

Securities Class Actions for Negligent Misrepresentation: A Test of Reliance

by Thomas G. Heintzman O.C., Q.C. and Sara J. Erskine¹
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I Introduction

In the modern era of the widespread distribution of goods, securities and services, purchasers and investors seek to rely on class actions to make affordable claims, which cannot realistically be brought individually. As plaintiffs, these purchasers and investors assert that class actions provide greater access to justice and judicial economy.

Purchasing a security in the secondary market is an inherently risky venture. When the price of a security plummets, investors may wish to assert that they relied upon someone else's advice or opinion in purchasing a security, and to hold that person responsible for their losses. While a class action would allow the investors to sue on behalf of many other investors, the certification of a securities class action confronts some of the basic tenets of the law of negligent misrepresentation.

The focus of this paper is on the issue of reliance as it impacts on each of the criteria for the certification of a class action. This paper analyses that issue in the context of the purchase of securities after they have been issued by a public issuer and are trading in the public secondary markets, usually on a stock exchange. We do not address issues which arise from the purchase of securities in the course of a primary distribution. Liability for the primary distribution of securities is governed by Section 130 of the *Securities Act*.² Under section 130, investors are

¹ Thomas G. Heintzman is a partner in the Toronto office of McCarthy Tétrault. Sara J. Erskine is an articling student with McCarthy Tétrault.

² *Securities Act*, R.S.O 1990, c. 55, s. 130 and s. 130(1).

deemed to rely upon the representations contained in the prospectus. Under the regime mandated by parts XV and XVI of the *Securities Act*, purchasers of securities in primary distributions are required to receive a prospectus. It is not surprising, therefore, that investors are taken to have relied upon the uniform representations in the prospectus relating to the distribution of those securities.

An analysis of the issue of reliance in relation to securities class action is timely, having regard to the recommendations of the Allen Committee Report³ issued by the Toronto Stock Exchange in 1997. That report has since been adopted by Canadian Securities Regulators and is in draft bill form in Ontario.⁴ The Allen Report recommends, and the draft Ontario Bill provides for, the adoption of deemed reliance in the secondary securities market. Misrepresentations contained in documents, oral disclosure or public statements by influential persons will be deemed to have been relied on by investors⁵. The investors will have a right of action for damages against the issuer, its directors and officers, as well as a controlling person or promoter of the security. This paper discusses the ramifications of deemed reliance in a secondary securities market.

This paper examines the legal and factual foundation for a presumption of reliance on a representation based on the market price of the security: the fraud-on-the-market theory. This theory postulates that in an efficient market, the price of the security is a function of all of the information available in the market and presumes that investors rely on any representation made

³ *Responsible Corporate Disclosure: A Search for Balance*, Report of The Toronto Stock Exchange (March 1997), page 63, section 1(1) (the "Allen Committee Report"). Thomas I.A. Allen, Q.C. is the Chairman of the Committee on Corporate Disclosure.

⁴ Canadian Securities Administrators, Notice 53-302, "Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definition of "Material Fact" and Material Change", (3 November 2000), (2000), 23 O.S.C.B 1

⁵ Allen Committee Report, para.

by relying on the price.⁶ According to American legal theory, this presumption can be rebutted if the defendant establishes that the representation did not affect the price of the security, or that the plaintiff relied on a factor other than the price in purchasing the security. According to the Canadian regime proposed by the Allen Committee, the defendant is entitled to prove that the plaintiff acquired or disposed of the securities with knowledge of the misrepresentation, but otherwise reliance upon the representations is deemed to have occurred.⁷

II The Tort Action of Negligent Misrepresentation

A key element in a negligent misrepresentation action is the actual reliance of the plaintiff on the representation made by the defendant. The plaintiff must show that there was reliance on the information resulting in damages. In the absence of actual reliance, the plaintiff cannot succeed in his or her claim that the defendant is liable for their losses.⁸

The requirements for establishing the tort action of negligent misrepresentation were set out by the Supreme Court of Canada in *Queen v. Cognos Inc.*⁹:

- (a) there must be a duty of care based on a “special relationship” between the representor and the representee;
- (b) the representation in question must be untrue, inaccurate, or misleading;
- (c) the representor must have acted negligently in making said misrepresentation;
- (d) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and

⁶ *Basic Inc. v. Levinson*, 485 U.S. 224 (1988) [hereinafter *Basic*].

⁷ Allen Committee Report, para. 4.20 – 4.25 and Section 1(1) and (3) of Proposed Draft Legislation attached thereto. The Allen Committee Report also proposes defences based *inter alia* on due diligence and an officer’s or director’s lack of knowledge of the misrepresentation.

⁸ *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165 at para. 18 [hereinafter *Hercules Management*].

⁹ [1993] 1 S.C.R. 87 at 110 [hereinafter *Cognos*].

- (e) the reliance must have been detrimental to the representee in the sense that damages resulted.

These requirements were affirmed by the Supreme Court in *Hercules Management*.¹⁰

In negligence cases in Canada, the court must use the two part test, set out in *Neilson v. Kamloops (City)*,¹¹ to determine the defendant owes the plaintiff a duty of care. First, the court must determine if there is a sufficiently close relationship (proximity) between the defendant and the plaintiff, so that the defendant should have reasonably contemplated that its actions might cause damage to the plaintiff. Second, the court must inquire as to whether there are any policy considerations which ought to negate or limit the scope of the duty of care, to the class of persons to whom the duty is owed, or to limit the damages.¹² In *Kamloops*, the Supreme Court of Canada rejected the notion that there should be a separate “pocket” of negligent misrepresentation cases in which the duty of care is determined differently from that of other negligence actions.¹³

The test set out in *Anns* and *Kamloops* requires a consideration of reliance in determining whether there is a special relationship or proximity between the plaintiff and the defendant.¹⁴ In *Hercules Management*, Justice LaForest stated that for proximity between the defendant and the plaintiff to exist, two criteria relating to reliance have to be established on the facts:

- (a) the defendant ought reasonably to foresee that the plaintiff will rely on his or her representation; and

¹⁰ *Hercules Management, supra*, at para. 18.

¹¹ [1984] 2 S.C.R. 2 [hereinafter *Kamloops*], adopting the test set out in the House of Lords decision in *Anns v. Merton London Borough Council (1977)*, [1978] A.C. 7287 [hereinafter *Anns*].

¹² *Ibid.* at 10.

¹³ *Ibid.*, at para. 21.

¹⁴ *Collette v. Great Pacific Management Co.* (2001) 86 B.C.L.R. (3d) 92 at para. 43-44 (S.C.) [hereinafter *Collette*].

