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Settlements with Ontario Securities Commission do not preclude class action claims

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Facts
Preferable procedure: class action or regulatory proceeding?
Ontario Court of Appeal decision
Comment

On January 27 2012 the Ontario Court of Appeal released its decision in *Fischer v IG Investment Management Ltd*.(1) The court held that capital markets participants which reach a settlement agreement with the Ontario Securities Commission (OSC) with respect to securities law infractions may still be exposed to civil liability in class actions.

Facts

In 2004 the OSC initiated regulatory proceedings against certain mutual fund managers for failing to act in the public interest in relation to market timing activity, which harmed the financial interests of the mutual funds' long-term investors.(2) The OSC eventually reached settlement agreements with the mutual fund managers which required them to pay $205.6 million to the affected investors, but the settlements constituted only a fraction of what the investors believed that they had lost. The investors brought a motion for the certification of a class action against the mutual fund managers for the remaining amount, asserting that the mutual fund managers had breached fiduciary and other duties owed to the investors.

Preferable procedure: class action or regulatory proceeding?

The primary issue was whether a class action was the preferable procedure to resolve the investors' claims, given that they had already received compensation from the mutual fund managers as a result of the OSC settlements. Section 5(1)(d) of the Ontario Class Proceedings Act, 1992(3) provides that "the court shall certify a class proceeding on a motion if…(d) a class proceeding would be the preferable procedure for the resolution of the common issues".

The motion judge denied certification of the proposed class action,(4) holding that while the investors had satisfied all other criteria of class action certification, they had failed to meet the 'preferable procedure' requirement of Section 5(1)(d). The motion judge stated that the OSC proceeding had already provided a reasonably available means of resolving the investors' claims. While the resulting settlements may have 'left money on the table', the investors were not denied access to justice because the OSC had helped them to obtain restitution through a process that was adequate.

The investors appealed to the divisional court, which reversed the motion judge's decision and granted certification of the class action.(5) The divisional court found that because the investors' proposed class action was for monetary damages that were significantly more than the amount recovered in the OSC proceedings, it was illogical for the motion judge "to characterise the OSC proceeding as the preferable procedure for recovering money which the OSC proceeding failed to recover in the first place".(6) Instead, the class action was the preferable procedure because there was no other viable alternative for the investors to recover all, or substantially all, of the remaining shortfall from the OSC settlement.

Ontario Court of Appeal decision

In a unanimous opinion penned by Chief Justice Warren K Winkler, the court of appeal upheld the divisional court's decision to have the class action certified. However, the court found that both the motion judge and the divisional court had erred in their analyses of the preferable procedure requirement for certification.

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The court stated that the lower courts had incorrectly focused on the substantive outcome of the OSC proceeding (in other words, the fact that the OSC had secured payments to the investors), when they should instead have examined the procedural characteristics of the two types of proceeding. He provided the following analytical framework:

"*[I]n considering whether an alternative means of resolving the class members' claims is preferable to the mechanism of a class action, a court must examine the fundamental characteristics of the proposed alternative proceeding, such as the scope and nature of the jurisdiction and remedial powers of the alternative forum, the procedural safeguards that apply, and the accessibility of the alternative proceeding. The court must then compare these characteristics to those of a class proceeding in order to determine which is the preferable means of fulfilling the judicial economy, access to justice and behaviour modification purposes of the [Class Proceedings Act, 1992]. In a given case, certain characteristics will drive the preferability analysis more than others*."

The court found that there were two fundamental characteristics of the OSC proceeding that, when compared to class actions, did not give investors comparable or adequate access to justice to have their claims resolved. First, the OSC's jurisdiction and remedial powers are regulatory, not compensatory, in nature. The goal of an OSC proceeding is to protect the public and prevent market inefficiency, not to assess the specific claims of injured market participants or to quantify their losses. Hence the OSC's remedial powers, as provided by Section 127 of the Ontario Securities Act,(7) could not enable the OSC to address fully the investors' compensatory claims in the proposed class action. The fact that the OSC settlements included some form of monetary payment to the investors did not alter the regulatory objectives of the OSC proceeding.

Second, the OSC proceeding provided no participatory rights for the investors – rights which they would have as class members in a class action. The OSC and mutual fund managers arrived at the settlement terms, including the quantum of compensation, without any participation from the investors. The investors also received no direct notice of the hearings to approve the settlement, which were conducted in private. The regulatory purpose of the OSC proceeding meant that the OSC did not, and never intended to, include the investors as parties to the proceeding.

These two fundamental characteristics of the OSC proceeding meant that it did not afford the same level of access to justice as the investors would enjoy in a class action. The OSC proceeding was therefore not a preferable procedure for the adjudication of the investors' claims. The OSC proceeding was only "a parallel or complementary proceeding to any civil action brought by the investors";(8) it did not displace the availability of class actions. The court noted in passing that the settlement agreements expressly stated that the mutual fund managers remained open to civil liability in relation to the conduct that gave rise to the OSC proceedings; hence, not even the parties themselves contemplated that the settlements would limit the investors' recourse to the courts, whether individually or as a class.

Comment

The court of appeal's decision is significant for capital markets participants because it clarifies that a participant embroiled in a regulatory proceeding with the OSC may find itself vulnerable to class action liability even if it reaches a settlement with the OSC. Although it has long been recognised that an OSC settlement does not necessarily preclude civil liability, prior to *Fischer* it was unclear whether parties that were injured by the market participant's conduct could bring a class action, especially if they had already received substantial compensation from the regulatory proceeding for their losses. One of the immediate effects of *Fischer* is that it may discourage a defendant in an OSC proceeding from agreeing to compensate injured parties as part of a settlement with the OSC, since any injured parties that are unhappy with the settlement amount could still assert a class action in civil courts for the remaining amount of their damages.

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Endnotes

(1) *Fischer v IG Investment Management Ltd*, 2012 ONCA 47.

(2) Market timing in the mutual fund industry involves taking advantage of the fact that mutual funds are valuated only once a day. Due to time zone differences, the price of foreign equity in a mutual fund may already be 12 to 15 hours old by the time that the mutual fund is valuated. Short-term investors purchase temporarily undervalued mutual funds and sell them once the valuation is made. Market timing activity, while not illegal in Ontario, can negatively impact on long-term investors (the vast majority of unit holders in mutual funds), by causing an annual loss in the value of the mutual funds

and adding to transaction costs. See *Fischer*, supra note 1, paras 11 and 19.

(3) Class Proceedings Act, 1992, SO 1992, c 6.

(4) *Fischer v IG Investment Management Inc*, 2010 ONSC 296.

(5) *Fischer v IG Investment Management Inc*, 2011 ONSC 292 (Div Ct).

(6) *Fischer* (Div Ct), supra note 5, para 41.

(7) Securities Act, RSO 1990, c S5.

(8) *Fischer* (CA), supra note 1, para 9.

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