


# COMMERCIAL LITIGATION UPDATE

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## FEATURE COMMENT

Justices of the Supreme Court of Canada visited their US counterparts in Washington, DC last month as part of a legal exchange between the two countries. During the visit, the United States Supreme Court heard oral argument in a case that could allow Canadian shareholders to sue in US courts Canadian companies for alleged misrepresentations in disclosure documents filed with Canadian authorities, even when no securities have

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Cases like *Morrison v. National Australia Bank* ("*Morrison*") are called "f-cubed" cases because they involve foreign plaintiffs, foreign defendants, and fraud alleged to have occurred in a foreign jurisdiction. The *Morrison* plaintiffs are Australian shareholders of the Defendant, National Australia Bank ("NAB"). NAB is incorporated in Australia, headquartered in Australia, and over half of its assets and revenues come from its Australian operations. NAB's shares are listed for trading on exchanges in Australia, London, Tokyo, and New Zealand. NAB's shares are not traded on any US exchange. Its American Deposit Receipts (ADRs) do trade on the New York Stock Exchange but the proposed class was not based on these securities.

In 1999, NAB owned HomeSide Lending, Inc. (HomeSide), located in Florida. Homeside was at one time the sixth largest mortgage servicer in the United States. The plaintiffs allege that HomeSide fraudulently overvalued its portfolio, and transmitted falsified financial information to Australia, where the inaccuracies were incorporated into NAB's Annual Report to investors. As a result of the overstatements, NAB reduced its valuation of HomeSide by over US$ 2 billion and NAB's share price fell by over 13%.

Although Australian law allows shareholders to bring class action suits for misrepresentation, the plaintiffs sought to advance their claim in the United States pursuant to the US Securities and Exchange Commission ("SEC")'s Rule 10b-5. The American jurisprudence relating to the implied civil remedy is well developed, and innumerable class actions have proceeded under Rule 10b-5 over the years. More importantly to plaintiffs like those in *Morrison*, US courts have embraced the "fraud-on-the-market" theory with greater enthusiasm than have courts in Australia, or Canada.

The "fraud-on-the-market" theory was adopted by the United States Supreme Court in a landmark decision that held that, under certain circumstances, plaintiff investors do not need to show that each of them actually relied on a misrepresentation in order to sue based on that misrepresentation. The adoption of this doctrine makes it easier to bring securities misrepresentation claims on a class basis.

The Morrison plaintiffs have so far been unable to take advantage of the "fraud-on-the-market" theory, however, as the US Federal Court for the Southern District of New York dismissed the case on the basis that the court lacked jurisdiction to hear the "f-cubed" claim. The US Court of Appeals for the Second Circuit affirmed that decision, but declined to hold that "f-cubed" suits would always fail, citing the need to stop frauds from being "exported".

Before the US Supreme Court, the plaintiffs argued that US courts had jurisdiction to hear the claim because the misleading information originated in Florida, even though it was ultimately disseminated overseas. The plaintiffs relied on the SEC's submission in the courts below that the antifraud provisions of US securities laws apply to transnational frauds if there is conduct in the US which forms a substantial component of the fraudulent scheme, notwithstanding that the fraud results exclusively or principally in losses abroad.

The defendants were supported by various governments, including the governments of Australia, France, and the United Kingdom. They relied on the Court's established presumption against the extraterritorial application of US law. According to the presumption, if US securities laws were intended by Congress to apply to frauds outside the US, they would have to say so explicitly.

At the hearing, the Supreme Court justices appeared unreceptive to the plaintiffs' position. Even if the appeal is unsuccessful, the Court's holding may advance the law

by defining the circumstances under which a "f-cubed" case will be allowed to proceed.

## CASE BRIEFS

### Court of Appeal for British Columbia

*DeJesus v. Sharif*, 2010 BCCA 121

The Appellant real estate agent contracted to sell real estate he owned to the Respondent. The parties agreed that the Appellant would serve as "dual agent" to both the buyer and seller, even though he himself was the seller. The purchase price was nearly double what the Appellant had paid for the property 5 months earlier, and more than $100,000 more than the fair market value. The trial court awarded the Respondent the amount of money over fair market value that the Appellant received from the purchase.

The Court of Appeal affirmed the trial court's ruling, reasoning that in agreeing to act as agent for the Respondent, the Appellant took on a fiduciary obligation to disclose to her all material facts that may have influenced her decision to purchase the property.

Full text of the decision is available here.

*British Columbia (Securities Commission) v. Eilers*, 2010 BCCA 134

The Securities Commission found Ms. Eilers acted contrary to the public interest and imposed restrictions on when she could return to serve as an officer or director of an issuer. After filing for appeal, Ms. Eilers died. The Court of Appeal considered whether her husband could be substituted in the appeal for the purpose of vindicating Ms. Eilers.