- (b) reliance by the plaintiff would, in the particular circumstances of the case, be reasonable.¹⁵

Both of these criteria have an objective element. As to the first, the defendant must have been able to reasonably foresee the plaintiff's reliance, whether he or she did or not. The second criteria is that the plaintiff's reliance must have been reasonable in the particular circumstances. Without the objective elements of reliance, there is no proximity between the defendant and the plaintiff and the defendant cannot be found liable.

In addition, the plaintiff must have actually relied upon the representation. Justice La Forest in *Hercules Management*, points out the subjective and objective elements of the plaintiff's reliance:

In negligent misrepresentation actions, however, the plaintiff's claim stems from his or her detrimental reliance on the defendant's (negligent) statement, and it is abundantly clear that reliance on the statement or representation of another will not, in all circumstances, be reasonable.¹⁶

The objective and subjective requirements for the plaintiff to establish reliance on the defendant's representation were established in the British case, *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*¹⁷ This case is significant because it was the first common law case to recognize a cause of action and recovery for pure economic loss *simpliciter*. Lord Morris of Borth-Y-Gest, stated:

My lords, I consider that it follows and that it should now be regarded as settled that if someone possessed of a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies on such skill, a duty of care

¹⁵ *Hercules Management*, *supra*, at para. 24.

¹⁶ *Ibid.*, at para. 26.

¹⁷ [1963] 2 All ER 575 (HL) [hereinafter *Hedley Byrne*].

will arise. The fact that the service is to be given by means of, or by the instrumentality of, words can make no difference. Furthermore if, in a sphere in which a person is so placed that other could reasonably rely on his judgment or his skill or on his ability to make careful inquiry, a person takes it on himself to give advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance on it, then a duty of care will arise.¹⁸ (emphasis added)

The reliance principle in *Hedley Byrne* has been cited by the common law courts as requiring that the defendant knew, or ought to have known, that the plaintiff or class of plaintiffs would rely on the statement, and secondly, that the plaintiff did in fact rely on the statement, in a reasonable manner, causing damages.¹⁹ Accordingly, while actual knowledge or reasonable knowledge by the defendant of the plaintiff's reliance is required, actual reliance and reasonable reliance is required of the plaintiff.

The requirement of actual reliance by the plaintiff is an established principle of the British common law which has been, more recently, upheld by the British House of Lords in *Caparo Industries plc v. Dickman*.²⁰ Lord Bridge of Harwich stated that “[T]he damage which may be caused by the negligently spoken or written word will normally be confined to economic loss sustained by those who rely on the accuracy of the information or advice they receive as a basis for action.”²¹ (emphasis added) The House of Lords considered the liability of auditors for the losses incurred by shareholders and potential investors who might have relied on the auditors' reports. The information in the reports was found to be false and investors suffered significant losses. At the pleadings motion, the Court reaffirmed that the principle of reliance and proximity

¹⁸ *Ibid.*, at 598.

¹⁹ See *Hercules Management, supra*, at para. 27 and *Kripps v. Touche Ross & Co.* (1992) 94 D.L.R. (4th) 284 at 291 (B.C. C.A.) leave to SCC refused [1993] 2 S.C.R. viii.

²⁰ *Caparo Industries plc v. Dickman and others*, [1990] 1 All ER 568 (HL) [hereinafter *Caparo*].

of relationships between the defendant and the plaintiff is essential to sustain a claim for negligent misrepresentation.²²

Since the *Hedley Byrne* and *Caparo* decisions, the House of Lords has consistently held that the requirement of actual reliance is necessary for a plaintiff to establish a claim for pure economic loss.²³ The defendant must not only objectively foresee that someone would rely on the representation; in addition, the plaintiff must objectively and subjectively rely on the representation to their detriment.²⁴ The question that will be explored in this paper is how this principle is to be applied in class actions, and how it should be incorporated into the certification process under the Canadian class proceeding acts.

III Class Proceedings Acts

To date, Class Proceeding Acts have been adopted in British Columbia²⁵, Quebec²⁶ and Ontario.²⁷ As the Supreme Court of Canada has recently stated, these statutes provide a principled approach for the courts to follow in a certification motion, rather than an *ad hoc* basis, for the increasingly complicated cases that are emerging.²⁸

²¹ *Ibid.*, at 573.

²² *Ibid.*, at 576.

²³ See *South Australia Asset Management Corp v. York Montague Ltd*, [1996] 3 All ER 365 at 371-374. (HL); *Williams and another v. Natural Life Health Foods Ltd. and another*, [1998] 2 All ER 577 at 583 (HL); and *Sasea Finance Ltd (in liquidation) v. KPMG*, [2000] 1 All ER 676 at 781-782 (HL).

²⁴ *Sesea Finance*, *supra*, at 681-682.

²⁵ *Class Proceedings Act*, R.S.B.C. 1996, c.50.

²⁶ *Code of Civil Procedure*, R.S.Q., c. C-25.

²⁷ *Class Proceedings Act, 1992*, S.O. 1992, c.6.

²⁸ *Hollick v. Toronto (City)*, 2001 SCC 68 para. 14 [hereinafter *Hollick*].

To certify a class action, an individual purporting to represent the class must establish all of the criteria set out in the statute for certification.²⁹ Under the Ontario *Class Proceeding Act* (the “Act”), the person seeking to certify the class actions must meet all five criteria in section 5(1):

S.5(1) The court shall certify a class proceeding on a motion under section 2, 3 or 4 if,

- (a) the pleadings or the notice of application discloses a cause of action;
- (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff or defendant;
- (c) the claims or defences of the class members raise common issues;
- (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and
- (e) there is a representative plaintiff or defendant who,
 - (i) would fairly and adequately represent the interests of the class,
 - (ii) has produced a plan for the proceeding that sets out a workable method of advancing the proceeding on behalf of the class and of notifying class members of the proceeding, and
 - (iii) does not have, on the common issues for the class, an interest in conflict with the interests of other class members. (emphasis added)

The plaintiff bears the burden of establishing the criteria in the certification motion. Unless all of the elements of the certification process are satisfied, the judge will not certify the class action. To survive the motion to certify the class action, the plaintiff must present evidence for each of the criteria in the certification process, other than the requirement that the pleadings

²⁹ *Hollick, supra*, at para. 13.

disclose a cause of action.³⁰ In a class action for negligent misrepresentation, the plaintiff must establish the criteria for certification in the context of the requirements set out by the Supreme Court of Canada for negligent misrepresentation.³¹

In a negligent misrepresentation case, the issue of reliance may impact most, if not all, of these criteria. Indeed, a party's pleading or argument concerning reliance on one factor may impact the consequences for that party on another factor.

³⁰ *Ibid.*, at para. 25.

³¹ See *Collette, supra*, at para. 40.

