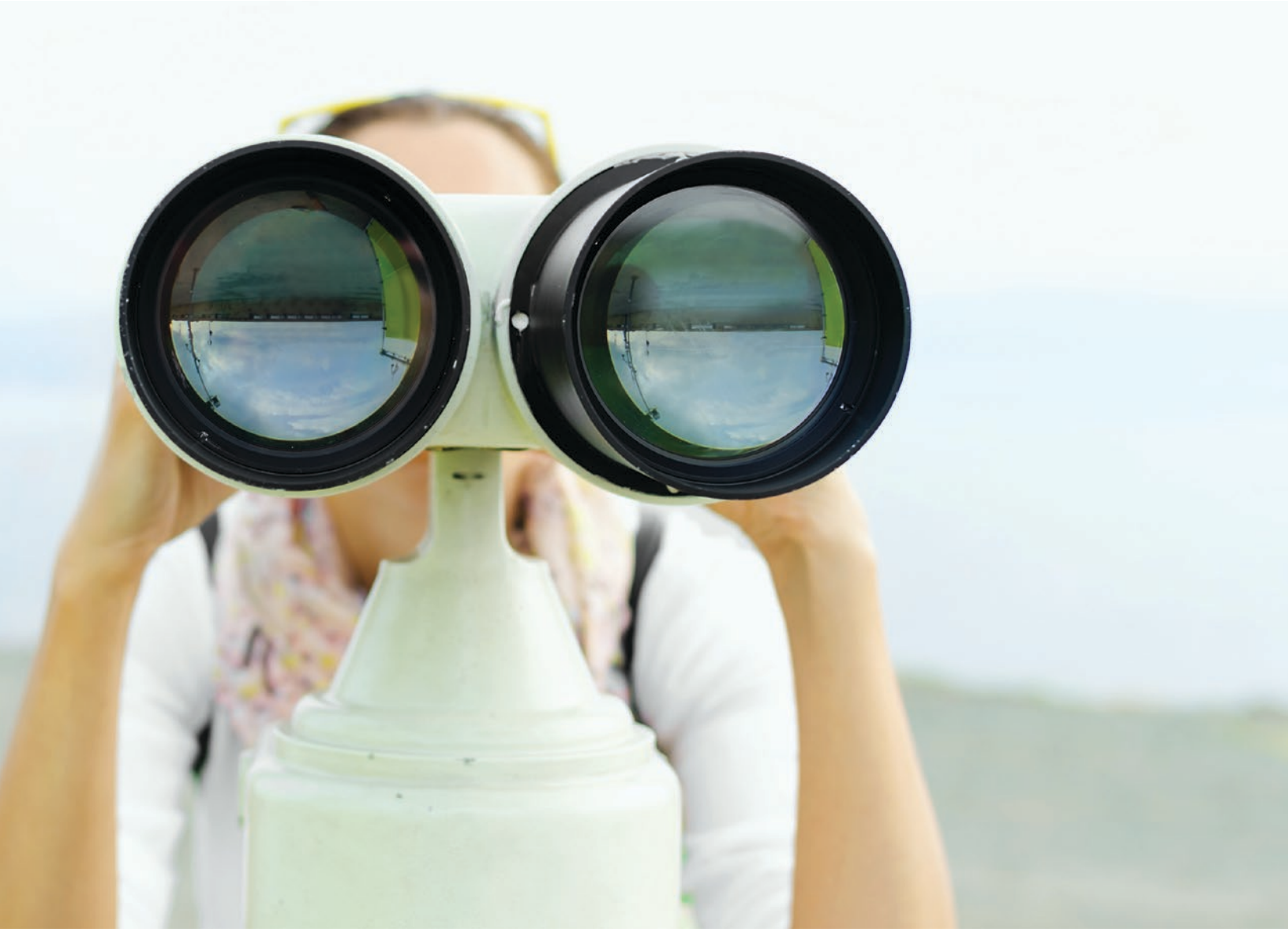

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