



Defence for Misrepresentations in Forward-Looking Information

The Ontario Securities Commission has published for comment proposed OSC Policy 51-604 – *Defence for Misrepresentations in Forward-Looking Information* (the “Policy”). The Policy addresses the interpretation of certain aspects of the defence (the “Defence”) available under the *Securities Act* (Ontario) in a civil action for damages for a misrepresentation in forward-looking information contained in an issuer’s disclosure.¹ The Defence was included in the recent legislation creating civil liability for secondary market disclosure in Ontario (the “Secondary Market Liability Rules”).

Defence for Misrepresentations in Forward-Looking Information

Pursuant to the Defence, a person or company is not liable for a misrepresentation in forward-looking information if the person or company proves that the document or oral statement containing the forward-looking information included proximate to the information:

- reasonable cautionary language identifying the information as forward-looking and identifying material factors that could cause results to diverge materially from any conclusion, forecast or projection therein; and
- a statement of the material factors or assumptions that were applied in drawing any conclusion or making any forecast or projection set out in the forward-looking information.

In addition, the person or company has to prove having a reasonable basis for drawing the conclusions or making the forecasts and projections set out in the forward-looking information.

With respect to public oral statements² containing forward-looking information, the Defence is available if the person who made the public oral statement:

- made a cautionary statement that the oral statement

¹ “Forward-looking information” is defined in the *Securities Act* to mean disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action and includes future oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented either as a forecast or a projection. The Policy states that earnings guidance is forward-looking information.

² “Public oral statement” is defined in the *Securities Act* to mean an oral statement made in circumstances in which a reasonable person would believe that information contained in the statement will become generally disclosed.

contains forward-looking information;

- stated that (i) the actual results could differ materially from any conclusion, forecast or projection in the forward-looking information, and (ii) that certain material factors or assumptions were applied in drawing the conclusion or making the forecast or projection, as reflected in the forward-looking information;
- stated that additional information about (i) the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information, and (ii) the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information is contained in a readily-available document³ or in a portion of such a document; and
- identified the readily-available document (or that portion thereof) in which additional information is contained.

The person would also have to prove that he or she had a reasonable basis for drawing the conclusions or making the forecasts or projections set out in the forward-looking information.

The Policy

The Policy is first being issued for comment so that participants in the capital markets will have the opportunity to express their views as to the assistance the Policy will bring to the disclosure issues involved.⁴ The Policy does not have the force of law, as courts will interpret and apply the Secondary Market Liability Rules. However, courts have traditionally shown deference toward the views of securities regulators, so the Policy may be important in any legal action.

In the Policy, the OSC explains its interpretation of the following aspects of the Defence:

Proximity

The requirement for “proximate” cautionary language is not intended to unduly complicate the issuer’s disclosure; in the Policy, the OSC identifies that effective disclosure is based on clarity of presentation and simplicity of language

³ For the purposes of this element of the Defence, a document is “readily available” if it is filed with the OSC or is otherwise generally disclosed.

⁴ The comment period for the Policy is open until August 2, 2006.

and style. Proximate does not require immediate juxtaposition in every instance. As a general rule, the more closely-tied a particular risk factor or assumption is to a particular conclusion, forecast or projection, the more proximate it should be to the forward-looking information.

With respect to MD&A, single broad references prefacing or following the disclosure which identify and set out the applicable assumptions and risk factors may be satisfactory where such an approach prevents complexity in presentation that could frustrate an investor's ability to readily follow the MD&A discussion and appreciate the nature of the information being presented.

In situations where particular assumptions and risk factors apply equally to multiple instances of forward-looking information in a single document, an issuer can use its judgment and balance the value of cross referencing against having all relevant information stated in full in each instance.

Risk Factor Disclosure

The risk factors identified in the cautionary language should be relevant to the conclusion, forecast or projection and not boilerplate.

The qualification of factors as "material" means that the Defence should not be interpreted as requiring an issuer to anticipate and discuss everything that could conceivably cause results to differ from the conclusion, forecast or projection in the forward-looking information. In the OSC's view, the Defence does not require issuers to warn of every risk factor that, with the benefit of hindsight, ultimately could or might cause the forward-looking information not to come true.

Assumption Disclosure

The Defence does not require an exhaustive statement of every factor or assumption applied, just the materially relevant ones.

Reasonable Basis

The Defence requires a reasonable basis for drawing the conclusion or making the forecast or projection in the forward-looking information. The OSC believes that in interpreting what constitutes a "reasonable basis", factors would include the reasonableness of the assumptions applied in drawing the conclusion or making the forecast or projection, as well as the inquiries made and the process followed in preparing and reviewing the forward-looking information.

Oral Disclosures

The requirements for the Defence in relation to public oral statements should not be treated as exhaustive and should

be supported by a pragmatic interpretation. For example, the Defence may be satisfied in appropriate circumstances by one person making the required cautionary statements on behalf of another person making the forward-looking statement.

Duty to Update

The OSC does not interpret the Defence as imposing a duty to update forward-looking information beyond any duty imposed under securities laws.⁵

Intent, Liability Caps and Certifications

The Secondary Market Liability Rules contain provisions for calculating damages incurred as a result of misrepresentations in secondary market disclosure and failure to make timely disclosure. Included in these provisions are rules establishing limits on damages. However, these limits do not apply (except in the case of the responsible issuer) if a plaintiff can prove that the defendant authorized, permitted or acquiesced in the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or a failure to make timely disclosure, or influenced the making of the misrepresentation or the failure to make timely disclosure while knowing that it was a misrepresentation or failure to make timely disclosure.

It is anticipated that in litigation commenced under the Secondary Market Liability Rules, plaintiffs will usually attempt to establish knowledge of the misrepresentation or failure to make timely disclosure in order to escape the damages limits imposed under the Secondary Market Liability Rules.

In a recent US case, *In re Watchguard Securities Litigation* (April, 2006), the plaintiffs in a class action attempted to establish intent to deceive by virtue of the certification of the issuer's financial statements under the *Sarbanes-Oxley Act*. In refusing to make that connection, the judge in the case held that the mere fact that the issuer officers certified financial statements containing misrepresentations did not necessarily mean that they were reckless in so doing, amounting to a purported intent to deceive the public: "The court must infer that a defendant who would be at least deliberately reckless in stating corporate earnings would be at least deliberately

⁵ Section 6.9 of National Policy 51-201 – *Disclosure Standards* makes the following recommendation with respect to updating forward-looking information:

"When making voluntary forward-looking statements, clearly indicate what your practice is for updating those statements. We [the Canadian Securities Administrators] believe that updating forward-looking information in light of subsequent developments is a good practice that can enhance a company's credibility with analysts and investors. Whatever your practice is, you should disclose it at the time you make any forward-looking statement and adhere to it consistently."

reckless in certifying those earnings under Sarbanes-Oxley... In a case like this one, however, where the court finds no strong inference that any Defendant was at least deliberately reckless in issuing corporate earnings statements, the court has no basis for a strong inference that the Sarbanes-Oxley certifications are culpably false.”

If the reasoning in *Watchguard* is followed by Ontario courts, it will mean that a plaintiff in a civil action under the Secondary Market Liability Rules will not be able to automatically connect a certification⁶ of a filing containing a misrepresentation with knowledge of that misrepresentation, and by so doing avoid the limits on damages contained in the Secondary Market Liability Rules. Instead, the plaintiff will be required to produce independent evidence in order to prove knowledge of the misrepresentation and thereby avoidance of the damages limits.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation. If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us at:

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⁶ A certification under Multilateral Instrument 52-109 – *Certification of Disclosure in Issuers’ Annual and Interim Filings*