IV Reliance and Causation Relating to the Certification Process

A. Cause of Action

Establishing a cause of action is a threshold issue in the certification of a class action. The pleadings must disclose a cause of action, and the test to be applied is that for a motion to strike pleadings for failure to disclose a cause of action.³² Before the pleading is struck out, it must be plain and obvious beyond a doubt that the plaintiffs could not succeed. If this cannot be shown, then the pleadings suffices for the plaintiffs to survive the certification motion.³³

Accordingly, in order to disclose a cause of action on behalf of the class members for negligent misrepresentation, the representative plaintiff in the proposed class must plead actual reliance by each member of the class on the representations. As we have discussed, this is a threshold issue for a negligent misrepresentation class action. The Supreme Court of Canada, in *Hercules Management*, has affirmed the long-standing principle, of the British common law, that actual reliance to the detriment of the plaintiff is essential to claim recovery for pure economic loss. Thus, without actual reliance there is no cause of action.

The defendant's submission in response to the certification motion is that the court will be required to conduct individual inquiries into the investment transactions of each plaintiff in order to determine whether there was actual reliance on the representations.³⁴ In addition, the defendant will submit that causation is an individual issue, and that the court is required to determine whether each class member's loss was caused by, or arose out of, his or her reliance.

³² See *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Gen. Div.) [hereinafter *Abdool*] and *Carom v. Bre-X Minerals Ltd.* (1999), 44 O.R. (3d) 173 (S.C.J.) [hereinafter *Bre-X I*].

³³ See *Hollick, supra*, at para. 25.

Issues of reliance and causation will, in most cases, vary from plaintiff to plaintiff. The defendant will only be held liable for the plaintiffs' losses if the representations were both relied upon and caused the plaintiffs' damages. In determining whether the plaintiffs disclosed a cause of action in a motion to certify a class action for negligent misrepresentation, Justice Macaulay, in *Collette*, stated:

Unless the plaintiff is able to frame his pleadings to avoid the individual determination of those issues [reliance and reliance based causation], it is highly unlikely that the case will be suitable for certification.³⁵

In order to avoid the problem of individual reliance in the plaintiffs' pleadings, the plaintiffs may rely upon the objective elements of reliance: that the defendant ought reasonably to have foreseen that the plaintiffs would rely on the representations, and that reliance by the plaintiffs was reasonable.³⁶ As such, the plaintiffs may argue that, in order to establish a cause of action for certification purposes, they should only be required to meet the objective components of reliance, that these components are common to all members of the class and suitable for certification and that the subjective component of reliance only relates to the proof of damages. In *Hercules Management*, Justice La Forest noted the distinction between reliance in relation to a duty of care, and its importance for other purposes, in stating that "the absence of a duty of care renders inconsequential the question of actual reliance."³⁷ Thus, although actual reliance is a necessary element of an action for negligent misrepresentation, the plaintiff may argue that the objective elements of reliance are suitable issues for certification. The plaintiffs may also assert

³⁴ *Ibid.* at para. 40.

³⁵ *Ibid.*, at para. 40.

that, if actual reliance is not pleaded, the plaintiffs are still entitled to rely upon inferred reliance, with the defendant having the burden of rebutting the inference of reliance.³⁸

In response to this submission, the defendant will assert that in the absence of actual reliance, the plaintiff cannot succeed in holding the defendant liable for his or her losses. If the plaintiffs do not plead actual reliance on the representations made by the defendant, it is plain and obvious beyond a doubt that the plaintiffs cannot succeed.³⁹ The absence of actual reliance, the defendant will argue, renders moot the issue of reasonable reliance. In essence, the defendant will argue that it is a waste of time to certify a class based on an alleged objective element of reliance if the issue of subjective reliance must still be proven to recover any damages. This would result in individual trials for each plaintiff on the issue of actual reliance, a time-consuming exercise which defeats the objective of judicial economy.⁴⁰

We can see from this analysis that the representative plaintiff may plead actual reliance by the class members, and thus potentially avoid the “cause of action” or Section 5(1)(a) issue. But by so pleading, the representative plaintiff may push the issue of actual reliance into one of the other Section 5 issues relating to “identifiable class”, and “preferable procedure”.

B. Identifiable Class

The members of the proposed class should be able to be determined without reference to the merits of the action. In a motion to certify a class action, the role of the judge is not to determine

³⁶ *Kamloops, supra*, at 10.

³⁷ *Hercules Management, supra*, at para. 18.

³⁸ *Kripps v. Touche Ross & Co.* (1997), 33 B.C.L.R. (3d) 254 (B.C.C.A.) at 282-284; *Collette, supra*, at para. 57-59.

³⁹ See *Collette, supra*, at para. 40.

⁴⁰ See *Bre-X 1, supra*, at 242 and 244 and *Collette, supra*, at para. 93 & 97.

the merits of the case. Therefore, if the certifying judge cannot determine the members of the class without referring to the merits of the case, the action should not be certified.⁴¹

In a securities class action it may be difficult for a motions judge to determine the members of a securities class action without reference to the merits of the action. Whether or not a plaintiff is a member of the class does not simply depend on whether the plaintiff purchased or sold the security. Unlike a good or service, it is not (just) the security which is allegedly defective; it is a company's business or prospects, and the representations with respect to those matters.

Each member of the proposed class must show actual reliance to ensure that the class is not over-inclusive. The Supreme Court of Canada, in *Hollick*, stated:

There must be some showing, however, that the class is not unnecessarily broad – that is, that the class could not be defined more narrowly without arbitrarily excluding some people who share the same interest in the resolution of the common issue. Where the class could be defined more narrowly, the court should either disallow certification or allow certification on condition that the definition of the class be amended.⁴²

In a securities class action for negligent misrepresentation, the issue of reliance necessarily narrows the class. If the proposed plaintiffs to the class action did not actually rely on the representations, then the action would be over-inclusive if it was certified. For starters, the class would have to be narrowed by defining it as only those plaintiffs that actually relied on the representations to their detriment.

⁴¹ *Hollick, supra*, at para. 17.

⁴² *Ibid.*, at para. 21.

Justice Winkler, in *Mouhteros v. DeVry Canada Inc.*, refused to certify a class action for negligent misrepresentation, in part, because the class of plaintiffs would be over-inclusive.⁴³

The proposed class included all students of DeVry in a relative period, however, many of the students may not have a claim if they did not rely on the representations. Justice Winkler stated:

The essence of the claim is that members of the proposed class relied to their detriment on misrepresentations of the defendant as to the quality of a DeVry education and its marketability to prospective employers. ... the proposed class includes all students who enrolled, regardless of whether they heard or relied upon any of the alleged misrepresentations. Such persons might well have no claim against DeVry for any of the relief pleaded, let alone a claim which raises a common issues.⁴⁴

In a securities class action, the class cannot be simply defined as individuals who purchased the securities during the period between the time the representations were made and the truth was revealed. The class would be over-inclusive unless the court were to assume that every member of the class may have relied on the representations. In addition, such a class would fail to provide a rational connection between the class members and the proposed class and the common issues.⁴⁵

The *Hollick* decision will, perhaps, be the case upon which both the plaintiffs and defendants in a securities class action will rely. Plaintiffs will argue that the Supreme Court appears to have been satisfied with a description of the class which included all owners or occupiers of property within a specific area within a specific period of time, and that by analogy a class composed of

⁴³ (1998), 41 O.R. (3d) 63 at para. 18 (Gen. Div.) [hereinafter *Devry*]. *Devry* was cited with approval in *Hollick* at para. 21.