The Court held that it has jurisdiction to make the requested substitution, but whether to do so was

discretionary and the decision should be based on the factors relevant to whether a moot appeal should be allowed to proceed. The Court outlined and considered each of those factors, including the appeal's strength and grounds, adversarial nature, circumstances transcending the death of the appellant, what relief is available, and whether the appeal would constitute legislating.

The Court noted that the general test is whether there exists "special circumstances that make it in the interests of justice to proceed." The Court found such circumstances did not exist in this instance and denied the request for substitution filed by Ms. Eilers' husband.

Full text of the decision is available here.

*Bank of Montreal v. Tortora*, 2010 BCCA 139

The Bank of Montreal filed suit against a mortgage specialist, a financial services manager, and the financial services manager's husband, in connection with an alleged scheme wherein the mortgage specialist and financial services manager approved mortgages by accepting fraudulently altered appraisals. The mortgage specialist would then split the commission with the financial services manager by paying half the commission to the latter's husband.

The Court of Appeal upheld the trial court's dismissal of the unjust enrichment claim against the husband because the bank was not deprived by his accepting of the payments, since it had already made the commission payment to the mortgage specialist. The Court also upheld the dismissal of the conspiracy claim against the husband, because without unjust enrichment, there was no unlawful act on his part alleged that could support a conspiracy claim. Finally, the Court of Appeal ruled that the Bank did not need to allege damages specific to the conspiracy claim and independent of the breach of contract and breach of fiduciary claims against the

mortgage specialist and financial services manager.

Full text of the decision is available here.

**British Columbia Securities Commission**

*Microline Veneer & Forest Products Corp. and Peter William Arthur Wise*, 2010 BCSECCOM 170

The executive director issued a temporary order prohibiting the trading in the securities of Microline Veneer & Forest Products Corp. ("Microline") and prohibiting Peter William Arthur Wise from performing a variety of actions related to investor relations activities. After two weeks, the Commission dismissed the application to extend the order until a hearing because Staff had failed to provide prima facie evidence that misconduct had occurred.

The evidence provided by Staff included affidavits that Staff had telephone conversations with three investors, who Staff stated were not accredited at the time they made investments in Microline. However, Staff did not provide any factual basis for these conclusions. The Commission held that the conclusions alone were insufficient to constitute prima facie evidence of misconduct. Further, Staff alleged "concerns" that illegal trades may occur, but failed to provide a solid factual basis for their concern, when all of the trades at issue except one occurred in 2007.

Full text of the decision is available here.

**Alberta Securities Commission**
*Wilby, Re*, 2010 ABASC 121

The Commission evaluated allegations that executives in The Hear Now Incorporated ("THN") had breached the *Securities Act* by making prohibited representations to investors and by conducting trades without the requisite

registration or exemption.

THN sought to use the "private issuer" exemption from the registration and prospectus requirements, which is available for distributions of securities to an aggregate of not more than 50 investors. The plan was to keep the number of direct THN shareholders below 50, regardless of how many investors were actually involved through the intermediate companies. While those ultimate investors were, technically, purchasing shares in an intermediate company, the subscription money was used by that intermediate company to purchase an equal number of shares in THN. The Commission held that this investment structure was wholly inconsistent with the purpose and spirit of the private company exemption, breached the terms of the exemption, and was clearly contrary to the public interest.

The Commission also examined the financial forecast outlined in a letter sent to "potential investors", and concluded that it was unjustifiably optimistic. Although Staff did not take the position that the executive signing the letter intended to mislead, and the executive claimed he signed the letter without reading it, the Commission found that the executive ought to have known that the contents were misleading and by signing it, he made "it his statement to the addressee 'potential investors.'" The Commission accordingly held that the THN executives had contravened the *Act*, and set a schedule for submissions on sanctions.

Full text of the decision is available here.

*Flag Resources (1985) Limited, Re*, 2010 ABASC 143

Staff alleged the two corporate Respondents contravened Alberta securities laws by failing to file, or by filing deficient continuous disclosure. Staff further alleged the president of one of the corporate respondents, McLeod, was responsible for these deficiencies. The corporate

Respondents argued that to the extent the filings were deficient, they contained mere "technical defects." The Commission rejected this argument, stating, "We cannot overemphasize the importance we place on reporting issuers' scrupulous compliance with all continuous disclosure reporting obligations."

The Commission examined the Financial Statements, MD&A, and Certifications of Interim and Annual Filings. The Financial Statements were deemed not prepared in accordance with GAAP because they failed to provide sufficiently clear information about mineral interests, which were a significant asset of corporate respondents. The Impugned MD&A was held not prepared in accordance with NI 51-102 and Form 51-102F1. Three Interim Certificates were required, and only one was filed, that one being deficient under MI 52-109.

The Commission found the corporate respondencts contravened Alberta securities laws and acted contrary to the public interest, and McLeod was deemed responsible for the contraventions. The Commission entered a scheduling order for the submission of written statements on sanctions.

Full text of the decision is available here.

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