⁴⁴ *Ibid.*

⁴⁵ *Hollick, supra*, at para. 20 and *Devry, supra*, at para. 17.

all purchasers or vendors of securities should suffice.⁴⁶ Defendants will argue that the Supreme Court proceeded on the basis that “everyone in the class shares the same interest in the resolution of the asserted common issue”, and “each of the putative class members does indeed have a claim ..or at least what might be termed a “colourable claim”...against the respondent”.⁴⁷ Defendants will assert that while, in a nuisance case such as *Hollick* each landowner or occupant potentially is a claimant, in a securities class action a purchaser or seller of the security is not a potential claimant absent actual reliance. For this reason, a definition of the class without a pleading of actual reliance may not survive the same “objective criteria” analysis that sufficed in *Hollick*.

C. Common Issues

In a certification motion in a negligent misrepresentation action, the principle debate is whether the required reliance by each plaintiff on the representations of the defendant permits the certification of an appropriate common issue. An issue will be common to the class only where its resolution is necessary to the determination of each member’s claim and is a substantial component of the action.⁴⁸ In the certification motion for *Bre-X*, Justice Winkler stated that:

The sense of a common issue in the context of a class proceeding is, therefore, one which will not only move the litigation forward as a matter of logic, but is an issue in respect of which will contribute to the case in a legally material way.⁴⁹

⁴⁶ *Hollick, supra*, at para. 17

⁴⁷ *Hollick, supra*, at para 21 and 19

⁴⁸ *Hollick, supra*, at para. 18.

⁴⁹ *Bre-X 1, supra*, at 193.

It is important to consider the cause of action as a whole, when determining what issue will move the litigation forward.⁵⁰ In a certification motion relating to a negligent misrepresentation action, some of the material issues relating to reliance are objective in nature. In large measure, those issues establish the duty of care: the defendant's reasonable knowledge of the plaintiffs' reliance and the reasonableness of the plaintiffs' reliance:

“The result of the foregoing is that it is now broadly accepted in Canada that a proximity test involving an objective consideration of reliance will always be required as a matter of law in cases of negligent misrepresentation”.⁵¹

But a further material issue is the plaintiffs' actual reliance on the representations of the defendant resulting in damages.

In the certification action, the court will have to consider whether the objective elements of reliance sufficiently outweigh the subjective elements to make certification appropriate, or whether the proof of actual reliance and causation are sufficiently important or sufficiently intertwined with any objective elements of reliance that certification is inappropriate. The plaintiffs will seek to carve out the objective elements of reliance as suitable for certification as common issues, while the defendants will assert that objective and subjective reliance is so intertwined that these issues cannot be separate. In this regard, the remarks of Madam Justice McLaughlin in another context, the postponement of a limitation period, may be relevant. While the test for such a postponement involves both objective and subjective elements, the Supreme Court in *Novak v. Bond* held that the application of the test “inevitably will require an

⁵⁰ *Rosedale Motors Inc. v. Petro-Canada Inc.* (1998), 42 O.R. (3d) 776 at para. 23 (S.C.J.) [hereinafter *Rosedale I*].

⁵¹ *Collette, supra*, at para. 44

examination of the individual circumstance of each class member to overcome an otherwise applicable limitation barrier”⁵²:

“Whether a particular circumstance or interest has the practical effect of preventing the plaintiff from being able to commence the action must be assessed in each individual case. Section 6(4)(b) requires that the circumstances and interests of the individual plaintiff be taken into account. What is a serious, substantial, and compelling interest in one case may not be so in another case. Purely tactical concerns play no role in this analysis because they do not relate to the practical inability of the plaintiff to bring an action, as asserted by a reasonable person who takes into account all his or her circumstances and interests.”⁵³

Traditionally, Canadian courts have held that reliance issues are not appropriate for certification as common issues in a negligent misrepresentation action, and more particularly one involving secondary securities markets.⁵⁴ This is likely because in that market, there may have been many representations made about the company’s business and its prospects over a long period of time. Different investors may have learned about the securities in different ways and at different times. They may have purchased the securities through different brokers at different prices and after different corporate disclosure. In these circumstances, the disparate nature of the events, the parties, their intermediaries and their relationships have usually led courts not to certify due to the lack of commonality of reliance.

The recent decision of the Ontario Divisional Court in the *Rosedale* decision may be relied upon by plaintiffs in securities class actions on the criteria of common issues.⁵⁵ In this decision, the

⁵² *Rumley, supra*, at para. 46

⁵³ *Novak v. Bond* (1999), 45 C.C.L.T. (2d) 1 at p.30 (S.C.C.), quoted in *Rumley* at para. 46. Emphasis in the original.

⁵⁴ *Collette, supra*, at paras. 65-66.

⁵⁵ *Rosedale Motors Inc. v. Petro-Canada Inc.*, unreported, October 22, 2001 (Ont. Div. Ct.) [hereinafter *Rosedale 2*] leave to the Ontario Court of Appeal is being sought.

Ontario Divisional Court certified a class action in relation to negligent misrepresentations allegedly made by a franchisor, Petro Canada, to its franchisees. The alleged misrepresentations related to market research Petro-Canada had made and the economic viability of the franchise system it was holding out to franchisees.

In *Rosedale*, the Divisional Court certified the following common issues: (1) whether Petro-Canada had a legal duty to use reasonable care to ensure that the economic and market research it conducted prior to implementing the franchise system was accurate and reliable and whether Petro-Canada fell below the standard of care in conducting its research, (2) whether Petro-Canada's representations to prospective franchisees concerning economic viability of the Certigard franchise system based upon its research were false or misleading. The court did not certify as common issues the questions of whether the representations constituted pre-contractual warranties and whether punitive damages should be awarded, since these questions required individual evidence from each class member. Although the court certified of the issue of their legal duty of care in relation to conducting the market research, it did not expressly certify any issue of reliance.

The issue for discussion is how *Rosedale* may be applied to the typical securities class action. In *Rosedale*, the relationship and representation between the franchisor and franchisees was direct and immediate, which is not the typical situation between investors in a secondary securities market and the issuing corporation. Second, in *Rosedale*, the defendant appears to have "acknowledged" that the franchisees were invited to rely on the representations and that the franchisees were directly told that their franchises would be economically viable and profitable. In the case of corporate disclosure to the secondary market, investors are not usually told these things by the issuing corporation, although they may be by their broker.

In addition, and at least in the context of negligent misrepresentation cases not involving such a close connection, courts have cautioned that the issue of actual reliance must be dealt with having regard to the over-riding reality of the circumstances. As the Court stated in *Hollick*, “[O]nce the common issue is seen in the context of the entire claim, it becomes difficult to say that the resolution of the common issue will significantly advance the action”.⁵⁶ In emphasizing the role of common sense analysis which requires that a connection be made between the preferable procedure and common issue analysis, Madam Justice McLaughlin said:

“I cannot conclude, however, that the drafters intended the preferability analysis to take place in a vacuum. There must be a consideration of the common issues in context.”⁵⁷

In the *Bre-X* securities class action for negligent misrepresentation, Justice Winkler emphasized that a class action cannot be certified on common issues without proof of actual reliance, which requires individualized inquiries into the securities transactions:

The common issue cannot be dependent upon findings which will have to be made at individual trials, nor can it be based on an assumption to circumvent the necessity for the individual inquiries. As such, there is no prospect of a resolution in a trial on common issues which would advance this litigation in any manner as it relates to the claim in negligent misrepresentation.⁵⁸

In *Rumley v. British Columbia*,⁵⁹ the Supreme Court of Canada upheld the British Columbia Court of Appeal’s refusal to certify a class action for negligent misrepresentation because the

⁵⁶ *Hollick, supra*, at para. 32.

⁵⁷ *Hollick, supra*, at para. 30.

⁵⁸ *Bre-X I, supra*, at 196-197.

⁵⁹ (1999), 180 D.L.R. (4th) 639 (B.C. C.A.) aff’d 2001 SCC 69 [hereinafter *Rumley*]. Botyh courts upheld this certification of a class action based upon several issues arising from alleged systemic negligence or breach of fiduciary duty: 80 D.L.R. (4th) 639 at paras. 14, 25, 52 [2000] SCR at para. 30.

issue of reliance and causation linking the representations to the damages would vary for each plaintiff. That court held that these considerations support the conclusion that the claims lacked sufficient commonality to certify the class action.⁶⁰ Similarly, the Ontario Court of Justice, in *Williams v. Mutual Life Assurance Co. of Canada*, refused to certify a class action for negligent misrepresentation because the claim did not raise common issues holding that the result of one trial cannot stand as proof of the cause of action of any other plaintiff.⁶¹

Other courts in British Columbia and Ontario have refused to certify class actions for negligent misrepresentation.⁶² The courts highlighted that in claims for negligent misrepresentation the separate transactions and differing representations precluded the finding of common issues. Nevertheless, there have been class action certified for negligent misrepresentation. They have occurred in circumstances like those in *Peppiatt v. Nicol*, where the representation was contained in a single information package sent to all members of the class.⁶³

To highlight the critical importance of reliance, it should be noted that a securities class action was certified in *Maxwell v. M.L.G. Ventures Ltd.*⁶⁴ In *Maxwell*, the representations were contained in a securities offering circular and the plaintiffs alleged that the defendant's breached s. 130 of the Ontario *Securities Act*. As noted above, Section 130 of the Ontario *Securities Act* deems that representations contained in the common securities offering documentation is relied upon by the purchasers. In both *Peppiatt* and *Maxwell*, there were single representations made in

⁶⁰ *Ibid.*, at para. 45.

⁶¹ (2000), 51 O.R. (3d) 54 at para. 22 (S.C.J.); [2001] O.C.J. No. 4952 (Div. Ct.) [hereinafter *Williams*]. An appeal to the Divisional Court has been argued and is presently reserved.

⁶² See *Bre-X 1*, *supra*; at 246; *Collette*, *supra*, at para. 99; and *DeVry*, *supra*, at 73.

⁶³ (1993), 16 O.R. (3d) 133 (Ont Gen Div.) [hereinafter *Peppiatt*].

⁶⁴ [1995] O.J. No. 1136 (Ont. Gen. Div.) [hereinafter *Maxwell*].

documents sent to all members of the class, which is a different situation than the numerous representations typically made in the secondary market.

In the Ontario Court of Appeal decision in *Bre-X*, the court allowed the certification of a securities class action for negligent misrepresentation. The court found that fraudulent and negligent misrepresentation should not be treated differently on a certification motion because there is a substantial overlap of factual issues common to both torts.⁶⁵ Justice MacPherson stated:

I do not agree that there is a sufficient difference between the plaintiffs' claims in fraudulent misrepresentation and negligent misrepresentation to justify certification of the former and non-certification of the latter.

...

Given the accepted definitions of the torts of fraudulent misrepresentation and negligent misrepresentation, I can see no logical or principled basis for treating them differently on the question of certification. I could understand an order certifying, or refusing to certify, both claims. I do not, however, understand why opposite orders were considered appropriate for the two claims.⁶⁶

The Court of Appeal did not deal with the merits of the certification of fraudulent misrepresentation since that was not raised before it. Nor did the Court of Appeal certify an issue relating to reliance, and rather dealt with whether the defendants knew or ought to have known of the alleged fraud.⁶⁷ The court simply determined that since the issue of fraudulent misrepresentation was certified, the tort of negligent misrepresentation should have been

⁶⁵ *Carom v. Bre-X Minerals Ltd.* (2000), 51 O.R. (3d) 236 (C.A.) [hereinafter *Bre-X 2*].

⁶⁶ *Bre-X 2*, *supra*, at para. 37 and 42.

⁶⁷ This point was noted in *Collette*, *supra*, at para. 87.

certified as well. In light of the Supreme Court of Canada's more recent refusal to certify a class action for negligent misrepresentation in *Rumley*, affirming the British Columbia Court of Appeal's decision that certification should be denied because issues of reliance and causation will vary for each plaintiff, the impact of the decision to certify both negligent and fraudulent misrepresentation in *Bre-X* is uncertain.

In light of the recent decision of the Supreme Court of Canada in *Western Canadian Shopping Centres, Hollick and Rumley*, the Divisional Court's decision in *Rosedale* and the Court of Appeal's decision in *Bre-X*, how is a Canadian court likely to address the criteria of common issues in a securities class action. It seems to us that these cases are on a continuum. At one end are those cases where the relationship between the plaintiff and defendant is close, there are no intermediaries between them injecting their own opinions or representations, and the documents or circumstances are relatively similar. This is exemplified by the franchisor/franchisee situation in *Rosedale* and the fiduciary relationship situation in *Western Canadian Shopping Centres*. In these cases the limited number of plaintiffs and the more definable relationship make the court's certification of the objective elements of reliance a more profitable step, and the subsequent and individual determination of actual reliance to be a cost-effective and sensible one.

At the other end of the spectrum are cases where the relationship between the parties is distant, the circumstances relating to each damaging event is more differentiated and the potential impact of intermediaries is much greater. This is similar to the situation in *Hollick*, where the court was dis-inclined to certify because the dissimilarities and distances made the individual elements more important and their determination more essential. *Rumley* is in a similar category to *Hollick* because it involved no commonality of misrepresentation.

In this continuum, most securities class actions including widely held securities will tend to be at the *Hollick* end of the spectrum, and therefore less conducive to a class proceeding. The relationship between the investor and the company is usually distant; the purchase or sale of securities is made under disparate times and circumstances and through different brokers with different views about the securities that the individual elements appear to require separate trials. Other securities class actions involving closely held securities, the same or similar representations and few or no intermediaries, may be more readily certified.

D. Preferable Procedure

Section 5(1)(d) of the *Act* requires that the class action must be the preferable procedure for the resolution of the common issues.⁶⁸ In determining whether or not a class action is the preferable procedure, the court must take into account the importance of the common issues in relation to the claim as a whole.⁶⁹ The Canadian *Class Proceeding Acts* acknowledge that class actions can be certified when there are individual issues. Thus, the Ontario legislature rejected the United States model where the common issues are required to predominate over the individual issues. However, where the individual issues will complicate the action, thereby defeating the purpose of judicial economy, a class action will usually not be the appropriate procedure.⁷⁰

The reluctance of Canadian courts to certify a securities class action for negligent misrepresentation arises from the individual circumstances surrounding the securities transaction.

A determination would have to be made with respect to each member of the class as to whether

⁶⁸ *Hollick, supra*, at para. 29.

⁶⁹ *Ibidi.*, at para. 30.

⁷⁰ See *Williams, supra*, at paras. 45; *Collette, supra*, at para. 97; *Devry, supra*, at 73; and *Bre-X 1, supra*, at 244.

they actually relied on the representations, or the same representations, made by the same defendant, and whether that reliance was causally connected to each members' loss. As a result, Canadian courts have typically concluded that a class proceeding would not be the fair, efficient or manageable method of determining the issue of reliance if the securities are widely held.⁷¹ Since the result of a trial of one plaintiff's claim cannot stand as proof of this element of the claim by any other plaintiff, a separate inquiry into the reliance and loss will have to be conducted, and this will defeat judicial economy.⁷² Canadian courts have usually concluded that the other common issues would not significantly advance the action where they are negligible in relation to the individual issues.⁷³

In *Western Canadian Shopping Centres*, the court certified a class action for breach of fiduciary duty in light of arguments that in the circumstances each plaintiff must necessarily show actual reliance.⁷⁴ In that case, representations were made in an offering memoranda accompanying the initial issuance of debentures, so that the representations were common to the class members and arose from circumstances akin to a primary distribution of securities. Furthermore, in *Western Canadian Shopping Centres*, the court was not prepared to hold that, in a fiduciary duty case, the investors must show individual reliance.⁷⁵ However, actual reliance has been clearly established by the Supreme Court of Canada in *Queen v. Cognos*, as an essential element of an action for negligent misrepresentation.

⁷¹ *Bre-X I*, *supra*, at 239-240.

⁷² See *Williams*, *supra*, at paras. 45; *Collette*, *supra*, at para. 97; *Devry*, *supra*, at 73; and *Bre-X I*, *supra*, at 244.

⁷³ *Hollick*, *supra*, at para. 32.

⁷⁴ *Western Canadian Shopping Centres*, *supra*, at para. 53.

⁷⁵ *Western Canadian Shopping Centres*, *supra* at para. 55.

As stated above, the Ontario Divisional Court just recently reversed the motion judge's decision in *Rosedale* and certified a class action for negligent misrepresentation. While the Divisional Court certified the class action, it did so only with respect to the defendant's conduct in carrying out its market research and the accuracy of its representations, and did not expressly certify any issue of reliance, causation or damages. Having regard to the acknowledgements made concerning the plaintiffs' reliance, the issues so certified were considered by the Divisional Court to make the class action a preferable procedure.

In *Abdool v. Anaheim Management Ltd.* the Divisional Court held that it would be inappropriate to certify a class action where, if some or all of the common issues are determined in favour of the plaintiffs, it would not be the end, but just the beginning of the liability inquiry.⁷⁶ In their recent paper, Paul J. Martin and Shelly M. Feld highlighted the *Abdool* decision and pointed out the realistic hurdle to certifying a class action for negligent misrepresentation:

This decision was premised on the very practical consideration that where separate trials will inevitably be required to resolve complex factual and legal questions that are central to the alleged cause of action, no benefit would be served by certifying the action as a class proceeding because the goals of judicial economy and access to justice would not be significantly advanced by the class action process. Effectively, certification in such circumstances would simply impose an extra burden on plaintiffs intent on recovering damages as such plaintiffs would have to participate in the class proceeding before incurring the substantial costs and enduring the lengthy process of participating in individual trials to obtain a remedy.⁷⁷

⁷⁶ *Abdool v. Anaheim Management Ltd.* (1995), 21 O.R. (3d) 453 (Ont Div. Ct).

⁷⁷ Paul J. Martin and Shelly M. Feld, "Class Actions – Recent Developments of Importance" (Fall, 2001), online: Fasken Martineau DuMoulin LLP <<http://www.fasken.com>>.

In the result, the issue is whether a class action is the preferable procedure for claims involving multiple representations to many class members who purchased their securities through different brokers over a lengthy period of time, a circumstance usually found in a securities class action involving widely held securities. As with common issues, the recent case law tells us that the issue of preferable procedure will be addressed along a continuum. Where the representations were different (as in *Rumley*) or where the relationship between the parties was distant and the individual circumstances giving rise to damage were different (as in *Hollick*), then a court is less likely to find that a class action is the preferable procedure. When the parties were in a direct relationship with each other, and the representations were identical or similar and were made during a short time frame, then it is more likely, as in *Rosedale*, for the court to find that a determination of some common issues will lead to real judicial expediency.

The remarks of Chief Justice McLaughlin in *Hollick* are, perhaps a good indicator of how a future Appellate Court will address this issue of preferable procedure in relation to a securities class action. In relation to a nuisance and negligence claim, she said:

While each of the class members must, in order to recover establish that the Keele Valley landfill emitted physical or noise pollution, there is no reason to think that any pollution was distributed evenly across the geographic area or time period specified in the class definition. On the contrary, it is likely that some areas were affected more seriously than others, and that some areas were affected at one time while other areas were affect at other times. ... Some class members are close to the site, some are further away. Some class embers are close to other possible sources of pollution. Once the common issue is seen in the context

of the entire claim, it becomes difficult to say that the resolution of the common issue will significantly advance the action.⁷⁸

These circumstances can, perhaps, be analogized to those which pertain to class members owning widely held securities action who, as noted above, may have purchased their securities through different brokers, at different times, at different prices and after different press releases issued by the company.

A class action is not the preferable procedure when there are other methods the plaintiffs can use to seek redress from a defendant. The Supreme Court of Canada, in *Hollick*, stated that “a court cannot ignore the availability of avenues of redress apart from individual ones.”⁷⁹ The existence of another scheme of redress must be taken into account when assessing the seriousness of access-to-justice concerns.⁸⁰ Since institutional investors occupy such a large presence in Canadian securities markets and usually hold significant positions in widely held Canadian securities, the alternative of an individual action by one or more of such investors must be considered in a class action certification motion.

Another alternative method of redressing the plaintiffs claim is the oppression remedy. The oppression remedy is a statutory right of recovery under most Canadian corporations statutes, which was designed to alleviate unfairness between corporate stakeholders. No certification as a class action is necessary for the judgment in the oppression action to be effectively binding on

⁷⁸ *Hollick, supra*, at para. 32.

⁷⁹ *Ibid.*, at para. 31.

⁸⁰ *Ibid.*, at para. 33.

the company and its directors and officers and for a remedy to be granted to all security holders.⁸¹

E. Representative Plaintiff

To qualify as the representative plaintiff, the individual must fairly and adequately represent the interests of the class, must have produced a plan for the proceeding setting out a workable method of advancing and notifying the class, and must not have an interest that is in conflict with the interests of the other class members.⁸² An issue on certification motion may be whether an individual plaintiff in the class can fairly and adequately represent the interests of the class, having regard to the particular representations made to him or her. As Justice Cumming stated in *Williams*, “[T]he result of the trial of any one alleged misrepresentation to a claimant cannot generally stand as proof of the cause of action of any other claimant”.⁸³ For this reason, a court may decline to certify having regard to the difference in circumstances between those of the representative plaintiffs and other class members.

V Fraud-On-The-Market Theory

The fraud-on-the-market theory is a presumption of reliance on any misleading statements upon the purchase or sale of a security. The rationale behind the presumption is based on the theory that in an efficient securities market, the price of a security is determined by all of the available information regarding the company and its business.⁸⁴ By relying on the price of the security, an

⁸¹ *Palmer v. Carling O’Keefe* (1989), 67 O.R. (2d) 161 (Div. Ct.); and *Fischer v. Tee-Comm Electronics Inc.*, October 22, 1999, 2672/97 CP. at paras. 7-8 (Ont. S.C.J.) (unreported).

⁸² *Class Proceedings Act, 1992*, S.O. 1992, c.6., s. 5(1)(e).

⁸³ *Williams, supra*, at para. 22.

⁸⁴ *Basic Incorporated et al., Petitioners v. Max L. Levinson et al.*, 485 U.S. 224 (1988) at 242 [hereinafter *Basic*].

investor is also relying on any misleading statements that the company may have made, even if the investors had not directly relied on the misstatements.

The Canadian courts have traditionally found that there is no exception to the requirement of reliance in an action for negligent misrepresentation in Canada. The Supreme Court of Canada has held that a plaintiff must have detrimentally relied on the representation by the defendant to establish a claim for negligent misrepresentation.⁸⁵ In class action certification motions for negligent misrepresentation, Canadian courts have rejected the United States presumption of reliance and the fraud-on-the-market theory.⁸⁶ Justice Winkler, in *Bre-X* stated that:

Simply put, the proposition advanced is ill-conceived. The torts of fraudulent and negligent misrepresentation are neither novel nor undeveloped in Canada. Both have been canvassed by the Supreme Court of Canada and the pronouncements of that court on the elements of each must be considered to be settled law. In my view, the presumption of reliance created by the fraud on the market theory can have no application as a substitute for the requirement of actual reliance in either tort.⁸⁷

Nevertheless, it is well to review the origins of the fraud-on-the-market theory in light of the possibility of further appellate consideration of it, and the Allen Committee's recommendation that it be adopted. The theory was accepted and applied by the United States Supreme Court in *Basic Incorporated v. Levinson*⁸⁸ for actions under the Securities Exchange Act of 1934⁸⁹. In order to invoke the presumption of reliance, the plaintiff must prove the following five criteria:

- (a) that the defendant made public misrepresentations;

⁸⁵ *Cognos, supra*, at 110.

⁸⁶ See *Bre-X I, supra* at 794; *Collette, supra*, at para 59; and *Kripps, supra*, at 86.

⁸⁷ *Bre-X I, supra*, at 794.

⁸⁸ *Ibid.* at 248-249.

⁸⁹ 48 Stat. 881.

- (b) that the misrepresentations were material;
- (c) that the shares were traded on an efficient market;
- (d) that the misrepresentations would induce a reasonable, relying investor to misjudge the value of the shares; and
- (e) that the plaintiff traded the shares between the time the misrepresentations were made and the time the truth was revealed.⁹⁰

By establishing the above criteria, the plaintiff is relieved of the burden of proving a *prima facie* case of actual reliance on the misrepresentations. The presumption of reliance is rebuttable by the defendant by showing any factor which severs the link between the misrepresentation and the price paid by the plaintiff or their decision to purchase the security at the market price.⁹¹

The presumption of reliance forces the defendant to inquire into the plaintiffs' actual reliance on the market price. In order to defeat a certification motion for securities fraud, the American defendant must question the proposed plaintiffs' motive for purchasing the stock. Issues of individual reliance have been raised by defendants and have been successful in defeating motions for certification under the federal statute. The United States District Courts have refused to certify class actions when the representative plaintiff would be subject to attack for non-reliance on the representation and would therefore not be typical of the other members of the proposed class.⁹²

⁹⁰ *Ibid.*, at 248.

⁹¹ *Ibid at*

⁹² See *Hanon v. Dataproducts Corp.*, 976 F.2d 497 (9th Cir. 1992); *Rolex Empl. Ret. Trust v. Mentor Graphics Corp.*, 136 F.R.D. 658 (D.Or. 1991); and *Ganesh v. Computer Learning Ctrs, Inc.*, 183 F.R.D. 487 (E.D. Va. 1998) cited in Brian E. Pastuszewski, Paul A Ferrillo, and Alexis L. Shapiro, "Refusing to Surrender – Strategies for Combatting Class Certification in Securities Fraud Class Actions" (2001) 11 *Securities News* 13 at 14-15.

Since the fraud-on-the-market theory can only apply where there is an efficient market, the defendant can also rebut the presumption of reliance by showing that the securities were not traded in an efficient market. Simply because a security is traded on a stock market does not mean that the market is efficient.⁹³ Courts have often required the plaintiffs to show market efficiency by demonstrating that the securities were tracked by analysts and that there is empirical evidence showing the cause and effect between the information released to the public and stock price movements.⁹⁴

The refusal to certify class actions based on the fraud-on-the-market theory reflects the concerns articulated by Justice White in his dissent in *Basic*. These concerns are based upon the absence of staff economists or experts schooled in the “efficient-capital-market hypothesis” in the federal court system to test the validity of empirical evidence presented to the court, and the superior ability of the legislature, rather than the courts, to determine whether modern economic theories should be applied to established legal notions of fraud.⁹⁵

The fraud-on-the-market theory is a judge-made response based upon the statutory regime contained in the Securities Exchange Act of 1934. The United States Supreme Court, in *Basic*, accepted the applicability of the theory to the statutory claim since it was consistent with the congressional policy embodied in the federal Securities Exchange Act of 1934. However, the Court clearly stated that a claim of federal securities fraud under Rule 10b-5 of the Federal Act is distinct from the common law claims of deceit and misrepresentation.⁹⁶

⁹³ See *Stat-Tech liquidating Trust v. Thornton*, 981 F. Supp. 1325 (D. Co. 1997).

⁹⁴ Pastuszewski, Ferrillo and Shapiro, *supra*, at 16.

⁹⁵ *Basic, supra*, at 253.

⁹⁶ *Ibid.*, at 245.

Since the decision in *Basic*, American State Courts have not applied the fraud-on-the-market theory to a common law claim of negligent misrepresentation. In *Kaufman v. I-Stat Corporation*, the Supreme Court of New Jersey recognized that there is no exception under the common law for the requirement of reliance in a claim for negligent misrepresentations.⁹⁷ The Court found that since the common law action covers areas other than securities, to allow the use of the fraud-on-the-market theory would expand the common law too broadly. Under the common law, the plaintiffs must have actually received and considered the misrepresentations, however indirectly uttered.⁹⁸

Since the fraud-on-the-market theory was accepted by the United States Supreme Court for federal causes of action under the Securities Exchange Act of 1934, there has been a flurry of economic and legal criticism. Economists have shown that the price of a commodity is affected by more than just the information available in the market.⁹⁹ In addition, even if the theory is accepted, the fact of whether a stock market was efficient at the time the misrepresentation was made and the securities were purchased is a question of financial economics. Those who oppose the application of this theory argue that judges on a certification motion should not attempt to determine if the market was efficient.

The intention of the investor is relevant to determine whether or not there were factors other than the market price that influenced the investor's decision to purchase the securities. Empirical

⁹⁷ 754 A. 2d 1188 (New Jersey Supreme Court, 2000) at 1194.

⁹⁸ *Ibid.*, at 1195.

⁹⁹ Victor L. Bernard, Christine Botosan, and Gregory D. Phillips, "Challenges to the Efficient Market Hypothesis: Limits to the Applicability of Fraud-on-the-market Theory" 73 *Neb. L. Rev.* 781 at 786-787. Recently three American economists have been awarded the Nobel Prize in Economics for their work on the disparate theory of economics, which states that decisions in the market are made based on many different factors and not one selective criteria.

evidence has shown that most investors purchase securities for one of two reasons. One reason is to create a diversified portfolio of investments to eliminate firm-specific risks. The second reason is to attempt to find undervalued securities and purchase them in an attempt to beat the market. In pursuing the second reason, the investors are expressly relying on the inefficiency of the market and the absence of reliance by others on information considered by the investors to be imperfect, when purchasing the stocks.¹⁰⁰ So in fact, some or all of the investors may not actually have relied on the market price. Indeed, reliance on the market price might dictate that the security be neither bought nor sold.

Although no Canadian court has accepted the fraud-on-the-market theory to presume reliance in securities negligence actions, the Allen Committee has proposed securities disclosure legislation which would deem reliance on any representations. The Allen Committee Report recommends that any misrepresentations contained in documents, oral disclosure, and statements by influential persons made available to the public will be deemed to have been relied upon by investors. Investors would have a right of action for damages against the issuer, its directors and officers as well as a controlling person or promoter of the security.¹⁰¹

¹⁰⁰ Jonathan R. Macey, "Symposium on the Regulation of Secondary Trading Markets: Program Trading, Volatility, Portfolio Insurance, and the Role of Specialists and Market Makers: The Fraud on the Market Theory: Some Preliminary Issues" 74 *Cornell L. Rev.* 923 at 925-926.

¹⁰¹ Allen Committee Report, *suara*.

Unlike the fraud-on-the-market theory, the presumption of reliance recommended by the Allen Committee would not be rebuttable by asserting that the investors relied on something other than the representations in purchasing the securities. The presumption might eliminate or impair the assertion that the investors were contributorily negligent. It might enable investors who actually relied on other factors to be included in the action.

VI Conclusion

The issue of reliance permeates almost all of the criteria in the certification motion brought in a securities class action based upon negligent misrepresentation. It impacts the necessity that a cause of action be pleaded, since actual reliance is a necessary element of an action for negligent misrepresentation. It impacts the definition of a class, since the class must be limited to those individuals who relied on the representation. It affects the criteria of common issues and preferable procedure since both of those criteria are fundamentally determined by whether the individual elements of the action, including reliance and causation, are sufficiently important that certification is justified.

Typically, Canadian courts have refused to certify securities class actions for negligent misrepresentation, because the reliance issue has run afoul of one or more of the certification criteria. However, recently the Court of Appeal of Ontario in *Bre-X* and the Divisional Court in *Rosedale* have certified class actions for negligent misrepresentations, and this may lead to more securities class actions being considered for certification. In considering whether those claims ought to be certified, it is likely that courts will look at negligent misrepresentation cases as falling within a continuum. At one end of the continuum are those claims based upon circumstances in which the plaintiffs and defendants have a close relationship, the

representations are common or similar, and the circumstances or number of the plaintiffs are relatively similar and small. In these cases, certification may be held to be appropriate, because a determination of the remaining individual issues will likely take relatively little judicial time. If the relationships between the parties are distant, the circumstances in which the events occurred or the damage was caused are disparate and different, and the representations are different, it is less likely that certification will be justified as the individual issues relating to reliance, causation and damages will be sufficiently important to require considerable judicial time. A securities class action, involving the trading of widely held securities in the secondary market over a lengthy period of time, is more likely to fall at the latter end of the continuum than one involving more closely held securities involving a limited number of investors who received the same representation.

American Courts have adopted the fraud-on-the-market theory to relieve the plaintiff of the burden of proving actual reliance in securities fraud cases under the United States federal securities legislation, leading to the ready certification of federal securities claim. To date, Canadian and American courts have not applied the theory to common law claims for negligent misrepresentation. Presently, the Allen Committee Report proposes a statutory regime of deemed reliance. However, the whole legal and economic rationale for deeming or presuming reliance has been the subject of considerable controversy. Today at least, actual reliance remains a central ingredient to be addressed in the certification motion in any Canadian securities class action.